

CATCHING UP WITH THE REST OF THE WORLD JAPAN IN THE RACE FOR DIGITAL CURRENCIES

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SUMMARY

For a long time, Japan has been one of the most popular digital currency trading hubs. Investors were attracted by very lax regulations that allowed them to efficiently operate some of the world's largest cryptocurrency exchange platforms. Unfortunately, after a series of hacking attacks, which resulted in a loss of a significant amount of assets, the country has introduced new regulations governing the cryptocurrency market. Those changes did not diminish the interest of potential investors. The data released by Japan's Financial Services Agency shows that the revenue from digital currency trading rose to 543 billion USD in 2017 from just 2 million USD in 2014. For a very long time, the Japanese government and, the Central Bank remained sceptical about the idea of granting digital currencies a full and legitimate status. The situation changed when Facebook announced plans to issue its digital currency Libra and the People's Republic of China authorities presented a strategy of introducing the Digital Currency Electronic Payment system. It seems that Japanese financial institutions, pressured by business circles, can no longer remain ignorant of the concept of introducing official digital currency.

INTRODUCTION

Since the emergence of the block-chain technology and Bitcoin, which for a time had been called a new global currency, the interest in digital currencies has been increasing significantly. The year 2020, which was marked by the global economic slump, has been very good for the digital cryptocurrency market. Digital currencies, which initially aroused

the interest of private recipients and businesses, are now at the centre of the global competition for technological advantage in the Fourth Industrial Revolution era. For a long time, most central banks and major financial institutions have been suspicious of the global increase in the interest in digital currencies, highlighting their high vulnerability to manipulation. Governments of the world's largest economies, including the United States, have also been cautious in accepting digital currencies as equal means of conducting transactions. The situation changed when the global corporation, Facebook announced plans to issue its digital currency. Not long after, the People's Republic of China authorities presented a plan to introduce the Digital Currency Electronic Payment system. The central government's interest in releasing the first sovereign digital currency and the speed at which China is developing its own non-cash payment system has showcased the weakness of other players, including the United States, EU, South Korea, and Japan in a race that will reveal a new leader of the global financial system. Today, many other governments, central banks, and corporations are interested in issuing their own digital currencies. A similar phenomenon can be observed in Japan, who from the very beginning, held one of the leading positions in the global race for digital currencies.

DEVELOPMENT OF CRYPTOCURRENCY MARKET IN JAPAN

Cryptocurrencies has been extremely popular in Japan since the initiation of blockchain technology. In time with the growing prices of Bitcoin and other leading digital currencies, the Japanese crypto asset market's value has seen some spectacular growth. Japan was the first country in the world to introduce cryptocurrencies' regulations and defined the legal term of crypto asset. The need for those regulations arose after a series of incidents and security breaches, which resulted in the disappearance of a significant number of cryptocurrencies from Japanese trade and exchange platforms. In February 2014, the MTGOX Company, at that time was one of the largest Bitcoin exchange platforms in the world, reported that cryptocurrency worth almost \$450 million USD was stolen as a result of a hacking attack. Another important factor was the Leaders' Declaration at the G7 Elmau Summit, which recommended more stringent regulations of virtual currencies and other new payment methods.

In response, the Japanese government submitted a bill to amend the Payment Services Act and the Act on Prevention of Transfer of Criminal Proceeds. The purpose of those regulations was to protect customers of Exchange Providers and combat money laundering and the financing of terrorism using cryptocurrencies. As a result of the increasing fluctuation of Bitcoin prices in 2018, Japan has become the world's largest hub for crypto exchange. The reason for the considerable interest of foreign investors was the relatively lenient regulation of the sector. It was not until April 2017 that the Japanese government introduced mandatory registration of cryptocurrency exchanges.



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In January 2018, Coincheck Inc., one of Japan's largest exchange platforms, reported a cryptocurrency loss of approximately \$530 million in a hacking attack. Despite immediate actions aimed at regulating the digital stock exchanges, another large-scale theft was reported in September 2018. The hackers managed to steal cryptocurrencies of a total value of 60 million USD from the Zaif exchange platform. In that same year, the Japanese police was informed of more than 7000 cases of suspicious transactions using cryptocurrencies. The number of crimes involving the use of those assets had increased tenfold compared to 669 cases reported between April and December 2017, when the obligation to report suspicious transactions by digital exchange operators was imposed. Most of the reports concerned cases of money laundering attempts. The situation mentioned above led to further amendments in regulations and laws governing the cryptocurrency market. Some of the most significant changes include:

- changing the term “Virtual Currency” to “Crypto Asset”
- stricter regulations for exchange service providers
- establishing the Electronically Recorded Transferable Rights
- regulations on unfair acts in Crypto Asset or Crypto Asset Derivative Transactions.

