Is Cryptocurrency the New Solution to Difficulties in Transferring Currency?

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Chinese regulators have succeeded in putting the brakes on overseas use of China's currency by increasing the scrutiny of certain foreign investments. A slowing economy along with an exodus of money has compelled such action. Capital controls in China already restrict the movement of money; individuals, for example, are not supposed to move more than $50,000 out of the country annually. Companies, too, have limits and other approval processes. On July 1, 2017, the Chinese Central Bank announced that:

> "…Banks and other financial institutions in China will have to report all domestic and overseas cash transactions of more than RMB 50,000 Yuan (approximately USD 7,195), compared to RMB 200,000 Yuan previously... Banks will also need to report any overseas transfers by individuals of USD 10,000 or more."[1]

This latest directive basically adds another layer of approval essentially creating further hurdles for investors attempting to transfer money out of China. "The authorities, under the relentless pressures of capital outflows, are poised to impose extensive restrictions on capital movements, marking a reversal of the gradual liberalizations introduced in recent years," Fred Hu, the chairman of the Primavera Capital Group, an investment firm based in Beijing and Hong Kong.[2]

Complications in transferring funds out of the country is not a problem that singularly affects Chinese investors; other countries, including Vietnam and India, similarly have controls on personal capital transactions. These countries are in the top 6 of the most EB-5 visas, with South Korea, Brazil, and Russia, being the exceptions. Yet, these countries, instead of controls on personal capital transactions, have controls on direct investment. While Chinese regulators are increasing their scrutiny, they have been reluctant to ban overseas investment outright. It is still acceptable for Chinese companies and households to invest overseas, just a lot more difficult. This has led to the rise of complicated multilayered investment vehicles and products such as cryptocurrency. The use of cryptocurrency allows entrepreneurs and skilled investors to seek alternate, yet still legal, means of transferring funds from out of the country to the United States.

WHAT IS CRYPTOCURRENCY?

Cryptocurrency is a digital asset that can be used as a form of electronic payment. Its source of value stems from its derivation in its unique and specialized digital signature and its sales volume. The currencies are without centralized control and maintained using a technology known as Blockchain. Blockchain is a digital ledger in which transactions made in Bitcoin or other cryptocurrencyies are recorded chronologically and publicly.

This distributed ledger is preserved by a group of mutually distrustful parties called miners, which avoids one of the perceived weaknesses of the current financial system which ultimately relies on centralized control. The miners are members of the public that use their computers to validate and timestamp their transactions and then add them to the ledger and acquire them in their own digital wallets. The security of the system is based on the idea that each miner is trying to honestly maintain it, due to the financial incentives in doing so and the computational impracticality in reversing the transactions.[3]

Due to this feature, cryptocurrency is not subject to the same regulations and verification procedures by financial institutions, thus reducing the transaction costs associated with using their mediating services of a trusted third party. However, despite the financial incentive, there are serious security risks involved in investments in these alternative cryptocurrencies, among them is their proclivity to be used in black market transactions and the need to be either pseudonymous or anonymous. As a result, it is difficult for regulators to track the transactions, but advantageous for users to engage in this peer to peer (direct person to person) system of financing.[4]

THE CRYPTOCURRENCY SOLUTION

In China, for example, Bitcoin, a popular cryptocurrency, has been traded freely for

1 http://www.reuters.com/article/us-china-yuan-idUSKBN14M032 Business News (January 1, 2017). China's new rules on yuan transfers are not capital controls: Xinhua. Retrieved from: http://www.reuters.com/article/us-china-yuan-idUSKBN14M032

2 https://www.nytimes.com/2016/11/29/business/economy/china-tightens-controls-on-overseas-use-of-its- currency.htm

3 https://bitcoin.org/bitcoin.pdf

4 https://bitcoin.org/bitcoin.pdf

years. Investors have used their personal bank accounts to purchase Bitcoin (at the local RMB to Bitcoin exchange rate), and deposited their bitcoins into a Bitcoin digital wallet. From there, the Bitcoin can be sold on the open international market for US dollars. The proceeds from that sale are then free to be sent to a bank account of choice in the US, as long as the investor is able to create a US bank account. As, many banks have restrictions as to whom can create a U.S. bank account, an investor can create a foreign account that will accept USD and use it to transfer USD from their Bitcoin wallet. From here, the investor can transfer their money into an EB-5 project for investment purposes.

