Cryptocurrencies and the passion for secrecy

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Cryptocurrencies have developed over the past 15 years, benefiting from a passion for secrecy and a desire to abolish government control. This has created vast opportunities for the financial crimes that opacity allows, among which money laundering. More government is needed, more of a state whose financial regulation serves the needs of citizens, not the "less government" claimed by the first promoters of cryptocurrencies. More government, and more global regulation, since the financial world is global whereas the political world is fragmented.

This article owes much to the very clever and attentive reading of my friend and Transparency International founding member Laurence Cockcroft, as well as to other friends from Transparency International: Ilia Shumanov and his colleagues from Transparency International Russia, Ke Rafitoson from Transparency International Madagascar. The reader interested in this topic may also read with great profit "Cryptocurrencies, corruption and organised crime (u4.no)" at https://www.u4.no/publications/cryptocurrencies-corruption-and-organised-crime.

Since the article signed under the pseudonym of Satoshi Nakamoto and now celebrated as the founding myth of Bitcoin, cryptocurrencies have only grown in importance in the financial economy, reaching in 2021 a total transaction volume of sixteen trillion dollars. This amount, which grew by 567% from 2020[1], is of the same magnitude as the total US banking assets of twenty-four trillion dollars.

We can talk about cryptocurrencies in different ways and easily get lost in the numerical complexities of the codes and algorithms implemented to ensure the proper mechanics of these tools.

We can also try to say what these cryptocurrencies reveal about the diseases of our time and more particularly about two of them, the passion for secrecy and the rejection of any form of government. Cryptocurrencies are a symptom of cryptomania and what we could call statophobia, or rejection of any statal control.

At the very origin of cryptocurrencies, there is the secrecy surrounding the person behind the pseudonym Nakamoto, a secrecy that strangely seems to have given confidence to the first investors in Bitcoin, a secrecy as a guarantee that public institutions could not get their hands on this new currency. The very name cryptocurrency is ambiguous, in that it covers two meanings. Cryptocurrency is a currency that uses encryption algorithms to operate, but it is also a secret currency that satisfies the dream of completely hidden wealth, a treasure island that can be enjoyed by lucky or smart investors, hiding their good fortune from those around them.

[1] Chainanalysis, "The 2022 Crypto Crime Report".

Cryptocurrency indeed is like a far-away island, very comparable to the offshore center whose model it carries to near perfection. This is not lost on cryptocurrency practitioners, who often use real offshore centers in addition to cryptocurrency. Sam Bankman-Fried, the founder of FTX, the much-celebrated cryptocurrency player whose bankruptcy in November 2023 cost several billion dollars, was arrested the following month in the Bahamas, where FTX was otherwise registered, and regulated with the lightness that we know characterizes regulation in offshore centers. Several other cryptocurrency players are registered in offshore centers, such as Ideg Asset Management Limited in the British Virgin Islands.

The proximity between the cryptocurrency and the offshore center does not end however with the cryptocurrency actors' taste for the offshore centers. Cryptocurrencies themselves are offshore centers, far simpler and more efficient in their secrecy than any of the jurisdictions specializing in that sort of business. Laundering through traditional and physical offshore centers required, and still requires, an intermediary who opens an offshore account, a transfer from a third institution and a number of people aware of the transaction. On the contrary, hiding money in cryptocurrencies whose owners cannot be unmasked only requires the digital ability to use electronic marketplaces that sell to their investors the anonymity of transactions in currencies whose owners will not be known.

A cryptocurrency is an offshore center transformed and simplified into a series of codes

The passion for secrecy, or cryptomania, that characterizes cryptocurrencies also amplifies a justifying narrative that we already heard about offshore centers. Cryptocurrencies would allow investors, and human beings in general, to free themselves from a supposedly tyrannical state constraint. The creation of money, since the ancient times, has always been the privilege of a power established at the head of a territory. The ideology of cryptocurrency is to question this privilege of the powerful in order to put money at the service of the greatest number, outside of any central regulation.

The tool that allows this challenge is decentralized control, distributed among the users, a control which can take various technical forms depending on the cryptocurrency, but always amounts to entrusting control to a moving set of human beings, who owe their role in the system only to their digital skills. The technical innovation allowing such decentralized control is the blockchain, and the individuals, or now companies, who replace the central banks and spend days and nights validating transactions, are called the miners. The combination between blockchain innovation and the work of tech-savvy miners would lead to the end of state monetary privilege and to a currency accessible to the greatest number of people, close to all needs, particularly in regions of the world with limited banking services or without strong state structures. Conversely, where the state is oppressive, cryptocurrency would allow to escape its grip.

An anarchist utopia has thus developed in support of cryptocurrencies, an anarchist utopia of our time, therefore more widespread among the affluent than among those deprived of everything, but an anarchy all the same, which hopes for a lasting weakening of all governments or at least of their central banks and financial regulators, and this for the supposed benefit of the greatest number.

