

**Forum:** International Monetary Fund

**Issue:** Addressing the challenges of digital currencies

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## Introduction

Digital currencies, including cryptocurrencies and central bank digital currencies (CBDCs), are reshaping the global financial landscape, offering both unprecedented opportunities and complex challenges. As these digital assets gain traction, they promise enhanced financial inclusion, faster transactions, and reduced reliance on traditional banking systems. However, they also introduce a range of risks and regulatory dilemmas. The volatility of cryptocurrencies, cybersecurity concerns, regulatory inconsistencies across borders, and potential misuse for illicit activities are pressing issues that demand global attention.

In this report, we will explore the multifaceted challenges associated with digital currencies and propose solutions that address these concerns in a balanced, forward-thinking manner. By examining the regulatory, economic, and social implications, this committee aims to foster dialogue and collaboration among member states. Our goal is to develop actionable strategies that safeguard users, ensure financial stability, and promote the responsible integration of digital currencies into the world economy. Through this framework, we hope to navigate the complexities of digital currencies while maximizing their potential to benefit individuals and societies globally.

## Definition of Key Terms

### Digital currency

The term digital currency refers to a form of currency that is available only in digital or electronic form. It is also called digital money, electronic money [...]. This means that there is no physical form. As such, it cannot be handled, stored, or manipulated. Consumers and businesses can use digital currencies to execute transactions and trades. These currencies may not be used by all countries or communities (Investopedia).

### Cryptocurrency

A type of digital currency that uses cryptography for security and operates on decentralized networks based on blockchain technology. Its most common examples include Bitcoin, Ethereum and Dogecoin. Their use has sparked debates over financial freedom, regulatory oversight, and the impact on traditional banking.

### Blockchain

Blockchain is the underlying technology behind most cryptocurrencies. It's a decentralized, distributed ledger that records transactions across multiple computers in a way that ensures transparency and security. Each transaction is grouped into a "block," and blocks are linked together in chronological order, forming a "chain." Blockchains are praised for their potential applications beyond cryptocurrency, such as in supply chain management, healthcare, and identity verification.

### Decentralized Finance (DeFi)

DeFi refers to a broad category of financial services that are executed on blockchain technology, enabling users to perform functions like lending, borrowing, and trading without needing intermediaries like banks or brokers. It has rapidly grown since 2020 and is reshaping how financial services are provided, but it also comes with risks related to regulatory oversight, cybersecurity, and market volatility.

### Central Bank Digital Currency (CBDC)

Unlike decentralized cryptocurrencies, CBDCs are digital forms of a country's sovereign currency, issued and regulated by its central bank. Countries like China, Sweden, and the Bahamas are at the forefront of CBDC development. These digital currencies aim to provide more secure, efficient means of payment while addressing challenges related to financial stability, cross-border transactions, and payment infrastructure.

### Initial Coin Offering (ICO)

ICOs are a means by which cryptocurrency projects raise capital from investors, usually in exchange for newly created tokens or coins. These tokens often serve a specific function within the platform or project. However, many ICOs have been associated with fraud and regulatory challenges, leading to increased scrutiny from financial regulators worldwide.

## **Mining**

Cryptocurrency mining is the process of solving complex mathematical problems to validate transactions on the blockchain. Miners are rewarded with cryptocurrency for their efforts. While mining is essential to the security of decentralized cryptocurrencies, it has raised concerns due to its energy consumption and environmental impact.

## **Stablecoins**

These digital currencies are designed to minimize price volatility by pegging their value to a stable asset, such as the U.S. dollar or gold. Tether (USDT) and USD Coin (USDC) are examples. Stablecoins have grown popular because they offer the benefits of cryptocurrencies (speed, low fees, and accessibility) without the extreme volatility of assets like Bitcoin.

## **Know Your Customer (KYC)**

KYC regulations require financial institutions to verify the identities of their clients to prevent fraud, money laundering, and terrorism financing. These policies are essential in the crypto space to ensure the legitimacy of transactions and maintain regulatory compliance.

## **Anti-Money Laundering (AML)**

AML refers to the set of laws, regulations, and procedures designed to stop criminals from disguising illegally obtained money as legitimate funds. Cryptocurrencies have been targeted for misuse in money laundering due to their anonymity features, leading to calls for stringent AML enforcement across cryptocurrency exchanges and platforms.

