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Understanding China's Cryptocurrency Stance: Analysis of the Recent Developments and Future Prospects

By: Zhengchun Wan



In September 2021, the People's Bank of China (PBOC), China's central bank, in conjunction with nine other state bodies, including the police and the supreme court, issued a statement regarding the country's stance on cryptocurrency businesses.[1] There, regulators have explicitly stated that all cryptocurrency trading, exchanges, and investments—both crypto-to-crypto and crypto-to-fiat—are prohibited, whether they are carried out through domestic or international platforms. [2] Despite China's official strong hostilities toward cryptocurrencies, some believe the policy might change soon.

On January 30, 2022, Justin Sun, founder of the TRON network and a WTO diplomat for Grenada,[3] posted in a Twitter thread that he believes China will soon loosen restrictions on cryptocurrency. He wrote: "[Chinese regulator's tax collection effort on cryptocurrencies] signals the country's increasing embrace of cryptocurrencies. The tax on transactions is a clear indication that the Chinese government views cryptocurrencies as a legitimate form of wealth and wants to ensure its proper taxation." [4]

This tweet was a reaction to a report written by Chinese cryptocurrency reporter Colin Wu on January 25 about the Chinese government's effort to tax individual cryptocurrency investors and Bitcoin miners' investment gains at a rate of 20%. [5] Wu quoted an anonymous source "since the beginning of 2022, a local tax department asked for an audit of its personal income tax. There are many people and a detailed list of the whales that have been inspected." [6]

Despite Wu's reporting, Wu does not share Sun's sentiment. On January 25, 2023, Wu wrote on Twitter, "Some have taken this to mean that the Chinese government may recognize the legitimacy of cryptocurrencies, but the reality is clearly more complex, with tax authorities and financial authorities having differing views." [7]

Wu's view is not unsupported, considering there are many reasons that China banned cryptocurrencies in the first place. In the late September 2021 PBOC statement banning all cryptocurrency transactions, the organization stated their decisions were motivated by the role of cryptocurrencies in facilitating financial crime as well as the growing risk to China's financial system due to cryptocurrencies' speculative nature. [8] However, one other possible reason behind the cryptocurrency ban is an attempt to combat capital flight from China.

Foreign exchange is heavily restricted in China. In 2007, the Chinese State Administration of Foreign Exchange (SAFE) promulgated the Measures for the Administration of Individual Foreign Exchange, setting \$50,000 as the maximum for the domestic individual purchase of foreign exchange per person per year. [9] In 2017, SAFE enhanced its scrutiny on foreign exchange by requiring all Chinese nationals purchasing foreign exchange to fill out the Application Form for Personal Purchase of Foreign Exchange, which requires the applicant to disclose the purpose of fund transfer and explicitly banned using foreign exchange for investment purposes. [10]

Due to the cryptocurrencies' decentralized nature and then lax regulation, cryptocurrencies were ideal as a tool for moving funds overseas, especially with the popularization of stablecoins that are pegged to a "stable" reserve asset like the U.S. dollar. [11] After the 2017 Chinese government's decision to ban Yuan-Crypto exchange, Chinese traders found ways to circumvent the restrictions by trading discreetly with over-the-counter brokers or directly purchasing assets from overseas. [12] Stablecoins, namely Tether, caught on in China so much, as a result, nearly 100% of crypto exchange trades between July 2019 and June 2020 in China were between Bitcoin and Tether. [13] When comparing to the trading data from Japan and Korea, where the market primarily only trades between fiat money and cryptocurrency, it is clear that Tether has become the de facto coin of choice for Chinese crypto traders. [14] According to a report from Chainalysis, between 2019 and 2020, more than \$50 billion in cryptocurrencies was transferred out of East Asian accounts and into other regions. [15] The analysts believe that a significant portion of this net outflow of cryptocurrencies was likely capital flight from China because of China's dominant position in East Asian cryptocurrency exchanges. [16] Given the compelling evidence that the ban on cryptocurrencies was a policy response to prevent capital flights, it is unlikely that Chinese authorities will seek to legitimize cryptocurrencies, at least in the decentralized form.

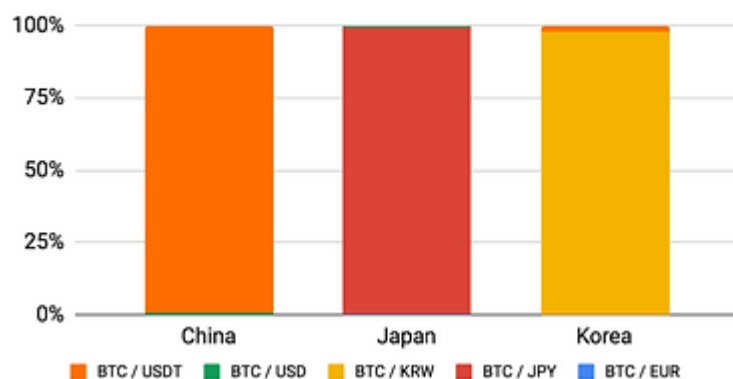
Despite its strong hostility to cryptocurrencies that are traded internationally, China is looking into its own way to explore the opportunity. China's answer to decentralized cryptocurrencies is to create its own but in a radically different way.