The benefit for the many has not been realized

What about the realization of this utopia? Benefit for the many has obviously not been realized. What has happened is what happens in any place where there is wealth, and where the lights are turned off and all control is removed: unscrupulous ingenuity unfortunately prevails over virtue.

Bandits of all kinds roam the world of cryptocurrencies to seize ill-protected sums of money, North Korea has made a specialty of these raids that would finance its nuclear missiles. Other criminals who do not have cryptocurrencies at their disposal ask for them as ransom when they have succeeded in hacking an organization's IT system. This allows them to hide their loot immediately: this is a far cry from the banknote numbers that used to help police track down criminals!

The possibility of money creation, when supported by the confidence of the crypto asset markets, also allows the created money to be used later as collateral for excessive loans that endanger the lending banks, their customers and the taxpayer if these banks need to be rescued. FTX, the second largest crypto asset marketplace, went bankrupt late last year because it had used billions of dollars entrusted to it to invest in its own cryptocurrency, which was thus supported in price, and used as a collateral to get the loans in central bank currencies.

This unregulated possibility of money creation is much more problematic than the abuse committed for centuries by princes or states when they created too much money compared to the wealth generated by the economies they controlled. Indeed, in the case of cryptocurrencies, there is no underlying economy and therefore absolutely no wealth creation beyond the work of the crypto-miners who replace the central banks and allow cryptocurrencies to circulate. The investor who buys dollars today can bet on the growth of the US economy, the one who buys Euros bets on the growth of the Eurozone. The one who buys bitcoins only bets on her or his ability to sell them to more naive people than her or him.

The cryptocurrency market is only speculative, and as it is otherwise very opaque it is also a market considerably exposed to insider trading. Contrary to the promises of the cryptocurrencies' promoters, these currencies remain dominated by intermediaries who create or trade them in large quantities. When Luna, the Terra cryptocurrency, collapsed in the spring of last year causing tens of billions of dollars in losses, the powerful intermediaries who had invested in the currency were able to dispose of it in time and the victims were found in the crowd of small investors who had dreamed of getting rich.

The dream of easy enrichment is at the heart of the cryptocurrency world, nurtured as it often is by high-profile influencers with a financial stake in the success of the cryptocurrency, through a mechanism quite comparable to the one used by some more or less scrupulous start-ups when they attract celebrity support in their search for funds.

Cryptocurrencies: secrecy, corruption and money laundering

Finally, the secrecy of cryptocurrencies and their platforms obviously encourages corruption and money laundering.

Cryptocurrencies have transformed bribe-paying, up to a certain amount, into an extremely easy and safe game. The bribe payer goes to a coffee shop with a used laptop and creates a cryptocurrency wallet. Regular cash deposits are then made to the wallet via a bitcoin ATM. Codes which are the keys to the wallet are then given to the bribe taker who can obtain cash in central bank currencies from a bitcoin ATM anywhere in the world, for example in a holiday resort.

Money laundering with cryptocurrencies is faster than through an offshore center and the hiding techniques are more powerful because they largely circumvent the banking system. To some extent and in spite of all their technological sophistication, the cryptocurrencies constitute a new informal sector, but not an informal sector allowing the poor to survive, rather an informal sector allowing the affluent to play, bet or hide. Money earned illegally can already exist in the form of cryptocurrencies, and for example a bribe can be paid in this form. In this case everything is already secret. If the money exists in the form of central bank money and if the amount goes beyond bitcoin ATM capacities, it can be used under a false identity to purchase cryptocurrencies, a process also called "cryptocurrency on-ramp", on a platform that does not verify the identity of the actors. Several successive transactions, using various cryptocurrencies and platforms, allow for further concealment of identities through so-called "layering". Adding such successive layers of opacity is obviously more effective than using more regulated markets. The final stage of laundering, using illicit money in the real economy, involves converting cryptocurrencies held in a secret account into usable currency in the open, a process which reverts the initial "on-ramp" and is therefore called "cryptocurrency off-ramp". Even if they are not very numerous, companies accepting payment in cryptocurrencies for services that are more or less easy to identify, or start-ups that can be sold for payment in cryptocurrencies, now form a sufficiently established model that can be used to justify a positive flow of cryptocurrencies.

The ease of concealing identities through trades in cryptocurrencies demonstrates how misguiding a certain narrative about cryptocurrencies is. Decentralized control among the users has always been presented by the promoters of the cryptocurrencies as the guarantee that every transaction is being recorded by the system in a more certain manner than by a centralized authority. This may be true, but if the main information is missing, which is the identity of the players, there is little value in being certain that a transaction happened at an exact day and time between two machines. Such knowledge may help investigative authorities at some point, but not until the identities of the individuals involved are known through other means.