# **History & Developments**

## **Digital banking**

The history of digital money in bank accounts began with the introduction of credit cards in the 1950s, which allowed consumers to make purchases without physical cash. Cards like Diners Club and later Visa represented the first steps toward a digital transaction system. The invention of Automated Teller Machines (ATMs) in the 1960s further digitized banking, as customers could access their bank accounts, withdraw cash, and check balances digitally. These systems used magnetic stripe cards to store account information, marking the early stages of digital banking. By the 1970s, Electronic Funds Transfer (EFT) systems emerged, enabling the digital movement of money between bank accounts. This development revolutionized financial transactions for both businesses and individuals, offering faster and more secure methods for sending and receiving payments. The creation of the SWIFT system in 1973 standardized international digital transfers between banks, making it easier and more secure to transfer funds across borders.

### *Emergence of online banking*

In the 1980s, personal banking software became more common, allowing users to perform basic banking functions from their homes. Although limited, these early home banking systems allowed for bill payments and balance inquiries, further transitioning banking services from physical branches to digital platforms. The rise of the personal computer helped drive this shift. As the internet gained traction in the 1990s, banks began offering online banking services, allowing customers to manage their accounts entirely over the web. This development was a major turning point in the digitization of bank accounts. At the same time, services like PayPal, launched in 1998, introduced a new way for individuals and businesses to transfer money digitally without relying on traditional banking channels. PayPal became particularly significant in the context of e-commerce, providing a digital payment method for online transactions.

### *Mobile banking*

The 2000s saw the rise of mobile banking, as smartphones became widespread. Banks developed apps that allowed customers to perform nearly all banking functions directly from their mobile devices, from paying bills to transferring money. The accessibility and convenience offered by mobile banking apps transformed how people interacted with their bank accounts. Around the same time, digital wallets such as Google Wallet (2011) and Apple Pay (2014) emerged, enabling users to store their debit or credit card information on their devices and make payments digitally. These wallets linked directly to bank accounts, accelerating the move toward a cashless society. The development of contactless payments, facilitated by Near Field Communication (NFC) technology, further enhanced the ease and speed of digital payments, as users could simply tap their phones at point-of-sale terminals.

### *Fintech role and further developments*

In the 2010s, fintech companies began to reshape the digital banking landscape. Challenger banks like Revolut, N26, and Monzo offered fully digital banking services without the need for physical branches. These banks provided accounts, debit cards, loans, and other financial services through mobile apps, further pushing the boundaries of digital money and banking. Another major development was the increasing focus on real-time payments (RTP), allowing users to send and receive funds instantly between bank accounts. This trend has had significant implications for consumers, businesses, and governments, as it has made financial transactions faster, more efficient, and more secure.

## First cryptocurrencies

The idea of digital currencies can be traced back to the 1980s. One of the earliest concepts, called “eCash,” was introduced by David Chaum, a cryptographer who envisioned a private, secure method of digital payments. However, the modern form of decentralized digital currencies took off with the launch of Bitcoin. In 2008, as a result of the global financial crisis, a whitepaper titled "Bitcoin: A Peer-to-Peer Electronic Cash System" was published by an anonymous figure or group known as Satoshi Nakamoto. Bitcoin introduced a decentralized, transparent, and secure method of transferring value without needing central authorities like banks or governments. Its key innovation was the use of blockchain technology, which solved the issue of double spending in digital environments. As Bitcoin gained popularity, alternative cryptocurrencies like Litecoin and Namecoin were launched to improve transaction speed or offer additional privacy features in 2011. This period also saw the creation of various exchanges that allowed users to trade cryptocurrencies. Ethereum’s creation in 2015 was a significant innovation in the blockchain space. Beyond just cryptocurrency, Ethereum enabled developers to create decentralized applications (DApps) and smart contracts, allowing more complex financial transactions and governance systems to be built on the blockchain.