China now has Digital renminbi (RMB), but it is complementary to cash in circulation RMB, with the exact same functional attributes as paper banknotes, except in digital form. [17] Explaining the policy of digital RMB, Yifei Fan, Vice Governor of the People's Bank of China, pointed out that the currency is primarily positioned as cash in circulation (M0) and developed to compete with crypto assets to provide a universal base currency for the development of the digital economy. [18] The currency follows the original currency management system and is issued under adherence to centralized management, and is subject to the provisions of the People's Bank of China Law and the RMB Management Regulations, and transactions are monitored. [19] The central bank takes a central position in the digital RMB system, issuing a certain amount of digital RMB to designated commercial banks and managing it throughout its life cycle, with commercial banks and other institutions then providing exchange and circulation to the public. [20]

In conclusion, despite the current hostile stance of the Chinese government on decentralized cryptocurrencies, the recent move towards taxing individuals and miners' investment gains in cryptocurrencies might suggest that China is starting

to embrace cryptocurrencies as a legitimate form of wealth. However, the motivations behind China's ban on cryptocurrencies and their attempts to combat capital flight from China imply that it is unlikely China will fully legitimize decentralized cryptocurrencies. Instead, China is exploring the opportunity through its own digital currency, the digital renminbi, which follows a centralized management system and is complementary to cash in circulation RMB. The future of cryptocurrencies in China remains uncertain, but the government's recent actions suggest that they are looking to find a balance between the benefits of cryptocurrencies and their control over the country's financial system.

Share of Bitcoin trading for fiat and stablecoins by country in APAC, YTD 2019



[21]

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[1] 关于进一步防范和处置虚拟货币交易炒作风险的通知 [Notice on further preventing and disposing of the risk of speculation in virtual currency transactions], 中国人民银行 [The People's Bank of China] (Sept. 15, 2021), <http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4348521/index.html> [<https://perma.cc/WT43-QQBR>].

[2] *Id.*

[3] *Justin Sun Appointed as the WTO Ambassador for Grenada by the Ministry of Foreign Affairs*, Newsfile (Dec. 17, 2021), <https://www.newsfilecorp.com/release/107860/Justin-Sun-Appointed-as-the-WTO-Ambassador-for-Grenada-by-the-Ministry-of-Foreign-Affairs> [<https://perma.cc/FYU9-33XE>].

[4] *Id.*

[5] Colin Wu, *What does it mean that China's tax authorities are speeding up efforts to tax cryptocurrency companies and individuals?*, Wu Blockchain (Jan. 25, 2023), <https://wublock.substack.com/p/what-does-it-mean-that-chinas-tax> [<https://perma.cc/HXM7-YSX7>].

[6] *Id.*

[7] @WuBlockchain, Twitter (Jan. 25, 2023, 7:22 AM), <https://twitter.com/WuBlockchain/status/1618222785830211586> [<https://perma.cc/S47F-B4VK>].

[8] 中国人民银行 [The People's Bank of China], *supra* note 1.

[9] Geren Waihui Guanli Banfa (个人外汇管理办法) [Personal Foreign Exchange Management Measures] (promulgated by State Administration of Foreign Exchange, Dec. 25, 2006, effective Feb. 1, 2007).

[10] Xiao Fan (范晓), Geren Gouhui Bude Yongyu Jingwai Maifang (个人购汇不得用于境外买房) [Personal Foreign Exchange Can Not Be Used For Investment], People.com (Jan 3, 2017), <https://house.people.com.cn/n1/2017/0103/c164220-28993331.html> [<https://perma.cc/4VBM-SY63>].

[11] *APAC Report Preview: Why Tether Dominates in China*, Chainalysis (Oct. 15, 2019), <https://blog.chainalysis.com/reports/tether-china-apac-report-preview/> [<https://perma.cc/S2J3-UVFK>].

- [12] Francis Shin, *What's behind China's cryptocurrency ban?*, World Econ. F. (Jan 31, 2022), <https://www.weforum.org/agenda/2022/01/what-s-behind-china-s-cryptocurrency-ban/> [<https://perma.cc/LK3M-EVPZ>].
- [13] *Id.*
- [14] *Id.*
- [15] *East Asia: Pro Traders and Stablecoins Drive World's Biggest Cryptocurrency Market*, Chainalysis (Aug. 20, 2020), <https://blog.chainalysis.com/reports/east-asia-cryptocurrency-market-2020/> [<https://perma.cc/8QJ9-NZQ2>].
- [16] *Id.*
- [17] Luo Yi (罗懿), 范一飞: 关于数字人民币M0定位的政策含义分析 [Fan Yifei: Analysis of the policy meaning of the positioning of digital RMB M0], Yicai (Sept. 14, 2020), <https://www.yicai.com/news/100770937.html> [<https://perma.cc/7FX9-MMQB>].
- [18] *Id.*
- [19] *Id.*
- [20] *Id.*
- [21] Chainalysis, *supra* note 11.