Regulating Digital Currencies: Bringing Bitcoin within the Reach of the IMF

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Abstract

This Comment examines the potentially destabilizing effects of emerging digital currencies on the international foreign currency exchange market. Specifically, it examines "Bitcoin," a decentralized, partially anonymous, and largely unregulated digital currency that has become particularly popular in the last few years. This Comment argues that the International Monetary Fund, the institution responsible for coordinating the stability of foreign exchange rates, is ill-equipped to handle the widespread use of digital currencies in the foreign currency exchange market. It highlights the inability of the Fund to intervene in the event of a speculative attack on a currency by Bitcoin users. This Comment concludes by suggesting two interpretations of the Fund's incorporating document, the Articles of Agreement, that would allow it to intervene in the event of such an attack.

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I. INTRODUCTION

The birth of the Internet heralded in a new era of cheaper, faster, and more efficient commercial transactions. This new type of commerce—also known as “e-commerce”—has brought with it a number of new and complicated social, legal, and economic challenges. In the last twenty years, a wealth of scholarship has been devoted to addressing these concerns.

But one area of research has fallen into neglect: the development of electronic (or Internet-based) currencies. In the 1990s, when the Internet was still fairly new, a sizeable amount of scholarship was devoted to exploring ways in which the Internet would change how we use and conceptualize money. Many theorized that the advent of the Internet would cause a new kind of money to be born. Rather than carrying around paper bills or metal coins, people would instead switch to digital currency: electronic money stored on a computer and transferred via the Internet. But as the newness of the Internet began to wear off, so did scholars’ interest in its potential to generate new forms of currency. Since then, little has been done to trace the growth of digital currencies in our increasingly computerized and complex digital economy.

Recently, however, particular attention has been given to an emerging digital currency called the “Bitcoin.” Bitcoin is a private digital currency traded online via a peer-to-peer network. Bitcoins are stored as electronic files on a computer’s hard drive, and can be accumulated or transferred just like an e-mail. Software algorithms embedded in the online Bitcoin network protect against fraud and ensure that the files are not counterfeited. Bitcoin was designed to operate without the need for intermediaries or any central issuing authority. It does not rely on a central bank to issue it, a commercial bank to store it, or a credit card company to transfer it. Instead, users interact with each other directly and anonymously, without third-party intervention.

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1 See, for example, Kerry Lynn Macintosh, How to Encourage Global Electronic Commerce: The Case for Private Currencies on the Internet, 11 Harv J L & Tech 733 (1998).
2 Barrett Sheridan, Bitcoins: Currency of the Geeks, Bloomberg Businessweek (June 16, 2011), online at http://www.businessweek.com/magazine/content/1126/b4234041554873.htm (visited Apr 10, 2013) (supporting the idea that a Bitcoin is “private” in the sense that “[t]he currency is backed only by the faith and credit of its participants and outside the scope of any banker, politician, or the Federal Reserve”).
5 Id at *5.
Although only four years old, Bitcoin’s ability to serve as regulation-free virtual cash poses a number of difficult legal questions due to its transnational and largely decentralized nature. While it has yet to gain the widespread acceptance enjoyed by other major international currencies, regulatory solutions for the challenges it presents will become necessary if Bitcoin continues to grow in popularity. Though some scholarship has been devoted to domestic regulation of Bitcoin transactions, virtually no attention has been given to regulating Bitcoin at the international level.

The International Monetary Fund (IMF) is the international institution tasked with coordinating the international foreign currency exchange market. It sets minimum standards for what member nations can do to their individual currencies in order to preserve global economic stability. Like almost every international institution, the IMF’s rules apply only to nations that have agreed to adhere to them. Every country—with the exception of North Korea—is a member of the IMF and, therefore, bound by its regulations. By ensuring that (almost) everyone plays by the same rules, the IMF is able to effectively coordinate global economic policy.

Because Bitcoin is not formally backed by a country’s government, it is not bound by the IMF’s guidelines. As a result, Bitcoin poses a serious threat to the economic stability of the foreign currency exchange market if it continues to grow in both value and usage. Any other digital currency that enters widespread use would pose similar problems. Because private digital currencies like Bitcoin fall outside the IMF’s legal framework, the IMF is unable to obtain those currencies directly. As a result, the IMF is limited in what it can do to intervene in the event that a private digital currency like Bitcoin is used to attack the value of a conventional currency through what is known as a “speculative attack.” A speculative attack occurs when an investor wishes to take advantage of a “weak

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8 See Articles of Agreement of the International Monetary Fund (1945), 2 UN Treaty Ser. 134 (1947) (IMF), Art 1: “The purposes of the International Monetary Fund are: . . . (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.” The term “foreign exchange market” describes the constantly fluctuating relative values of different countries’ currencies. See Marc Levinson, Guide to Financial Markets 14 (Profile 4th ed 2005).
currency, a currency that has depreciated in value relative to other currencies. If left unchecked, a successful attack can push a weak currency's value even lower, resulting in a destabilization of the international foreign currency exchange market. If Bitcoin—or a digital currency like it—becomes an important currency in international commerce, its use in speculative attacks could cause serious economic harms unless the IMF develops a way to counter those attacks.

To further complicate things, the longer the IMF takes to bring Bitcoin within its control, the more difficult controlling Bitcoin will become. Bitcoins are generated through computer software which is programmed to halt the production of new Bitcoins by approximately 2025. Once Bitcoins can no longer be generated, their supply becomes finite and their value can be expected to increase. As their value increases, so does the expense that the IMF has to incur in order to obtain them. Because having a supply of Bitcoins is necessary to effectively counter a speculative attack, the sooner the IMF can acquire a supply of Bitcoins, the cheaper counteracting such an attack will be.

This Comment examines the potential legal and economic challenges Bitcoin poses to the IMF's regulation of the international foreign currency exchange market, and suggests a possible solution. Section II explains Bitcoin, how it works, and what makes it unique. In addition, this Section suggests several advantages of digital currencies over traditional paper currencies, and introduces projections about Bitcoin's growth. Section III examines the IMF and its role in the global currency exchange. It provides an overview of why the IMF was created, what its principal goals are, and explains how it works with respect to the foreign currency exchange market. Section IV explains the potential destabilizing effects of Bitcoin on the foreign currency exchange market. It introduces the concept of a speculative attack, explores potential countermeasures to one, and explains why the IMF is currently ill-equipped to effectively intervene in the event of a speculative attack by Bitcoin users. Section V suggests two ways to use the IMF's founding document, the Articles of Agreement, to guard against a speculative attack by Bitcoin users. First, the understanding of certain provisions of the Articles of Agreement could be expanded to incorporate digital currencies like Bitcoin while leaving much of the underlying framework intact. Alternatively, the Articles of Agreement could be

11 Id.
amended to grant Bitcoin quasi-membership status in the IMF itself. This proposal would allow the IMF a more direct means of countering speculative attacks by Bitcoin users while also granting important benefits to Bitcoin users. By adopting either of these solutions, the IMF could effectively coordinate a defense to the threat posed by Bitcoin to the stability of the international foreign currency exchange market.

II. THE EMERGENCE OF BITCOIN AS A DIGITAL CURRENCY

In order to understand Bitcoin’s potential impact on the international foreign currency exchange market, it is important to understand exactly what Bitcoin is and how it works. This Section provides an overview of the technology that supports Bitcoin, discusses the potential benefits of Bitcoin over traditional currencies, and makes predictions about Bitcoin’s future.