Summarizing, the initial lack of regulations combined with the Japanese citizens' high interest turned the country into one of the most prominent digital currency markets. Numerous cases of currency theft, a large number of cases involving cryptocurrencies in criminal activities, and international pressure from G7 forced the Japanese government to introduce stricter regulations of digital currency exchange platforms. This trend raised fears of a slowing down of the cryptocurrency market development as a result of excessive legal regulations. So far, those fears have not materialized. In October 2020, Japan's Financial Services Agency released statistical data garnered from seventeen cryptocurrency exchanges. The publication shows that there are currently around 3,5 million active digital currency investors in the country. The revenue from trading rose to 543 billion USD in 2017 from just 2 million USD in 2014. Due to the economic slump caused by the COVID-19 pandemic, the prices of Bitcoin and interest in crypto assets as an alternative form of investment continue to grow. After the initial problems, the Japanese government, together with leading cryptocurrency exchange platforms, launched a program to increase transparency and security of digital currency trading. Hopefully, this may lead to the establishment of an investor-friendly system of regulations, which may in turn, become a significant asset for the Japanese economy.



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PROBLEMS WITH DIGITAL ECONOMY TRANSFORMATION

The initial problems of Japanese cryptocurrency markets revealed other weaknesses of Japan's financial system. Among other developed economies, Japan has one of the lowest rates in the number of digital payments globally. In 2019 cash accounted for 73.3% of the overall volume of payments. Japanese consumers prefer to manage transactions in cash because of cultural reasons and social changes like an aging society. Recent changes in consumer behaviour patterns, as well as several government-led policies, may herald significant developments in this sector. The younger generation in Japan is leading the way in shifting towards a system based on digital payments. During the coronavirus

pandemic, Japan registered significant growth in the number of cashless transactions. The government is actively promoting the use of digital and cashless payment methods and, support programs rewarding consumers for making cashless payments. As part of the efforts connected with re-organizing the postponed Olympic Games in Tokyo, the government encouraged small businesses to acquire cashless payment terminals. Those shifts have created a set of incentives for domestic and foreign investors to enter the Japanese digital payments market. This, in turn, can create favourable conditions for a broader dissemination of digital currencies. On the other hand, the governmental system of rewarding consumers for cashless payments with points has created tough competition between cashless payment service providers, which may discourage some foreign companies from entering the market.

Another critical set of problems that have to be addressed are issues connected with cybernetic security. In 2017 Japan was ranked first in the ranking of the safest countries for Internet users conducted by comparitech.com. The rating took into account several factors like the quality of cybersecurity legislation and the country's overall preparedness for cybernetic attacks. Unfortunately, a large number of Japanese digital exchange attacks have highlighted the system's vulnerability. Fortunately, on that front, one can also see some decisive actions taken by the central government and business entities involved. In 2020 the Japanese Ministry of Defence (MoD) announced plans to invest nearly USD 237 million to develop an AI-based security system in order to defend the country from cyberattacks. The government has created a Cyber Information Gathering System, which collects data on the tactics and techniques used in attacks on governmental and private entities. The MoD increased the number of personnel in the Cyber Defence Group from 220 to 290. Japanese cryptocurrency exchanges themselves are trying to come up with solutions to the growing security threats. In response to recent hacking attacks, sixteen licensed exchange platforms decided to form a self-regulatory body, which will be responsible for promoting new safety and operation standards.

BANK OF JAPAN'S LACK OF INTEREST IN DEVELOPING DIGITAL CURRENCIES

After Facebook announced its plans to release "Libra" currency and the global increase in the number of cashless payments due to COVID-19, the world's largest central banks

became interested in releasing the new cross-border digital currency (CDBC). Bank of Japan also expressed interest in experimenting with its digital currency. It seems that the Japanese government and, above all, the Central Bank remain sceptical about the idea of granting digital currencies a full and legitimate status. Under Japanese law, "Crypto Asset" is not treated as "money" or government-issued currency. Not a single Crypto Asset is officially supported by the Japanese government or Japan's central bank (BOJ).



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There are many reasons why one should not expect rapid progress with the introduction of the Japanese digital currency. For one, it looks like Japanese institutions are duplicating the cautious behaviour patterns adopted by the United States. Recently the U.S. Federal Reserve Chair Jerome Powell, while commenting on the idea of releasing CDBC stated that "it is more important for the United States to get it right than be first".

In July 2020, the BOJ released a report titled: "Technological Challenges in Having Central Bank Digital Currencies Function as Cash Equivalents." The report summarizes obstacles in recognizing digital currencies as cash equivalents. The title of the report and its content clearly displayed the attitude of the central bank, which perceives digital currencies as a difficult problem rather than a viable payment alternative. Although the BOJ has announced that it will start testing its digital currency in 2021, the representatives stated that the project is a long-term task that will require the general acceptance of the Japanese society. Since Japan currently has one of the oldest populations in the world, one should not expect that social acceptance for the idea of going cashless would be well received. The Japanese banking system is also afraid of a fast and uncontrollable outflow of money kept in the financial institution deposits. Therefore, Japanese banks are encouraging the government to come up with preventive measures, such as introducing a limit on the amount of central bank digital currency a single person can hold. This cautious stance and insistence on further regulations do not herald the acceleration of work on the digital currency system.