### *Security and Cybercrime Risks*

One of the most significant risks associated with digital currencies is cybersecurity. Digital currencies, particularly cryptocurrencies, are vulnerable to hacking, phishing attacks, and cyber theft. Since digital wallets and exchanges can be compromised, hackers often target platforms where these assets are stored. The loss of digital currencies can be irreversible, as transactions are typically final, and the decentralized nature of cryptocurrencies like Bitcoin often means there is no central authority to appeal to in case of fraud or theft. Moreover, if central bank digital currencies (CBDCs) are widely adopted, they could become attractive targets for cyberattacks, potentially destabilizing entire financial systems.

### *Privacy concerns*

While cryptocurrencies like Bitcoin offer a level of anonymity, many digital currencies, including proposed CBDCs, would likely be more traceable. Governments may want to monitor and control digital currency flows to combat illicit activities such as money laundering and terrorism financing. However, this could lead to concerns over personal privacy, as digital transactions would leave a trail that authorities or corporations could monitor, potentially infringing on individuals’ financial privacy. CBDCs could give governments unprecedented control over citizens' spending habits, as every transaction could be monitored and recorded. This could lead to fears of surveillance and loss of personal freedom.

### *Financial exclusion*

While digital currencies have the potential to increase financial inclusion, they could also inadvertently exacerbate financial exclusion. In regions with poor digital infrastructure, lack of internet access, or low levels of digital literacy, the adoption of digital currencies may marginalize certain populations. Elderly individuals or those in rural and underdeveloped areas may struggle to access or understand these new forms of money, leaving them without a reliable means of engaging in financial transactions. Moreover, if physical cash were phased out in favor of digital currencies, those who rely on cash for day-to-day transactions could be excluded from the financial system.

### *Volatility and Lack of Stability*

Cryptocurrencies are highly volatile, making them unreliable as stable stores of value. While CBDCs would likely be more stable, sudden shifts to digital currencies could disrupt traditional financial systems and cause liquidity problems for banks.

### *Impact on Traditional Banking Systems*

CBDCs could reduce commercial banks' role by drawing deposits away from traditional accounts, impacting their ability to lend and manage liquidity. This shift could disrupt the banking sector, leading to potential credit shortages and economic slowdowns.

### *Regulatory Challenges*

Regulating decentralized digital currencies is difficult due to their borderless nature. Inconsistent global regulations could lead to issues like tax evasion and illicit activity, while overly strict rules could stifle innovation in the financial technology sector.

### *Energy Consumption and Environmental Impact*

Cryptocurrencies using proof-of-work algorithms, like Bitcoin, require enormous energy consumption for mining, leading to environmental concerns. Although more energy-efficient alternatives are emerging, the environmental impact remains a key challenge for digital currencies.

### *Potential for Social and Economic Inequality*

Digital currencies could widen the gap between wealthy, tech-savvy users and those without access to digital tools. The concentration of credit control among larger institutions could also limit financial opportunities for smaller businesses and low-income individuals.

## *Legal and Governance Issues*

The global use of digital currencies presents legal challenges due to varying national regulations. Lack of international consensus could lead to conflicts, especially with decentralized cryptocurrencies, which lack clear governance structures.

## **Major Parties Involved**

### **The People's Republic of China (China)**

China is at the forefront of the CBDC movement, having launched pilot programs for its Digital Yuan. The country sees CBDCs as a way to modernize its payment systems and reduce the dominance of the U.S. dollar in international trade. Additionally, China has banned decentralized cryptocurrencies like Bitcoin, citing concerns over financial stability and fraud.

### **The United States of America (USA)**

The U.S. has been more cautious about CBDCs, but debates over a digital dollar have intensified in recent years. The Federal Reserve and Treasury Department are exploring the implications of a CBDC for financial stability, privacy, and monetary policy. U.S. regulatory agencies, such as the Securities and Exchange Commission (SEC), have been active in scrutinizing cryptocurrency exchanges and projects, including investigating ICOs for securities fraud.

### **European Union**

The European Central Bank (ECB) is working on developing a digital euro, with the goal of ensuring that Europe remains competitive in the digital economy while safeguarding its financial system. The EU has also passed the Markets in Crypto-Assets (MiCA) regulation, aimed at providing a clear framework for digital assets and improving consumer protection.