A. What is Bitcoin?

Conceptually, Bitcoin is two things at once. First, it is a digital currency, meaning that the unit of account it employs has no physical counterpart with legal tender status. Second, Bitcoin is what Friedrich A. Hayek described as a “private currency”: a currency provided by private enterprise aimed at combating government monopolies on the supply of money. Traditional financial actors, such as central banks or government institutions, are not involved with Bitcoin transactions. Consequently, there is little legal regulation or supervision of Bitcoin usage. The interaction between Bitcoin and traditional currencies is not regulated by law, and all aspects of Bitcoin—from its supply to the means by which it is generated—are controlled solely by its users. Hayek argued that traditional government-backed currencies are prone to a number of weaknesses, particularly susceptibility to inflation and political corruption. Private currencies, Hayek suggested, are more stable than traditional currencies because they do not share these weaknesses.

15 ECB, Virtual Currency Schemes at *5 (cited in note 4).
16 Id.
17 Id.
18 Macintosh, 11 Harv J L & Tech at 743 (cited in note 1).
19 Hayek, Denationalisation of Money at 89 (cited in note 14).
20 Id at 95-99.
In 2009, a pseudonymous hacker (or hackers) operating under the pseudonym Satoshi Nakamoto created “Bitcoin,” the world’s first digital, decentralized, and partially anonymous currency. Nakamoto was inspired by an article written back in 1998 by Wei Dai, a graduate from the University of Washington. Dai envisioned a system in which “untraceable pseudonymous entities . . . [could] cooperate with each other more efficiently, by providing them with a medium of exchange and a method of enforcing contracts.” He sought to create a medium of exchange that avoided the need for intermediaries in electronic transactions, and one in which government involvement “[was] not [only] temporarily destroyed but permanently forbidden and permanently unnecessary.”

Drawing on Dai’s vision, Nakamoto created Bitcoin, the world’s first private, decentralized digital currency. Unlike traditional fiat currencies, whose value is determined by law and underwritten by the state, Bitcoin is not backed by a government or legal entity. Bitcoin does not have a central authority in charge of the money supply or a central clearing house. Indeed, no traditional financial institutions are involved in Bitcoin transactions. Instead, users perform all steps of a transaction themselves. Bitcoins are not pegged to any real-world currency. Instead, their value with respect to other currencies is determined by supply and demand. Bitcoin operates using peer-to-peer networking and cryptography to maintain the anonymity of its users and the

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24 Id.

25 Fiat money is any legal tender designated and issued by a central authority, such as the dollar or euro. It is similar to commodity-backed money in appearance, but radically different in concept, as it can no longer be redeemed for a commodity like gold. Users are willing to accept it in exchange for goods and services simply because they trust this central authority. Trust is therefore a crucial element of any fiat money system. ECB, Virtual Currency Schemes at *9 (cited in note 4).


27 Id., Virtual Currency Schemes at *6 (cited in note 4).

28 Id.

29 Id.

30 Id at *21.

31 ECB, Virtual Currency Schemes at *6 (cited in note 4).
integrity of transactions. Bitcoin’s software is open source, allowing all users to view the underlying computer code and understand how it works.

B. How Does Bitcoin Work?

1. Bitcoin’s basics.

Bitcoins are computer files, similar to a music or text file, and can be destroyed or lost just like cash. They are stored either on a personal computer or entrusted to an online service. They can be spent on both goods (real or virtual) and services. Because Bitcoins are just computer files, “spending” them simply entails sending them from one user to another, like sending an email via the Internet.

Individual Bitcoin transactions are encrypted, logged by a decentralized network running on thousands of computers, and recorded in a public ledger. This public ledger records which Bitcoins have been spent or accepted but does not record the identifying information of the transacting parties, thereby securing users’ anonymity. Bitcoins are transferred from one user to another once the transaction has been cleared by another Bitcoin user on the peer-to-peer Bitcoin network. Transactions occur without the presence of a government, bank, payment network, regulator, or other third party entity. In lieu of traditional institutional protections, Bitcoin relies on various technological measures to ensure its transactions are secure.

2. Bitcoin’s security.

Bitcoin operates using a “cryptographic proof” system, which allows users to deal directly with one another without needing a third party to authorize the

34 Tukafoto, Bitcoin Mining for Fun and Net Loss (cited in note 3).
35 Id. Rather than storing their Bitcoin files locally on their own computers, some users chose to deposit their Bitcoin files onto remote computer servers. This service is colloquially referred to as an “online wallet.” See id.
36 ECB, Virtual Currency Schemes at *6 (cited in note 4).
39 Id.
40 Id. A peer-to-peer network is one in which each computer can act as a server for the others, allowing shared access to files and peripherals without the need for a central server. See Dinesh C. Verma, Legitimate Applications of Peer-to-Peer Networks 1–9 (Wiley 2004).
Regulating Digital Currencies

Each Bitcoin transaction uses public-key encryption to ensure the transacting parties' privacy. Public key encryption generates two mathematically related keys. One key is retained by the payee—somewhat like a private password or pin. The private key is used to access the Bitcoins kept in the payor's account. The other key is made public—like the name of a bank or an account location where the funds reside. The payee uses the public key to locate the payor's account. The payor's account can only be accessed (and funds can only be extracted) by someone with the associated private key. The payor then uses their own private key to authorize the extraction of Bitcoins from their account. All transactions associated with a public key are then broadcast to the entire Bitcoin community. Because public encryption is so complex, faking a Bitcoin transaction would require more processing power than the entire Bitcoin network combined. Public encryption, therefore, effectively ensures that Bitcoin transactions are secure.

Bitcoin also uses a widely-published "peer-to-peer distributed timestamp server" to verify that the digital coins have not been "double spent"—in other words, counterfeited. A timestamp records the exact time that a Bitcoin is created or sent from one user to another. Every ten minutes, a list of all Bitcoin transactions (and their timestamps) is recorded into something called a "block." These blocks are then aggregated into the "block chain," a master list that stitches together each ten minute snapshot of the entire Bitcoin network.

44 Id; see also J.P. and G.T., *Virtual Currency* (cited in note 26).
46 Id.
47 Nakamoto, *Bitcoin* at §6 (cited in note 41). This process is similar to systems used on stock exchanges that allow the public to know the time and size of the transaction without disclosing the identities of the parties themselves. Id.
52 Id.
The block chain is available to all users on a network, and is updated with every
subsequent ten minute chunk of transactions. Because computing the block
chain involves an enormous amount of data regarding previous transactions,
forging it is incredibly difficult to do. In that sense, the timestamp server—and
the block chain it creates—helps guard against Bitcoin fraud.

3. Obtaining Bitcoins.

There are three ways for users to obtain Bitcoins. First, users can purchase
Bitcoins by exchanging “real money,” such as the dollar or euro, for Bitcoin
files. Like a traditional exchange market, the price of Bitcoins floats against
other currencies and is valued by supply and demand. Second, users can obtain
Bitcoins in exchange for goods or services, as is true for a traditional currency.
Lastly, users can obtain Bitcoins by generating them through a process called
“mining.” Mining allows Bitcoin users to generate Bitcoins rather than
purchasing them. A user who wishes to “mine” a Bitcoin volunteers their
computer’s processing power to solve a complicated computer algorithm.
Every ten minutes, Bitcoins are awarded to whichever miner is able to compute
a number below a certain threshold.

