
Bitcoin Digital Currency: A Portend for India's National Security

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The bitcoin has been much in the news lately but there is a general lack of understanding of its concept, usage and the threats it poses to national security. Its legal status and its potential for terror financing require more deliberation. Decision-makers in the country need to be provided the whole ambit of bitcoin functioning to enable them to take the best decision in the interest of the nation. This brings us to the question of whether bitcoin digital currency is a dangerous portend for India's national security? Before we delve into the bitcoin, it is important to understand the concept of money so as to comprehend the relationship between money and bitcoins. Money today is printed on paper/plastic and has financial value attached to it. Some of the widely acceptable attributes of money are: durability, divisibility, convenience, consistency, possessing of value, limited in quantity, trustworthy and having a history of acceptance.¹ For example, the Zimbabwean currency ceased to be money after it lost its value. The bitcoin does fulfill some of these attributes but has also brought in new concepts not known hithertofore in the field of currency.

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N.B. The views expressed in this article are those of the author in his personal capacity and do not carry any official endorsement.

The Concept of Bitcoin

The bitcoin is a virtual digital currency – the technical aspects of which are largely unknown to the general public. The bitcoin, a peer-to-peer electronic cash system, is a good technical primer for the uninitiated or those keen to know about it.² The unique attributes of the bitcoin are as under:

- A bitcoin has no physical attribute. It is a string of data which retains its uniqueness. As currency notes have serial numbers to make each note unique, the bitcoins have their own method to remain unique.
- A bitcoin is safeguarded through a system of digital signatures, hash functions, chain blocks, and time stamps.³ This process ensures that there is no double spending in bitcoins.
- There is no need to establish a trusted third party (like the Reserve Bank of India in the case of the Indian rupee) as is done with normal currencies. In the case of the bitcoin, a peer-to-peer network ensures that the bitcoin remain unique. The trust factor is brought in by ensuring that each bitcoin has a unique identity.
- A bitcoin is not denominated in any national currency. Its basic unit is 1 bitcoin. You can trade it for any value, even in fractions.

Bitcoin history is building up: it possesses value (1 bitcoin = approximately Rs 18,000), is limited in quantity (approximately 21 million) and is becoming more prevalent, thus, fulfilling a few of the attributes of money. Users like the bitcoin for its ease of use, the anonymity it provides, and the ability to avoid hefty bank charges for transfer of money, amongst a host of other reasons.

The bitcoin has its concerns too. The first and foremost relates to its stability as a digital currency. The bitcoin volatility index today is 4.07 percent. In comparison, the volatility of gold averages around 1.2 percent while other major currencies average between 0.5 percent and 1.0 percent.⁴ Currently, the bitcoin is a volatile currency. The

next concern is, what happens if the cryptocurrency or a bitcoin exchange crashes? Mt Gox is one such example. Mt. Gox, a Tokyo based bitcoin exchange, was launched in July 2010 and by 2013 was handling 70 percent of all bitcoin transactions. In February 2014, the Mt. Gox company suspended trading, closed its website and exchange service, and filed for bankruptcy protection. It announced that around 850,000 bitcoins belonging to customers and the company were missing and likely stolen, an amount valued at more than \$450 million at the time.⁵ Court proceedings are underway but it is unlikely that the customers will get all their money back. However, the bitcoin is becoming legal in many countries though no financial institution in the world today is backing this currency. Thus, the bitcoin is a risky asset to hold. Some commentators feel that China supports it as it provides an alternative to the US dollar, and being a major locus of bitcoin nodes, China can control it.⁶

Status of Bitcoin in India

Use of the bitcoin is on the increase in India. Bitcoin exchanges allow buying and selling of bitcoins, using Indian rupees. On the internet, some of the bitcoin exchanges in India are bitcoin.in, unocoin, indiabitcoin.com, etc. It is possible to withdraw money in Indian rupees from bitcoins held in one's bitcoin wallet. Bitcoin transactions are being carried out in India and can, thus, act as a medium to carry out terror finance.