Interestingly, the factor motivating Japanese decision-making groups to develop digital currency projects is growing international competition and the threat of Chinese domination. BOJ representatives openly admitted that if Japan does not start its own experiments with the digital currency, in a few years, the Japanese financial sector will not be able to understand the processes taking place in China.

The lack of interest of central governmental institutions in developing digital currencies results from another problem related to changes in the digital economy. Japan has one of the world's best internet infrastructures, offering 90% of its population access to high-speed services. Unfortunately, this high potential remains largely underused by the Japanese government, businesses, and institutions. World Wide Web index data shows that Japan is in the bottom half of the rankings for government use of information and communications technology to improve efficiencies. COVID-19 pandemic has also shown that citizens and businesses could not successfully communicate with governmental and local institutions online, which made it sometimes impossible to continue regular operations. The current government of Prime Minister Suga Yoshihide has recognized this problem and announced a plan of creating a new Digital Agency. The new institution will be responsible for digitizing both public and private sectors by centralizing IT management processes in ministries and local governmental offices. By promoting the use "My Number" personal identification system, the new Agency may pave the way for creating a unified digital system of communication with bureaucratic institutions, which may also be used in creating a cashless payment platform accepted throughout the country.

PRIVATE SECTOR AND DEVELOPMENT OF DIGITAL CURRENCIES

Representatives of Japanese private businesses have long been aware that they cannot wait for support from the Central Bank and the government in the race for high places in the financial and digital currency markets. SoftBank group, which owns internet company Yahoo Japan, is planning to merge with Naver affiliate Line (a chat app operator that owns several crypto exchanges, including the Japanese Bitmax). Line is currently one of the leading providers of cashless payment systems using mobile phones in Japan. Other Japanese companies such as Toyota Systems have also started experimenting with digital

currencies and Japanese commercial banks are also joining the group of those interested. Two years ago, Mizuho Bank in cooperation with local banks, launched J-Coin payment application for cell phone payments. Mitsubishi UFJ Financial Group, one of the largest banking institutions in Japan, announced it would launch a block-chain payment system in cooperation with the U.S. based tech company Akami. In November 2020, two Japanese banks MUFG and SMBC formed a consortium with 38 Japanese companies to develop research on introducing digital currency in Japan. The initiative includes Mizuho, NTT, Accenture, JCB, and other companies from the financial, insurance, and energy sectors. The project involves companies issuing their own non-cash payment systems and their potential recipients. The team's main task is to create a standard payment system that could be used by all non-cash payment operators. The BOJ, the Financial Services Agency, the Ministry of Economy, Trade and Industry, the Finance Ministry and the Internal Affairs and Communications Ministry remain as observers of the project.



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In summary, private business representatives and part of the private banking sector are clearly voicing their support for further development of digital currencies, along with a national cashless payment system that would allow users to operate them freely. Although the central government and BOJ do not show much eagerness to the idea of creating a national digital currency, such a solution could be the next step on the road to creating a unified digital payment system for the entire country.

CONCLUSIONS

The initial stages of developing the digital currency market in Japan have shown that the country has great potential for developing the digital currency market. Despite initial problems, Japan remains one of the most prominent digital currency hubs in the world. Although the idea of creating a government-issued currency in Japan has received much praise from the representatives of the private business and banking sector, one can identify significant obstacles to the project. The most important one is that BOJ and

governmental institutions look at digital currencies as a regulatory and security problem rather than a viable economic solution. Other barriers in developing a thriving digital currency market are connected to cybernetic security, underdevelopment of cashless payment systems, and low level of digitalization of governmental institutions.

It seems that it is too late for the Japanese Central Bank and governmental institutions to draw a successful plan of catching up to China in the race for developing national digital currency. The only viable solution is adopting a similar model to the one currently discussed in the United States, which relies on private entities in the process of developing and releasing digital currencies that could compete with the digital RMB. The critical tool here is maintaining favourable conditions for private digital currency projects while taking care not to suffocate them with excessive regulations. Unfortunately, the initial problems on Japanese cryptocurrency stocks, caused by insufficient cybersecurity measures, as well as the negative attitude of the banking sector, have pushed Japanese institutions towards tighter regulation of the digital currency market, which may to a certain extent, slow down its development. In cooperation with the private sector, the government should focus on the quickest possible resolution of long-standing arrears in the banking sector, non-cash payment systems, digitalization, and cybersecurity. Fortunately, the government has already introduced several steps toward solving the most pressing issues.



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