There are, however, limits to Bitcoin mining. Mining is an arduous and
time-consuming process. The typical office computer would take roughly five to
ten years of running nonstop to find any Bitcoins, and the cost of electricity
would outweigh the value of the Bitcoins generated. In addition, the number of
Bitcoins generated through mining is tightly controlled. Currently, the reward for
solving the mining algorithm is fifty Bitcoins. But that number is halved with
every 210,000 blocks created (approximately every four years). Bitcoin’s

53 Id.
56 ECB, Virtual Currency Schemes at *25 (cited in note 4).
59 Kaplanov, Nerdy Money at *7 n 59 (cited in note 43).
61 Id.
software slows the generation of Bitcoins over time so that there will never be more than 21 million in circulation. In other words, the maximum number of Bitcoins in circulation is finite. Given the rate at which the success of Bitcoin mining slows, Bitcoin generation is estimated to come to halt in 2025. By systematically limiting the growth of Bitcoins, the system ensures that its value cannot be artificially inflated or deflated; "[n]o banker can control it. No evil dictator tyrant can print zillions and destroy the value."63

C. The Virtues of Digital Currency

Digital money offers some substantial advantages over traditional, paper-based fiat currencies. First, digital currencies do not require the physical presence of payer and payee for transaction finality. Transactions can be completed anytime, anywhere, without the need to coordinate direct interaction of the participants. This advantage creates several significant economic benefits. The costs associated with the production, transportation, and handling of physical currency can be substantial. It costs an estimated $60 billion each year to handle central bank currency in the US, including the costs of processing and accounting of money, storage, transport, and security. The cost of an electronic payment system would range from one-third to one-half of a paper payment system. Transitioning from a traditional paper-based currency to an electronic one would, therefore, reduce the overall transaction costs associated with transferring value among different types of accounts, banks, and countries. In sum, digital currencies would make currency transactions cheaper and more efficient overall for both individual users and financial institutions.

Transitioning to digital currencies also produces an interesting positive externality in the form of learning spillovers. Digital currencies require the use of software to function. Thus, transitioning to a predominantly digital currency regime would increase users' daily interaction with software systems. This, in turn, could help improve the skills and knowledge of users regarding personal

64 Id.
68 Berentsen, 51 KYKLOS at 92 (cited in note 66).
69 Id at 93.
finance software and finance optimization technologies. In a world that is increasingly focused on integrating technology into our lives, accustoming users to software-based finance could create long-lasting and valuable effects.

Finally, some scholars assert that digital currency performs the functions of a currency more efficiently than government-backed, physical money. Currency serves three primary functions. First, it serves as a medium of exchange. Second, it acts as a unit of account and a measure of relative worth. Third, currency acts as a store of value of current earnings for future spending. Digital currencies like Bitcoin have the potential to perform each of these roles more efficiently than traditional currencies.

1. Superior medium of exchange.

As previously discussed, digital currencies impose fewer transaction costs. They allow individuals to transact with one another regardless of where they are or whether they know each other. While the same might be said of other electronic payment systems like PayPal, digital currencies are unique in that they overcome the transaction costs imposed by exchanging one currency for another. Exchanging one form of currency for another imposes a number of costs. From the user’s perspective, it entails an extra step that needs to occur before a transaction can be completed. In addition, currency exchange often entails an actual fee. Digital currencies can avoid these costs because they are designed to be used transnationally via the Internet. For example, rather than converting US dollars into euro, yen, and pounds sterling, a Bitcoin user needs to engage in just one transaction—dollars to Bitcoin—in order to conduct commerce in France, Japan, and the United Kingdom. In this sense, digital currencies are “universal” in that they can operate outside a system that uses

70 Berentsen, 51 KYKLOS at 93 (cited in note 66).
71 Macintosh, 11 Harv J L & Tech at 756 (cited in note 1).
73 Id.
74 Id.
75 Paypal is an online service that allows people to send money without sharing financial information, with the flexibility to pay using their account balances, bank accounts, credit cards or promotional financing via the Internet. See About PayPal, online at https://www.paypal-media.com/about (visited Apr 12, 2013).
76 Macintosh, 11 Harv J L & Tech at 758 (cited in note 1). If the value is not intuitive, users must expend valuable time and money to familiarize themselves with the value indicated by the currency. Value associated in an obscure unit of account must be translated into value expressed in a familiar unit of account. See id.
77 Id at 756.
multiple currencies, thereby avoiding the transaction costs associated with currency exchange.\textsuperscript{78}

2. Superior unit of account and measure of relative worth.

In order to serve as an efficient unit of account, a currency must provide an almost intuitive measure of relative worth.\textsuperscript{79} Without an intuitive sense of value, users would have to spend time, money, and resources, to determine what the currency is really worth.\textsuperscript{80} Gold, for example, derives its value because of its rarity.\textsuperscript{81} Recall that generating a Bitcoin involves an incredibly complex and time-consuming process. A Bitcoin could be considered intrinsically and intuitively valuable given how difficult it is to produce. Also recall that Bitcoins will no longer be produced after 2025. The difficulty in producing new Bitcoins coupled with their artificial scarcity suggests that, one day, Bitcoins—like gold—might soon be considered “rare” and, therefore, valuable.

In addition, an effective currency must also be accepted as legitimate by its users.\textsuperscript{82} Traditional currencies in democratic societies, for example, derive legitimacy from the fact that a government issues, manages, and guarantees the currency by operation of law. While legitimacy in the eyes of a currency’s users is often obtained by government backing, a government’s susceptibility to interest groups can sometimes harm a currency’s stability more than it helps it.\textsuperscript{83} This suggests that the ideal currency should be viewed as legitimate without having to rely on government backing.

3. Superior store of value.

Digital currencies’ independence from direct political influence also makes them superior to traditional currencies because they are a more stable store of value. When assessing a currency as a store of value, the key question is whether the currency is viewed as reliable and stable enough to operate effectively.\textsuperscript{84}

\textsuperscript{78} Daniel Lynch, chairman of CyberCash, Inc., suggests that the ideal form of money would be “a currency without a country, or of all countries, infinitely exchangeable, without the expense or inconvenience of exchanging among local denominations.” Daniel C. Lynch and Leslie Lundquist, \textit{Digital Money: The New Era of Internet Commerce} 122 (Wiley 1996).

\textsuperscript{79} Macintosh, 11 Harv J L & Tech at 758–59 (cited in note 1).

\textsuperscript{80} Id.


\textsuperscript{82} Macintosh, 11 Harv J L & Tech at 759 (cited in note 1).

\textsuperscript{83} See Hayek, \textit{Denationalization of Money} at 117 (cited in note 14). Hayek notes that government-backed currencies are inherently unstable to the extent that the currency, like the government, will always be subject to interest groups. See id.

\textsuperscript{84} See ECB, \textit{Virtual Currency Schemes} at *11 (cited in note 4).
After all, storing wealth in any medium that is easily susceptible to collapse or fraud is unwise. As explained above, traditional currencies are often accepted as stores of value because they are backed by governments which, in turn, gives them a sense of legitimacy and stability in the eyes of users. But government backing is a double-edged sword. If, for example, a country is embroiled in conflict, its currency might suffer as a result. If a government decides to inflate its currency as a matter of some greater national economic policy, the wealth held by individuals in the form of currency decreases.