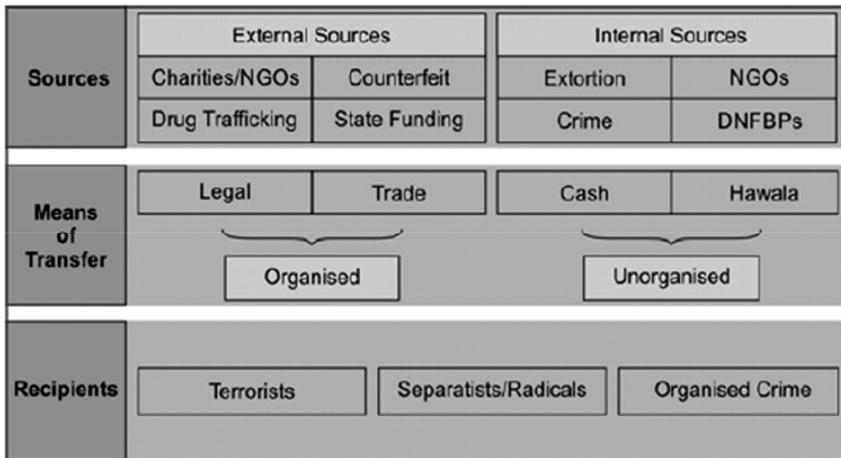
The responsibility for the regulation of currency in India rests with the Reserve Bank of India (RBI). As per its press release of December 24, 2013,⁷ the RBI has cautioned the users, holders and traders of Virtual Currencies (VCs), including bitcoins, about the potential financial, operational, legal, customer protection and security related risks that they are exposing themselves to. It mentions that use of virtual currencies like the bitcoin as a medium for payment is not

authorised by any central bank or monetary authority. The RBI has also stated that it is presently examining the issues associated with the usage, holding and trading of VCs under the extant legal and regulatory framework of the country, including foreign exchange and payment systems laws and regulations. However, no legislative or regulatory framework or law has been passed in India as yet. As the advice by the RBI is only a recommendation, use of the bitcoin is not illegal in India. Terrorists can, therefore utilise loopholes in the bitcoin regulatory framework in India for terror funding. However, supporters of the bitcoin in India state that it is reliable because the bitcoin service providers are following the Know Your Customer (KYC) guidelines. However, if the RBI has not recognised the bitcoin in India, the following of KYC guidelines has no meaning as these are not regulated by any legally authorised entity in India.

Terror Link with Bitcoin

Crime, money laundering and terror finance have a close nexus and are a national threat. The concept that the bitcoin could be used to help fund terrorists has been a long-standing concern among law enforcement and government agencies worldwide. Indeed, many restrictions placed on the use of digital currencies stem from these concerns.⁸ There have been instances where digital currency has been used earlier in illegal ways. Liberty Reserve, a Costa Rica-based centralised digital currency service, is alleged to have been used to launder more than \$6 billion in criminal proceeds during its history. There is evidence today that the Islamic State in Syria (ISIS) is using the bitcoin for fund-raising activities.⁹ Terrorists would use the bitcoin if it provides an opportunity to them to fund and provide goods and services without any regulation/interference from government authorities. The terrorism finance cycle can be diagrammatically represented as under.¹⁰

Fig 1



Source: *Lifeblood of Terrorism: Countering Terrorism Finance*,
http://www.idsa.in/book/Lifeblood_vchadha

While the bitcoin itself cannot act as a source of finance, it certainly acts as a means of transfer which can be tapped by sourcing agencies, both external and internal. It can be legally bought and traded in a number of countries. In India, bitcoin exchanges provide the medium to change this into cash even though the regulatory framework is not fully in place. Due to a loose regulatory framework, inimical elements can be recipients of this money. There is no doubt that the bitcoin system aids the terrorism finance cycle. The loopholes in the bitcoin system are being used by terrorists and their transnational networks. Some of the features of the bitcoin which facilitate terror funding are as follows:

Anonymity: It allows state sponsors of terrorism to funnel money in an anonymous manner. The money trail can be masked by using services such as Darkwallet.

Limited Regulation: The bitcoin doesn't have a gatekeeper. Fundamentally, no one needs to ask permission to use the bitcoin or

run a bitcoin client, making most financial blockades or sanctions at their core ineffectual. If and how bitcoins will be used in “battle” is a dystopian future that remains to be seen.¹¹

Money abroad can be routed through countries where the bitcoin is legal. Bitcoins in India can be converted into Indian rupees through currently operating bitcoin exchanges.