An argument often heard about the limitations of cryptocurrencies for money laundering purposes is that they would be associated to the high valuation risks due to their volatility. The argument does not apply, however, to the so-called "stable coins" linked to strong central bank currencies, and even for more volatile cryptocurrencies the speed of the processes may be such that volatility risks remain modest. A recent investigation by Transparency International has proven that stable coins brought to cryptocurrency dealers in Moscow could be delivered the same or next day in London and in pounds[2].

Total cryptocurrency laundering would have reached $9 billion by 2021, still a small portion of total global laundering (less than 1%[3]), but two observations can be made. Firstly, we are only at the beginning of the expansion of cryptocurrencies, so it is likely that their importance in money laundering will increase rapidly. Secondly, a significant advantage of money laundering through cryptocurrencies is the extreme speed of the operations required. One can have created the company that will receive the payments in cryptocurrencies even before realizing the illicit gain, and once this gain is realized the money can go through all the stages of opacification in a few hours and then return to the system after having erased all its origin. This largely offsets the risk associated with the high volatility of cryptocurrency prices, volatility that would be a significant obstacle if transactions required a longer time.

Fines against crypto companies, largely for non-prevention of money laundering, nearly doubled in 2022, reaching nearly $200 million worldwide, with the largest fines being $30 million against the three founders of BitMex, a U.S. platform.

Remarkably, cryptocurrencies now seem to be considered by money laundering actors as one of the standard tools of their operations. In February 2023, Australian police broke

[2] Transparency International Russia, *From Moscow-City with crypto: A step-by-step guide to receiving cash from Russia anonymously in London*, 2023.

[3] Frank Vogl (*The Enablers*, 2022) evaluates the total annual volume of cross-border illicit financial flows above $2 trillion, Global Financial Integrity's estimates of illicit financial flows related to trade only is $1 trillion (GFI, *Trade Related Illicit Financial Flows*, 2020).

up a laundering ring in Sydney that operated primarily in real estate and luxury goods, but also held cryptocurrencies.

What to do about it? The simplest answer to this question would be to ban cryptocurrencies worldwide. They are described as innovations but the term “innovation” is misleading because it induces an idea of progress. They are more a novelty whose economic impact is quite clearly negative, which favors crime by opacity and also costs a lot of energy, therefore often carbon, spent in the functioning of the decentralized network.

Experience has taught us, however, that such novelties are not easy to get rid of, and their power of attraction will continue to be exerted on various people for more or less legitimate reasons. This is the case with cryptocurrencies as well as with Credit Default Swaps, which largely contributed to the crisis of 2008, or with a number of other financial novelties with high risk and almost no economic utility. They unfortunately remain in the system, mainly because their speculative nature attracts individuals or organizations that are more gambling than investing.

The financial world is global whereas the political world is fragmented. Hence the need for global regulation of cryptocurrencies

Regulation of cryptocurrencies, as on almost every topic, is uneven across the globe. Within the European Union, the 5th Anti-Money Laundering Directive requires cryptocurrency exchanges and cryptocurrency wallet providers to identify their customers. Some countries ban cryptocurrencies, others however do not even regulate them.

The financial world is global whereas the political world is fragmented. This was already a lesson from the 2008 financial crisis and the cryptocurrencies further demonstrate how the regulatory loopholes across the globe can be easily exploited. Since the essential transactions are done digitally without being impeded by physical borders, a few countries with some international connections are enough for platforms and dealers to register there and offer worldwide services. International coordination is crucial and should be prominent on the agenda of the G20 and the international financial institutions such as the IMF. We now have to address a system that not only circumvents the governments, but also largely circumvents the banks and traditional exchanges. What matters is to target the individuals involved everywhere in the world and to target them through transnational cooperation.

Regulating cryptocurrencies is not enough, however. Cryptocurrencies are falsely presented as an answer to the shortcomings of the current financial system, the governance flaws of banks or the limits of financial inclusion. In the North as well as in the South, cryptocurrencies are often marketed to people who are refused loans by banks for their projects, and then end up losing their last savings in vain attempts to get their funding through cryptocurrency speculation. The more the financial system will be perceived as fair, economically and socially useful, the less cryptocurrencies will benefit from the ideological justification that allows their promoters to obtain favorable regulations in many countries. This requires more government, and more of a state whose financial regulation serves the needs of citizens, not the “less government” claimed by the first promoters of cryptocurrencies.

Lastly, the risks associated to cryptocurrencies have to be more vastly communicated by governments and regulating bodies. Young or less young would-be investors consider cryptocurrencies as a “cool” investment where part of our future would take shape. They often ignore the high risks associated to the volatility of the assets they invest in and they strengthen market players and places which offer secrecy to criminals. The battle to be fought is, as often, a battle of ideas. Investing in secrecy is not cool, it should belong to the past, not to the future.