Electronic currencies, on the other hand, would answer to market forces, rather than the policies of national governments and the various special interests they represent. Consequently, issuers of electronic currency would have a strong economic incentive to keep their currencies stable: the more stable the currency, the better a store of value it becomes and the more likely others are to invest in it as a result.

D. The Vices of Digital Currency

1. Uncertainty.

Despite the potential advantages of digital currencies like Bitcoin, their widespread adoption faces a number of obstacles. First and foremost, economists are worried about the uncertainty surrounding the operation and growth of digital currencies. Because so much of the data on these currencies is either supplied directly by the issuer or scattered across the Internet, it is difficult for scholars to draw any reliable conclusions on whether—and if so, how and when—these currencies might be widely accepted. Others criticize digital currencies like Bitcoin on a more theoretical level because they are neither intrinsically valuable, like gold, nor do they have roots in a commodity

85 Macintosh, 11 Harv J L & Tech at 764 (cited in note 1).
86 Id.
87 ECB, Virtual Currency Schemes at *33 (cited in note 4) states:

[It is very complicated to obtain a clear overview of the situation regarding virtual currency schemes at this stage. Almost all of the information that can be found is on the Internet, written in blogs or on web pages where personal bias cannot be excluded... With the exception of a few articles from respectable media sources or economics journals, it is almost impossible to find any comprehensive papers on this issue, since no international organizations have published statements. A similar problem exists with regard to the quantitative information and statistics that would be needed in order to assess the speed at which these virtual currency schemes are growing and the point at which they could become a real threat. The quantitative information that is available is not extensive and is usually provided by the respective scheme owner.]
expressing a certain purchasing power. Some critics go as far as to describe digital currencies like Bitcoin as nothing more than a Ponzi scheme.

2. Lack of regulation.

The lack of an underlying legal framework poses additional problems. Because digital currencies like Bitcoin lack regulation or public oversight, they are subject to credit, liquidity, and operational risks, as well as risk of fraud. The lack of oversight coupled with the finality and irrevocability of Bitcoin transactions gives many skeptics cause for concern. Because digital currency transactions necessarily occur over the Internet, cyber-security is a constant concern. Despite the technical measures used to secure individual Bitcoin transactions, user-end storage and usage of Bitcoins are a key security vulnerability. For instance, in June 2011, a hacker compromised a user account containing about 400,000 Bitcoins, totaling approximately $9 million, causing the value of one Bitcoin to plummet from $17.50 to $0.01 in only a few hours.


Finally, digital currencies like Bitcoin face the problem of network externalities. The benefit of using a digital currency depends on the number of other people using it: if only a few merchants accept digital money, individuals have little incentive to adopt digital currencies as form of every-day money; if few consumers use digital money, a merchant has little incentive to accept digital cash. Thus, even if digital currencies are able to overcome the aforementioned barriers, their biggest challenge lies in convincing users to use them and merchants to accept them.

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89 See ECB, *Virtual Currency Schemes* at *27* (cited in note 4). Users go into the system by buying Bitcoins against real currencies, but can only leave and retrieve their funds if other users wants to buy their Bitcoins, that is, if new participants want to join the system. Id. A Ponzi scheme is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. See US Securities and Exchange Commission, *Ponzi Schemes: Frequently Asked Questions*, online at http://www.sec.gov/answers/ponzi.htm (visited Apr 12, 2013).

90 See ECB, *Virtual Currency Schemes* at *17* (cited in note 4).

91 Id at *27*.


93 Berensten, 51 KYKLOS at 113 (cited in note 66).
E. The Current State of Bitcoin and Beyond

Despite all of these potential drawbacks, one thing is clear: Bitcoin’s value has surged in little over a year. In October 2011, one Bitcoin was worth approximately two US dollars.\(^94\) In March 2013, Bitcoin jumped to $36.\(^95\) On April 5 2013, one Bitcoin went for a little more than $140.\(^96\) Four days later, on April 9, Bitcoin leaped to an all-time high of $238!\(^97\) As of April 25, 2013, Bitcoin slumped back to its pre-boom value of a little less than $140, placing the value of Bitcoins in circulation at almost $1.5 billion.\(^98\) To put that into perspective, the value of Bitcoins circulating in April exceeded the value of the entire currency stock of over 30 countries, including Niger, Belize, and Malawi.\(^99\)

A 2012 study from the European Central Bank suggests that the use of digital currencies like Bitcoin is only expected to grow in the near future.\(^100\) Those predictions might be more prescient than they first seem. Recent financial crises in both Spain and Cyprus have caused Bitcoin prices to spike as worried citizens exchange their government-backed euros for Bitcoins.\(^101\) Bitcoin demand in parts of Europe has become so great that some have proposed installing physical Bitcoin ATMs.\(^102\) As European countries struggle to recover from financial crisis, more and more people seem to be losing confidence in traditional currencies and turning to Bitcoin as an alternative form of currency. The recent explosion in Bitcoin’s value demonstrates that more and more people are turning to Bitcoin despite the theoretical reasons for avoiding it.

\(^{94}\) Grinberg, 4 Hastings Sci & Tech L J at 160–61 (cited in note 7).
\(^{95}\) Bitcoin Charts, online at http://bitcoincharts.com/charts/mtgoxUSD (visited Apr 25, 2013).
\(^{96}\) See id.
\(^{97}\) See id.
\(^{98}\) The value of Bitcoins in circulation as of Apr 25, 2013 was obtained by multiplying Bitcoin exchange rate (1 Bitcoin = 135.55 USD as of Apr 25, 2013) times the number of Bitcoins in circulation as of Apr 5, 2013 (11,079,675). See id.
\(^{100}\) ECB, Virtual Currency Schemes at *47 (cited in note 4). The report suggests that this expected increase is due in large part to: (1) an increase in online financial transactions; (2) the increased anonymity of digital currencies; (3) their lower transaction costs than traditional payment systems; and (4) their ability to settle transactions more quickly than traditional paper money. See id.
Regulating Digital Currencies

If Bitcoin continues to grow in both usage and importance, policymakers will be faced with a number of difficult questions. What affects will it have on the exchange rates of other currencies? What, if anything, can be done to control those effects? Potential answers to these questions are further complicated by Bitcoin’s decentralized infrastructure. The sections that follow examine what might be done to regulate the use of Bitcoin and digital currencies like it in the international foreign currency exchange market.

III. THE INTERNATIONAL MONETARY FUND AND THE GLOBAL CURRENCY EXCHANGE

The International Monetary Fund (IMF) plays an important role in regulating the international foreign currency exchange market. It was created in 1944 to help coordinate international monetary policy following the turmoil of the Great Depression. The IMF’s goal is to regulate international economic transactions—including the foreign currency exchange market—in a way that helps promote the growth of world trade. It was created to set basic guidelines that all member nations were expected to follow, particularly with respect to the foreign currency exchange market, in order to promote a stable international economy.

As the following overview will demonstrate, the IMF was created to overcome the collective action problem of allowing individual countries to enact self-interested economic policies without jeopardizing the global economy. Since its inception, the IMF’s goal has been to protect the world from global economic destabilization. As we shall soon see, this makes the IMF the best institution to address the potentially destabilizing effects of Bitcoin on the international foreign currency exchange market.