This transfer of currency method can be adapted in other areas that have similar risks and national regulations associated with the flow of funds to foreign nations as long as there is not stricter regulations imposed by their local governments. The Chinese government for example, is discussing the possibility of freezing bank accounts which participate in Initial Coin Offerings (ICOs). Like an IPO, ICOs are meant to raise initial capital for a cryptocurrency. If this regulation takes place, it will be harder to purchase new cryptocurrencies from China, and Bitcoin may soon be regulated shortly after. It is also widely anticipated that the Chinese government will ban the ability to trade Bitcoin on exchanges. The government is still expected to allow over the counter Bitcoin purchases, however it is yet to be seen how this will affect the liquidity of Bitcoin in the Chinese market.

While some countries are shying away from Bitcoin, others are embracing it with open arms. At time of print, two companies have announced this month that they will be opening Bitcoin mining farms in Japan. This serves to improve the liquidity of the Bitcoin market and increase the overall value of the cryptocurrency as more bitcoins will be made available for trading and purchase. Japan's willingness to recognize Bitcoin as a currency, like the dollar or yen, can partially explain the expeditions to the country for Bitcoin mining. Likewise in the US, Bitcoin is recognized by the Commodity Futures Trading Commission ("CFTC") as a commodity and taxed as property by the IRS.[5] Based on these significant regulatory developments in the US, select cryptocurrencies represent another legally recognizable means of transferring capital to US for the purpose of investing in job creating projects. Many other countries have embraced the use of Bitcoin, and recognize the new wave of cryptocurrencies and blockchain technology as a part of their economy.

Bitcoin is digital money used for the secure and instant transfer of value anywhere in the world. It is not controlled or issued by any bank or government - instead it is purchased and sold on an open network which is managed by its users. The value of a bitcoin is not tied or pegged to the value of any other currency. Similar to stocks or property, bitcoin values are determined by buying and selling in the open market. A bitcoin's price changes in real time based on the number of people who want to buy or sell it at a given moment. Therefore, like trading on the stock market, there is volatility involved in trading Bitcoin, however prudent investors can still find ways to take advantage of the cryptocurrency market. Ultimately, Bitcoin allows for many investors to take part in a global financial network.

Another cryptocurrency growing in popularity is Ethereum. Ethereum allows the holder to participate in a global computational network. This is done by means of smart contracts, which are scripts of code that can be deployed in the Ethereum blockchain. Although smart contracts are still a very new technology, they have a wide range of potential applications in many different areas, such as voting, global supply chains, medical records, the financial system, and possibly others that have yet to be discovered. The value of Ethereum is not tied or pegged to the value of any other currency. Similar to stocks or property (and just like Bitcoin), Ethereum's value is determined by buying and selling in the open market. The price of Ethereum changes in real time based on the number of people who want to buy or sell it at any given moment. Ethereum is regularly traded for bitcoin, dollars, euros, yen, and other currencies in real time 24 hours a day. Ethereum is often referred to by its abbreviation of "ETH", while Bitcoin is abbreviated to "BTC". Ethereum was created by Vitalik Buterin, a cryptocurrency researcher and programmer, in 2013.

Of the many advantages to using cryptocurrency, the speed in which currency can be transferred from a country with strict restrictions is at the top of the list. Moving forward, it can be foreseen to be a legitimate method of money transfer for global direct investments as long as government regulators cooperate with this new and dynamic method of investing and trading money.

5 https://www.irs.gov/uac/newsroom/irs-virtual-currency-guidance