Transnational Nature: Its transnational nature makes jurisprudence very difficult. With very little international legislation and justice system in place, it is very difficult to book the culprits.

Easy Mobility: As an asset/commodity, the bitcoin is the easiest to move across geographical locations. For example, it is very difficult to move gold across borders but very easy to move bitcoins to the required handlers.

Terrorism/insurgency has affected India in different states to varying levels. External sources remain the main source of financing, especially for terrorist outfits in the state of Jammu and Kashmir and in the northeast. Amongst the means of transfer of money, while legal and trade means can come under government scrutiny, and cash and *hawala* transactions have problems of physical handling of money, the bitcoin is an easier solution to bypass government scrutiny and avoid handling a physical asset. Some clear concerns with reference to India are elaborated as follows. Terror fund raising has become much easier with the bitcoin. An organisation can raise funds in countries where bitcoin use is legal and transfer funds via bitcoins. Anonymity is provided to both individuals and state sponsors, thereby, making it hard for India to prove that funds for terrorist acts were provided by a nation state or its backers. With buying of products via bitcoin on the increase, illegal assets for terrorism can be easily bought using bitcoins and the terror funding trail will be extremely difficult to trace. With bitcoin exchanges opening up in India, bitcoins can also be transferred to a bank account of choice. Access to these funds is likely to

be done by an organisation's overground workers. Terrorists and their state sponsors will continue to find ways and means to fund and carry out terrorist activities using newer methods like bitcoin funding. Therefore, it is of utmost importance for us to understand the challenge and gravity of the use of bitcoin.

Way Forward

Links to terrorism are a concern to a host of government agencies involved in ensuring peace and stability in the country. For, this our forensic laws (Evidence Act, CrPC, CPC) and other money related laws like Foreign Exchange Regulation Act (FERA), banking regulations, Foreign Contribution Regulation Act (FCRA), benami transactions, money laundering, information technology and essential commodities have to be made more potent to deal with illegal transactions using bitcoins. Training and knowledge need to be imparted to the police, tax inspectors, regulators, prosecutors and judges to take up cases, with cross-border jurisdiction, to a logical conclusion in the quickest possible time. We are well aware that we have a long way to go as far as these aspects are concerned.¹²

Due to the clear and present danger of bitcoins being used for terror financing, India should take urgent steps to regulate bitcoin transactions. The recommended actions are as under

Status of Bitcoin: The government should clearly bring out the status (currency/commodity/property) of the bitcoin in India. It cannot be given the status of a currency based on our current laws. It may be given the status of asset as is given to gold or property.

Regulatory Authority: Based on the status given to the bitcoin, the requisite authority should be authorised to regulate its use in India. The bitcoin exchanges will thereafter come under its ambit.

Tax Laws: Bitcoin transactions need to be brought under the tax ambit. If the bitcoin is given the status of property, then capital gains tax should be levied on it.

Legislation: There is need to have laws covering the bitcoin's status, regulation, taxation, KYC norms, and prosecution for violations brought out at the earliest.

Securing Against Terror Funding/Crimes: Our security agencies need to be trained to investigate the use of bitcoins for terror funding and crimes.

Legal: The judicial system needs to be empowered to punish criminals by suitable amendments in the law.

Cooperation with International Agencies/Countries: As bitcoin operations are transnational in nature, we will have to cooperate with international agencies/countries to bring out coherent policies and agreements against criminal/terrorist use of the bitcoin virtual currency.

The government should appoint a technical committee to look into the aspects mentioned above. The committee will require representation from bitcoin specialists, cyber security experts, legal luminaries, RBI representatives and intelligence/security agencies to look into the whole issue holistically and thereafter present the same to the government to bring in legislation with respect to the bitcoin virtual digital currency. The legislation should be able to plug loopholes in the bitcoin terror financing and arm the security agencies to monitor, interject and take legal recourse in the bitcoin financed terrorist activities. Till that happens, India will remain vulnerable to the bitcoin being used as a means of terror financing.

Notes

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10. Vivek Chadha, *Lifeblood of Terrorism: Countering Terrorism Finance* (New Delhi: Bloomsbury Publishing India, 2015).
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