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103 IMF Art 1 (cited in note 8) states:

The purposes of the International Monetary Fund are:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems . . .

(ii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade . . .

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

104 Id.
A. The History behind the IMF

In order to best understand the IMF, it is important to first understand the climate in which it was conceived. Prior to the creation of the IMF, global currencies were fixed in relation to the price of gold. The gold standard allowed nations to value and maintain their currencies at a fixed rate of exchange with other currencies that were tied to gold. But in 1931, panic caused by World War I led to widespread attempts to “unload” paper currency in exchange for gold. Gold reserves were seriously depleted as a result, and the gold standard collapsed.

In its place, countries began to rely on competitive exchange controls and trade restrictions. In an effort to combat the unemployment caused by the Great Depression, countries sought to stimulate exports by competitively devaluing their currencies. To prevent speculative movement of currencies, some even adopted multiple exchange rates: one favoring trade and another discriminating against capital transactions. In addition, countries often imposed trade restrictions to protect domestic industries. Some argue that the competitive devaluing of currencies and imposition of import restrictions only exacerbated the financial problems created by the Great Depression. In describing the events following the deterioration of the gold standard, one influential diplomat explained:

In many countries controls and restrictions were set up without regard to their effect on other countries. Some countries, in a desperate attempt to grasp a share of the shrinking volume of world trade, aggravated the disorder by resorting to competitive depreciation of currency. Much of our economic ingenuity was expended in the fashioning of devices to hamper and limit the free movement of goods. These devices became economic weapons with which the earliest phase of our present war was fought by the Fascist dictators. There was an ironic inevitability in this process. Economic

107 Id at 39.
108 Shigeo Horie, The International Monetary Fund: Retrospect and Prospect 32–36 (St Martin’s 1964).
111 Id.
aggression can have no other offspring than war. It is a dangerous as it is futile.\textsuperscript{113} The IMF was established in 1945 to aid postwar reconstruction, address the problems created in the wake of the gold standard’s collapse, and regain control of the international monetary system. The IMF’s Articles of Agreement prohibited member nations from devaluing their currency to gain an economic advantage.\textsuperscript{114} In order to stabilize the foreign exchange rates, the IMF coordinated a “fixed parity system”—known by many as the Bretton Woods system.\textsuperscript{115} Between 1946 and 1971, all currencies were determined by the value of the US dollar, which was, in turn, determined by the price of a set amount of gold.\textsuperscript{116} IMF member nations could not change their exchange rates from the level recognized by the IMF by more than 10 percent without its permission.\textsuperscript{117} However, in 1971, this system collapsed when the US, without permission, devalued the dollar by more than 10.\textsuperscript{118}

In 1978, the IMF Articles of Agreement were amended to allow countries to use whatever exchange rates they chose so long as they conformed to the guidelines provided in the Articles of Agreement.\textsuperscript{119} Today’s international foreign currency exchange market is regulated under this regime.

B. How the IMF Works

The IMF’s primary purpose is to ensure the stability of the international monetary system by monitoring exchange rates and enabling countries to transact with one another.\textsuperscript{120} One way it accomplishes this is by issuing currency loans to member countries. The IMF holds a currency reservoir created by initial


\textsuperscript{114} “[Each member shall] avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.” IMF Art IV, § 1(iii) (cited in note 8).


\textsuperscript{117} Id.

\textsuperscript{118} Id.

\textsuperscript{119} See generally IMF Art IV (cited in note 8).

Upon joining the IMF, each member nation is assigned a quota—roughly equivalent to its relative size in the world economy—which determines its maximum contribution to the IMF’s pool of financial resources. Up to 25 percent of a nation’s quota is payable in widely accepted currencies, such as the dollar, yen, euro, or pound sterling. The rest must be paid in that nation’s own currency.

The IMF’s pool of currency is available for lending through a drawing system. A member is allowed to purchase any foreign currency it needs in exchange for an equal value of its own currency. All drawings are subject to the IMF’s approval. Furthermore, drawings are subject to a number of restrictions and charges that make it increasingly difficult to draw a currency once some has already been drawn. A member must eventually repay all drawings that it makes by repurchasing its own currency in exchange for gold or some other convertible currency. The drawing system provides the fundamental means by which IMF members acquire the resources to counter speculative currency flows and to maintain stable exchange rates between their currencies. Thus, the IMF is able to meet member nations’ borrowing needs (via the drawing system) by ensuring that it maintains a diverse and robust currency reservoir (via the quota system).

IV. THE DANGERS OF AN UNREGULATED BITCOIN

As Bitcoin continues to grow in popularity and value, it poses an increasingly serious threat to the stability of the foreign currency exchange market and, by extension, international commerce. Recall that the IMF was created to tackle two global economic problems: (1) the artificial devaluation of

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123 International Monetary Fund, Where the IMF Gets its Money (cited in note 122).
124 IMF Art III, § 3 (cited in note 8). A member pays in gold the smaller of 25 percent of its quota or 10 percent of its net official holdings of gold and United States dollars. See id at Art III, § 3(b) (cited in note 8).
126 Id.
127 See IMF Arts V §§ 3, 8 (discussing conditions on drawing rights and charges), VI (discussing the limitations for capital transfers) (cited in note 8).
129 See id. Speculative currency flows are discussed extensively in Section IV.
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one’s currency to gain an economic advantage; and (2) unstable exchange rates between various currencies. Bitcoin cannot trigger the first concern because the algorithm that supports it prohibits users from artificially manipulating its value. Bitcoin does, however, have the potential to create severe and possibly irreversible fluctuations in the foreign currency exchange market. Specifically, Bitcoin poses a liability to the IMF and its member nations in the event it is used in what is referred to as a “speculative attack” on another currency.

In order to fully appreciate the potential threat Bitcoin poses, it is important to first understand speculative attacks on currencies. A speculative attack on a currency occurs when an investor wishes to take advantage of a “weak currency,” a currency that has depreciated in value relative to other currencies. The attack begins by taking what is known as a “short position” in the currency. To do this, the attacker borrows a sum of the weak currency and sells it for a stronger (more valuable) currency, with the intention of buying the weak currency back for less than the attacker sold it for. If the currency continues to depreciate in value after the short sale, the attacker makes a profit when they buy it back. By way of illustration, the attacker borrows 100 apples and sells them for 80 oranges. If the value of apples-to-oranges gets weaker, the attacker can then sell their eighty oranges back to the market for 120 apples. The attacker then pays back their loan—100 apples—and is left with a 20 apple profit.

Speculators typically sell the weak currency to commercial banks through long-dated (at least one month) forward contracts. These forward contracts, however, pose a problem to the bank if the currency it purchased from the speculator continues to get weaker. Because forward contracts take some time to mature, the bank is forced to hold on to weak currency as it continues to depreciate in value. When it comes time to buy the currency back, the speculator makes a profit at the expense of the bank. By the time the forward contract matures, the bank is forced to buy the weak currency for more than the currency

130 IMF Art IV, §1(iii) (cited in note 8).
is worth once the contract matures. This is known as a “maturity mismatch.” This discrepancy gradually depletes the bank’s supply of the attacked currency over time. By making a profit at the expense of the bank, the attackers have more money to spend in perpetuating the speculative attack, and the banks have less to use in order to guard against it. If banks are unable to offset the speculative attack, the value of the attacked currency spirals uncontrollably downward, triggering destabilization in the foreign currency exchange market.