### **International Monetary Fund (IMF)**

The IMF plays a vital role in advising countries on how to regulate digital currencies and mitigate risks to financial stability. It has warned of the dangers of crypto adoption without proper regulation, especially in developing economies that could be vulnerable to financial instability (Look: Previous attempts to solve)

### **Financial Action Task Force (FATF)**

The FATF sets international standards for combating money laundering and terrorism financing. It has been working to ensure that digital currencies adhere to global AML and KYC standards, requiring exchanges and wallet providers to comply with stringent regulatory checks.

## Private Sector and Tech Companies

Companies like Meta (formerly Facebook) have also ventured into the digital currency space. Meta's Libra (later Diem) project aimed to create a global stablecoin but faced significant regulatory pushback and was ultimately shelved. Meanwhile, companies like PayPal and Tesla have integrated cryptocurrency payment options, further legitimizing the use of digital currencies in mainstream finance.

## Previous Attempts to Solve the Issue

### *Relevant UN Treaties and Events*

While the UN have not published a resolution focused directly on digital currencies as a whole, there have been resolutions or announcements referencing digital currencies. These have been linked below:

- UN Convention against Transnational Organized Crime and the Protocols thereto: [Resolution 9/3](#) (Cryptocurrencies)
- UN Development Programme: [Technical Paper 1.2](#). (CBDCs)

### *NGOs*

#### **Financial Action Task Force (FATF)**

The FATF has been a key player in setting global AML and combating the financing of terrorism (CFT) standards for digital currencies. It introduced the "Travel Rule" for cryptocurrencies, requiring exchanges to collect and share transaction data to prevent misuse of digital assets for illicit activities. The FATF's guidelines serve as a model for countries developing regulations to monitor and mitigate risks in digital transactions.

#### **World Economic Forum (WEF)**

The WEF has facilitated global discussions on digital currency governance, focusing on creating frameworks that promote responsible use and innovation. Through its "Global Blockchain Council" and the "CBDC Policy-Maker Toolkit," the WEF assists governments in evaluating the implications of digital currencies, including regulatory, economic, and social dimensions. The WEF advocates for inclusive, transparent systems that address the needs of both developed and emerging markets.

#### **International Monetary Fund (IMF)**

The IMF has been instrumental in advising member countries on how to regulate digital currencies and mitigate risks associated with economic stability. The IMF's reports, such as its Global Financial Stability Report, offer insights into the economic impacts of digital currencies and provide policy recommendations. Additionally, the IMF has engaged in capacity-building for developing countries to help them adapt to the digital currency landscape.



## Coin Center

As a nonprofit research and advocacy group, Coin Center focuses on ensuring that blockchain and cryptocurrency technologies are understood by policymakers and regulated fairly. Coin Center advocates for clear regulatory policies that protect innovation while safeguarding users. They provide resources and conduct research to inform governments about best practices in digital currency regulation.

## Blockchain Association

The Blockchain Association, based in the U.S., works to advance regulatory clarity for blockchain technology and digital assets. It collaborates with policymakers to ensure regulations balance innovation and user protection. The organization also focuses on educating the public and policymakers about blockchain technology's potential benefits and risks.

## Possible Solutions

### Privacy Protections

As digital currencies gain traction, ensuring user privacy becomes increasingly crucial. A balanced regulatory framework should aim to protect individuals' financial privacy while preventing illicit activities such as money laundering and terrorism financing. Some possible strategies to tackle this worry could include **implementing privacy-enhancing technologies, legislative safeguards and advocating for transparency in data usage.**

### Regulatory Frameworks and International Standards

Establishing comprehensive regulatory frameworks is essential for the safe operation of digital currencies. Countries should collaborate to develop international standards that promote user protection, ensure cybersecurity, and enforce anti-money laundering (AML) measures. This can help prevent fraud and ensure ethical practices in the digital currency space.

### Strengthening Cybersecurity Measures

Enhancing cybersecurity is crucial to protect users from the rising threats of hacking and cybercrime in the cryptocurrency space. Governments can work together to share best practices and resources, while private sector entities can invest in robust security protocols. Additionally, creating a global cybersecurity task force focused on digital currencies can further safeguard user assets.

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This source is strongly opposed to CBDCs and should not be used by delegates to inform themselves about the issue, rather look at it from a different perspective.

## Useful video resources

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