In order to counteract speculative attacks, banks typically rely on their country’s central bank for assistance. Central banks are public institutions which manage a state’s currency, money supply, and interest rates. Central banks hold currency reserves which can be loaned out in case of an economic or financial emergency. To counter a speculative attack, central banks have a few options. First, they can raise interest rates to deter speculation. Second, and more importantly, they can intervene directly into the foreign currency exchange market by offsetting, or “absorbing,” the maturity losses felt by commercial banks as a result of their forward contracts with investors. This requires the central bank to buy the commercial bank’s excess of the weak currency in exchange for stronger currency at the exchange rate. This ensures that commercial banks are not left with only excess amounts of weak currency thanks to their forward contracts with speculators.

In order for a central bank to absorb the maturity mismatches of a commercial bank, the central bank must have a reserve of currency upon which to draw. In the event of an emergency, where the central bank does not have a currency reserve, the nation served by the central bank can turn to the IMF for assistance, provided that nation is a member. This is where the importance of the IMF’s quota system comes into play. As discussed in Section III, the quota system allows the IMF to maintain a diverse stockpile of currencies in case they are needed to help stabilize foreign exchange rates. The amount and variety of

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136 Id.
139 Id.
140 Daniels, Jager, and Klaassen, Defending against Speculative Attacks at *4 (cited in note 134). Raising interest rates raises the forward rate of the forward contract, resulting in a smaller—if not nonexistent—profit for the speculator. See id.
141 Id at *7.
142 See Section III.B.
the currencies available to member nations is limited to the currencies submitted via the quota system.

Herein lies the threat posed by Bitcoin. In the event that a wealthy Bitcoin investor—or a number of Bitcoin investors—launches a speculative attack on a currency, what can be done to counter it? In theory, individual countries could diversify their reserve portfolio by purchasing Bitcoins from an online exchange. But if a central bank’s reserve is unable to absorb the maturity mismatches suffered by its central banks, who can it turn to? The IMF has no supply of Bitcoins; indeed it has almost no way to obtain them directly. The IMF obtains currency via the quota system and the IMF can only collect quotas from its members. Bitcoin is neither a member of the IMF, nor could it become one if it wanted to—IMF membership is only open to nation-states. The IMF could try to purchase its own reserve of Bitcoins, but whose money would it use? Which part of the IMF’s general fund would it deplete? In short, Bitcoin’s potential to become a major player in the foreign currency exchange market raises a number of substantial questions for the IMF. In its current state, the IMF would be unable to supply the currency needed to counter the destabilizing effect of a speculative attack by Bitcoin users on a member nation’s currency.

If nations are deprived of the ability to borrow Bitcoins to offset maturity mismatches, their only reasonable alternative is to rely on the ability to raise interest rates. As explained above, raising domestic interest rates is designed to make speculators’ financing costs higher than their anticipated capital gains in the event of a devaluation, which might force an eventual closing of short positions. But raising interest rates can have a number of negative side effects. First, the consequences of higher interest rates depend in large part on the status of the affected economy. If the effected economy is in a period of slow growth, raising interest rates—which, in turn, effectively raises prices—could trigger a recession. As the costs of heightened interest rates mount, confidence in the central bank begins to deteriorate: since increasing interest rates during an economically inopportune time only makes sense if the situation dire, those increases fuel speculation that the nation’s currency is truly weak and only going to get weaker. This leads to vicious spiral: expectations of devaluation force higher interest rates, which in turn imposes greater costs on the economy. Given the right—or, more accurately, wrong—economic climate, those costs may

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143 IMF Art II, § 2 (cited in note 8).
144 International Monetary Fund Research Department Staff, Capital Flow Sustainability at *9 (cited in note 135).
145 See Kraay, 59 J Intl Econ at 298 (cited in note 137).
146 Id.
prove too much, causing the nation to spiral into recession and further exacerbating the speculative attack on its currency.

In short, the ability to increase interest rates and the ability to borrow currency from central banks and the IMF work best in conjunction with one another. Without a reserve holding of Bitcoins, the IMF is severely restricted in what it can do to assist member nations facing a speculative attack by Bitcoin users. In effect, the IMF's inability to contribute leaves nations with only one option: to raise interest rates. And, depending on the state of that nations' economy, that option may prove economically disastrous.

The threat posed by Bitcoin, of course, has yet to materialize. But as Bitcoin usage continues to grow, so does the potential threat it poses to the stability of the foreign currency exchange market. Although particular attention has been given to Bitcoin in this regard, the same can be true for any digital currency that grows enough in terms of usage and value to be traded for substantial amounts of foreign currency. Without the ability offer digital currency as part of its currency reserves, the IMF would be ill-equipped to ensure global economic stability in a future where digital currency becomes a major player.

V. HOW TO COUNTER THE BITCOIN THREAT VIA THE IMF

Finding a way to regulate Bitcoin is critical in light of its potential destabilizing effects on the foreign currency exchange market. Although there might be a number of ways to mitigate Bitcoin's impact via domestic legislation, those solutions are beyond the scope of this Comment. Instead, I discuss ways in which the IMF can be used to counter the threat posed by Bitcoin.

The IMF is particularly well-situated to solve this problem for two reasons. First, the IMF is an institution specifically designed to help stabilize the global economic system via the foreign currency exchange market, as explained in Section III. Second, regulating Bitcoin falls squarely within the IMF's goals, as outlined by Article 1 of the Articles of Agreement. In both of these respects, the IMF is able to coordinate a global response to the threat posed by Bitcoin in a way no other institution can.

There are, however, challenges that must be overcome. The most obvious obstacle to regulating the impact of Bitcoins on the foreign currency exchange market via the IMF is one of enforcement. Article VII of the Articles of Agreement...
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Agreement allows the IMF to replenish its holding of a member nation’s currency. It also allows the IMF to restrict the flow of a currency it deems to be scarce and to apportion its allocation accordingly. Both are vital tools for countering a speculative attack. The first allows the IMF to overcome any currency shortages, ensuring that it has a sufficient amount of currency to lend in an effort to offset a speculative attack. The second gives the IMF the flexibility it needs to respond in the event of an emergency shortage, and allows the member nation whose currency is in short supply to limit the domestic exchange of its scarce currency.

Neither of these tools, however, is available to the IMF in the event of a speculative attack by Bitcoin users. The IMF draws its power from the obligations it imposes via the Articles of Agreement. Those obligations only bind members of the IMF (that is, signatories of the Articles of Agreement). Consequently, Article VII only authorizes the IMF to collect currency from member nations. Membership, however, is only open to nation-states. Furthermore, dealings with the IMF are expressly limited to those done via a member nation’s financial institutions. Bitcoin is neither a nation-state, nor does it have any centralized financial institution with which to do business with the IMF. As they are now, the Articles of Agreement do not permit the IMF to exercise direct control over the use of Bitcoins.

There are, however, two ways to incorporate Bitcoin into the IMF’s regime. The first option is to grant the IMF indirect control over Bitcoin by expanding the interpretation of an already-existing provision of the IMF. This approach requires the least amount of change and leaves the overall IMF framework mostly intact. The second option is to grant the IMF more direct control over Bitcoin by granting it and other digital currencies quasi-membership status. This more radical approach would require an amendment of

149 Id at Art VII, § 1: “The Fund may, if it deems such action appropriate to replenish its holdings of any member’s currency in the General Resources Account needed in connection with its transactions.”

150 IMF Art VII, § 3(a):

If it becomes evident to the Fund that the demand for a member’s currency seriously threatens the Fund’s ability to supply that currency, the Fund, whether or not it has issued a report under Section 2 of this Article, shall formally declare such currency scarce and shall thenceforth apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation, and any other pertinent considerations. The Fund shall also issue a report concerning its action.

151 Id at Art II, § 2.

152 Id at Art V, § 1: “Each member shall deal with the Fund only through its Treasury, central bank, stabilization fund, or other similar fiscal agency, and the Fund shall deal only with or through the same agencies.”
the Articles of Agreement and would fundamentally alter the existing framework’s conception of a non-state actor’s role in the IMF.

A. Indirect Control: Article IV, Section 5 and “Separate Currencies”

The Articles of Agreement contain a set of provisions that would allow the IMF to mitigate the impact of Bitcoins in foreign currency exchange market through the pre-existing quota system. Article IV of the Articles of Agreement outlines the obligations of IMF members with respect to exchange agreements. It requires member nations to cooperate with the IMF’s guidelines, to adopt domestic policies that facilitate international economic stability, and—most importantly—prohibits activity that would destabilize foreign exchange rates.153 Section 5 of Article IV holds member nations responsible for both its primary currency as well as any separate currencies it might use.154 More specifically, any act by the IMF towards a member nation applies to all currencies of a member nation.155 Any act by an individual member nation, however, applies to all of its currencies unless it specifies that the action relates to one currency and not the other.156

153 Id at Art IV, § 1:

[i] Each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

(i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;

(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;

(iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and

(iv) follow exchange policies compatible with the undertakings under this Section.

154 IMF Art IV, § 5 (cited in note 8) (emphasis added):

(a) Action by a member with respect to its currency under this Article shall be deemed to apply to the separate currencies of all territories in respect of which the member has accepted this Agreement under Article XXXI, Section 2 (g) unless the member declares that its action relates either to the metropolitan currency alone, or only to one or more specified separate currencies, or to the metropolitan currency and one or more specified separate currencies.

(b) Action by the Fund under this Article shall be deemed to relate to all currencies of a member referred to in (a) above unless the Fund declares otherwise.

155 Id at § 5(b).

156 Id at § 5(a).
The precise meaning of these provisions—and the intent that motivates how they should operate—is unclear.\textsuperscript{157} Article IV, Section 5(a) mentions “separate currencies” by referencing Article XXXI, Section 2, the provision under which signatories accede to the Article of Agreement.\textsuperscript{158} Section 2(g) explains that, by signing the Articles of Agreement, member nations accept its provisions on behalf of all of its “colonies, overseas territories, all territories under their protection, suzerainty, or authority, and all territories in respect of which they exercise a mandate.”\textsuperscript{159} Presumably, this suggests that the reference to “separate currencies” in Article IV is meant to hold principal nation-states responsible for the currencies of their subsidiaries. Put differently, reading Article IV, Section 5 and Article XXXI, Section 2(g) together was intended to prevent member nations from taking advantage of potential loopholes. If, for example, the United Kingdom was prohibited from devaluing the pound sterling in order to gain a competitive advantage, it was also prohibited from devaluing the rupee in its Indian colonies even though the colony was not—at the time the Articles of Agreement were drafted—formally a signatory to the Articles of Agreement. In essence, Article IV, Section 5’s reference to “separate currencies” is best read as authorizing a means by which the IMF can exercise indirect control over currencies not formally within its reach.

In order to mitigate the potential impact of Bitcoin, the meaning of Article IV, Section 5 could be expanded to include digital currencies. Rather than limiting its scope to currencies used by colonies or overseas territories, the IMF could use Article IV Section 5 to label Bitcoin—or other digital currencies like it—a “separate currency.”\textsuperscript{160} As such, the IMF could require member nations to pay part of their subscription quota with Bitcoins.\textsuperscript{161} This would require member nations to accept responsibility for the currencies of their subsidiaries, much like they currently do for their colonies or territories.

\textsuperscript{157} Indeed, the IMF’s own legal department takes the position that there is “very little legislative history to illuminate the meaning of [Article IV’s] provisions.” See International Monetary Fund Legal Department, \textit{Article IV of the Fund’s Articles of Agreement: An Overview of the Legal Framework} *3 (June 28, 2006), online at http://www.imf.org/external/np/pp/eng/2006/062806.pdf (visited Apr 12, 2013).

\textsuperscript{158} IMF Art XXXI, § 2 (cited in note 8).

\textsuperscript{159} See id at § 2(g): “By their signature of this Agreement, all governments accept it both on their own behalf and in respect of all their colonies, overseas territories, all territories under their protection, suzerainty, or authority, and all territories in respect of which they exercise a mandate.”

\textsuperscript{160} This approach works best once individual member nations have enacted domestic regulations on the use of Bitcoins. Once domestic legal oversight is imposed, Bitcoin becomes much more like the currency of a colony or territory in that it is controlled directly by the national government. Efforts to regulate Bitcoins in the US are already underway. See, for example, Brett Wolf, \textit{Senators Seek Crackdown on “Bitcoin” Currency}, Reuters (Jun 8, 2011), online at http://www.reuters.com/article/2011/06/08/us-financial-bitcoins-idUSTRE7573T320110608 (visited Apr 12, 2013).

\textsuperscript{161} The IMF’s Board of Governors conducts general quota reviews at regular intervals (usually every five years). Any changes in quotas must be approved by an 85 percent majority of the total voting
nations to purchase Bitcoins independently. They would then contribute that amount to the IMF’s general fund as part of their quota, receiving an amount of their own currency or special drawing rights equal to the value of the Bitcoins paid in exchange.\textsuperscript{162} In short, expanding the meaning of Article IV, Section 5 would grant the IMF a means of indirectly accumulating Bitcoins through its members.

To accomplish this, the IMF would have to make a minor amendment to the Articles of Agreement. An amendment of this nature would require three-fifths of the IMF’s members, having 85 percent of the total voting power, to ratify the change.\textsuperscript{163} With the necessary votes, the IMF could amend Article XXXI, Section 2(g) to expand the scope of the “separate currencies” referred to by Article IV, Section 5. An amendment would establish Bitcoin, and digital currencies like it, as “separate currencies” for the purposes of Article IV, Section 5 without making any major changes to the obligations outlined in Article IV generally.

Expanding the scope of Article IV Section 5 would accomplish three things. First, it would ensure that the IMF has an adequate supply of Bitcoins from which to draw on in order to counter a speculative attack on a member nation’s currency by Bitcoin users. Second, it would avoid undercapitalizing the IMF’s general fund by ensuring that the value of currency going in (Bitcoins) is equal to the value of currency coming out. Finally, incorporating Bitcoins into the IMF’s general fund would help reinforce its legitimacy and, in turn, its stability in the eyes of the international financial community.

Applying Article IV, Section 5 to Bitcoins in this way is a novel approach. Nothing in its sparse legislative history supports the proposed application. The

\textsuperscript{162} A special drawing right is an international reserve asset, created by the IMF in 1969 to supplement its member countries’ official reserves. Its value is based on a basket of four key international currencies, and SDRs can be exchanged for freely usable currencies. See International Monetary Fund, \textit{Fact Sheet: Special Drawing Rights} (Mar 29, 2013), online at \url{http://www.imf.org/external/np/ext/facts/sdr.htm} (visited Apr 12, 2013).

\textsuperscript{163} IMF Art XXVIII (cited in note 8):

\begin{quote}
Any proposal to introduce modifications in this Agreement… shall be communicated to the chairman of the Board of Governors who shall bring the proposal before the Board of Governors. If the proposed amendment is approved by the Board of Governors, the Fund shall, by circular letter or telegram, ask all members whether they accept the proposed amendment. When three-fifths of the members, having eighty-five percent of the total voting power, have accepted the proposed amendment, the Fund shall certify the fact by a formal communication addressed to all members.
\end{quote}
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most stringent reading of Article IV, Section 5 in light of Article XXXI, Section 2(g) would almost certainly prohibit extending its application to digital currencies like Bitcoin, as the Internet falls quite outside the bounds of “colonies, overseas territories, all territories under their protection, suzerainty, or authority, and all territories in respect of which they exercise a mandate.” Indeed, the greatest difficulty in adopting the proposed approach is that the Internet is not a physical place, is not under the exclusive control of any one country, and is thus markedly different from a territory or a colony.

But the absence of feasible statutory alternatives mitigates the thrust of these criticisms. Nothing else in the Articles of Agreement gives the IMF the power to control the impact of digital currencies. The very framework of the IMF is built on a conventional notion of state sovereignty, where nation-states, and only nation-states, are the key actors. Digital currencies like Bitcoin, on the other hand, are specifically designed to operate without the need for nation-states. In order to leave its underlying framework—with nation-states acting as the principal agents—intact, the IMF needs to find a way to acquire Bitcoins via its members. Expanding its interpretation of Article IV, Section 5 to include indirect control of virtual currencies would allow the IMF to adapt to the ever-changing economic realities of the digital age while retaining its underlying legal framework.

B. Direct Control: Granting Digital Currencies Quasi-Membership to the IMF

Alternatively, the IMF could collect Bitcoins directly from Bitcoin users rather than using member nations as intermediaries. Article II, Section 2 explicitly states that membership to the IMF is only open to other countries. Rather than expanding membership to include non-state actors, Article II could be amended to include a new section, Section 3, which provides quasi-membership status for digital currencies. This kind of an amendment would also require three-fifths of the IMF’s members, having 85 percent of the total voting power, to ratify the change. Instead of granting Bitcoin the full benefits or burdens of membership—for example, the ability to borrow money from the IMF or restrictions on who Bitcoin can do business with—Section 3 would

164 See id at Art II, § 2: “Membership shall be open to other countries at such times and in accordance with such terms as may be prescribed by the Board of Governors. These terms, including the terms for subscriptions, shall be based on principles consistent with those applied to other countries that are already members.”
165 See id at Art XXVIII.
166 Article XI prohibits IMF members from transacting with non-member countries such as North Korea. See id at Art XI.

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allow the IMF to recognize Bitcoin as an “IMF-official” digital currency once the IMF has obtained a certain amount of Bitcoins from Bitcoin users.¹⁶⁷

The trade-offs would be mutually beneficial. Bitcoin users would sell Bitcoins to the IMF for an equivalent value of other currencies. In exchange, Bitcoin users would benefit from the increased legitimacy that results from official IMF recognition. By doing business with an established international institution such as the IMF, Bitcoin users demonstrate that Bitcoin is committed to being a real player in global finance, not just a fringe currency. Direct interaction with the IMF would, in turn, bolster confidence in Bitcoin as a globally accessible digital currency and would increase the potential market for Bitcoins. It is worth noting that participating with the IMF in this manner would not violate Bitcoin’s anti-establishment ethos: selling Bitcoins to the IMF would be a simple transaction with none of the IMF’s regulatory strings attached.¹⁶⁸

The IMF, on the other hand, would benefit from having the Bitcoin reserves it needs to counter a speculative attack without requiring member nations to take any domestic action.

This solution is not, however, without its drawbacks. Collecting Bitcoins via a quasi-membership scheme creates a collective action problem. Because Bitcoin operates through a decentralized network of users, aggregating the necessary amount of Bitcoins would be difficult. There is no centralized institution for the IMF to go to, and no easy way for the IMF to contact Bitcoin users directly. The IMF would have to enter online Bitcoin exchanges like any other prospective Bitcoin user. Even if the IMF were able to transact with Bitcoin users directly, the recognition-in-exchange-for-trading scheme creates a tragedy of the commons: all Bitcoin users benefit from the increased legitimacy of IMF recognition, but no one individual user has an incentive to transact with the IMF. In fact, Bitcoin users might very well have incentive not to transact with the IMF right away. Recall that Bitcoin’s mining software is programmed to cap the generation of Bitcoins by approximately 2025.¹⁶⁹ Once the availability of Bitcoins becomes finite, we can expect the value of Bitcoins to increase. Thus, Bitcoin users have a short-term incentive to hold on to their Bitcoins rather than trade them. Since the proposed system relies on the completely voluntary

¹⁶⁷ An amendment to Article VII might also be required to enable the IMF to purchase currency from non-member entities like Bitcoin users. In its current state, Article VII only authorizes the purchasing of a member’s currency. See IMF Art VII (cited in note 8).

¹⁶⁸ It is again important to note that the only real restriction the IMF imposes on countries with respect to their exchange rates is requiring that currencies not be devalued in order to create a competitive advantage. Since Bitcoin’s software makes it impossible to devalue Bitcoins, the IMF would not be imposing any restrictions on Bitcoin that might detract from its largely decentralized and unregulated status.

participation of Bitcoin users, the incentive to hold on to Bitcoins creates a serious problem.

VI. CONCLUSION

This Comment introduced Bitcoin in conjunction with the history of the International Monetary Fund in order to demonstrate the possibility of future conflict between the two. The peer-to-peer, decentralized, and largely unregulated system that is Bitcoin contains the potential to threaten the global economic stability that the IMF was created to protect. The threat posed by Bitcoin is, for the moment, only theoretical. But as more and more people come to understand the advantages of digital money over paper money, the threat it poses becomes increasingly real. If the future of e-commerce entails a transition to digital currencies, it is critical that our economic, political, and legal institutions are prepared. Recognizing the importance of Bitcoin in the context of digital currencies is the first step in understanding how to best plan for the future.

How, when, and to what extent it will grow remains to be seen. But the potential consequences of widespread adoption of the Bitcoin are already palpable. In order to guard against the global economic destabilization that could occur if and when the world decides to adopt digital currencies, we must consider ways in which our national and international institutions can guide that transition in the here and now. At present, the IMF has at least two options. It can attempt to exercise indirect control over digital currencies vis-à-vis its member nations by expanding the scope of Article IV, Section 5 of the Articles of Agreement. Alternatively, it can attempt to exercise direct control over digital currencies by offering them a form of quasi-membership status, where increased legitimacy is traded for Bitcoin users' business.

Regardless of which measure is chosen, the potential need for a method to combat speculative attacks using Bitcoin is clear. As the Internet continues to play an increasingly important role in how we conduct commerce, our institutions have to adjust to the new challenges this change creates. The evolution of Bitcoin is no exception. Although still in its nascent stages, Bitcoin and other digital currencies like it are projected to become important players in the future of e-commerce. The time to consider how to prepare for that future is now, before practical problems arise.