

# **Cryptocurrency, Sovereignty, and the Rule of Law: A Comparative Analysis of India, the United States, and the European Union**

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## **Abstract**

The rapid emergence of cryptocurrency is becoming a challenge to the banking sector and is posing a threat to the financial sovereignty of states. As a decentralized and global currency, cryptocurrency is a medium of trade that reduces the ability of governments to control their monetary policy, taxation, and regulatory controls. This paper discusses the legal and regulatory response of India, the United States, and the European Union in terms of the challenges of the introduction of cryptocurrencies. India attempts to cope with it through the introduction of harsh taxes and cautious regulations. Instead, the United States is viewing cryptocurrency as an innovation-driven system that is immensely dependent on the decision of courts. Instead, the European Union has adopted an integrated legislative paradigm with the Markets in Crypto-Assets Regulation (MiCA) an indication of a joint ownership of sovereignty and the rule of law. The comparative analysis demonstrates that these strategies present different ideologies of governance but come to a compromise on the need to bring innovations to harmonize with the sovereign power. The paper argues that Central Bank Digital Currencies (CBDCs) are a viable sovereign problem, as it gives countries an option to reassert monetary sovereignty without undermining the principles of transparency, predictability, and the rule of law.

**Keywords:** Cryptocurrency, Financial sovereignty, Decentralization, Monetary policy

## **1. Introduction**

The introduction of cryptocurrency is one of the biggest changes in the international financial system in the twenty-first century. Contrary to the fiat currencies issued by the state, cryptocurrencies use decentralised blockchain networks, which allow borderless and peer-to-peer transactions that are not directly controlled by the governments and central banks. Although these technology advancements are expected to be financially inclusive, efficient, and innovative, it is also thought to disrupt the very principles of state sovereignty, prompting monetary authority, taxation, and regulatory measures to be eroded.

The disruptive trends are indicated by the global adoption trends. Chainalysis reports indicate that some of the countries that have been leading in grassroots adoption of crypto include Vietnam, Nigeria, and India. Meanwhile, the institutional investments are dominated by the developed jurisdictions like the

United States and the European Union members. The huge architectural meltdown of the FTX exchange in 2022, the trial of making Bitcoin a legal currency in El Salvador, and the total prohibition of the cryptocurrency trading by China are examples of the mixed reactions of the states to this technology. The developments demonstrate the political, economical, and legal controversies that cryptocurrencies are producing, specifically in the areas of sovereignty and legality.

In this paper, the legal and regulatory reactions of India, the United States, and the European Union to cryptocurrency are discussed in relation to their implications on sovereignty and rule of law. The research questions to be answered in the research are five:

1. What is the role played by cryptocurrency on the financial sovereignty of states?
2. What are some of the differences in the legal and regulatory reactions of India, the United States, and the European Union?
3. What impact does judicial influence have on cryptocurrency regulation in India and the United States over the legislative action taken by the EU?
4. How far are these regulatory responses in the spirit of the rule of law?
5. Will Central Bank Digital Currencies (CBDCs) become a sovereign answer?

Through the questions, this paper places cryptocurrency not just as a technological phenomenon but as one that forces states to reconsider their primary principles of law and economy.

## **2. Literature Review**

The study of cryptocurrency regulation has developed at an accelerated speed throughout the last ten years as more and more issues have expressed their interest in understanding how cryptocurrency leads to sovereignty, monetary policy, and legal governance.

It is based on the theoretical view of Jean Bodin (1576) on the concept of sovereignty as absolute and unending power of a state.<sup>1</sup>

Krasner (1999) and Susan Strange (1996) highlighted the fact that economic interdependence and global capital flows are eroding state sovereignty in the globalised finance context. Cryptocurrencies enhance this corrosion by establishing parallel systems of value exchange, which exist beyond the traditional systems of states.<sup>2</sup>

When Nakamoto (2008) introduced Bitcoin as a type of money that is decentralised, it created a number of debates among the scholars who consider cryptocurrencies as destabilising, and those who believe in the opportunities of innovation it provides.

An example is Hilary Allen (2019), who emphasizes the systemic risks of massive crypto adoption which in particular cases without firm regulatory guardrails. On the contrary, Chiu and Greene (2020) claim that legal systems that are designed in a careful manner can turn cryptocurrencies into regulated financial instruments without compromising innovation.

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<sup>1</sup> Jean Bodin, *Six Books of the Commonwealth* (1576).

<sup>2</sup> Stephen Krasner, *Sovereignty: Organized Hypocrisy* (Princeton University Press, 1999).

It is also important to conduct comparative research on the regulatory models. According to Arner, Barberis, and Buckley (2017), there are three national strategies: restrictive (with its focus on prohibitions and taxation), permissive (stimulation of innovation and experimentation), and experimental (creation of adaptive regulatory sandboxes). The country of India, the United States, and the European Union in general fit into these models with context-related peculiarities.

Das (2022) criticizes the dependence of punitive taxation of India that has suffocated innovation of crypto in the country.<sup>3</sup>

Goforth (2021) points to the fractured American strategy, which was determined by the coinciding regulatory powers and judicial intervention. The article by Zetzsche, Buckley, and Arner (2020) lauds the Markets in Crypto-Assets Regulation (MiCA) by the EU as an example of harmonised financial legislation.<sup>3</sup>

The dimension of the rule of law has been also investigated. According to Raz (1979) the rule of law is about the clarity, stability and predictability. Similar emphasis is laid on the significance of proportionality in regulatory interventions by Craig (1997). These values become particularly acute when countries are facing new technology such as cryptocurrency.

Lastly, the Central Bank Digital Currencies (CBDCs) literature places them in the category of a counter-response by the sovereign. CBDCs are introduced by the Bank for International Settlement (2021) and Bindseil (2020) as the means of integrating the digital innovation and maintaining the monetary power of states. Empirical cases can be cited of China and Nigeria Digital Yuan and eNaira which show how states can reestablish authority in the digital economy.

### **3. Cryptocurrency and State Sovereignty: Theoretical Framework**

There are various ways through which cryptocurrencies can compromise the financial sovereignty. To begin with, they circumvent central banks, which in the past have monopolized the issuance and regulation of money. This restricts the efficiency of monetary policy especially during crisis times when central banks use interest rate changes and quantitative easing.

Second, cryptocurrencies make taxation systems difficult. Cryptocurrency transactions are sometimes opaque and trace difficult, which makes it easy to evade taxes. The governments do not just lose the capital gains revenue, but also the consumption type of taxes like the Value Added Tax (VAT).

Third, the cryptocurrencies are borderless, making it difficult to enforce. The distributed nodes across jurisdictions validate transactions and therefore no state can have unilateral control. Cryptocurrency governance is extraterritorial because of international regulatory initiatives, including the Financial Action Task Force (FATF) guidelines on Anti-Money Laundering (AML) and Counter-Terrorist Financing (CFT).

In the context of the rule of law, states have a predicament to protect sovereignty without exaggerating it through limited prohibition measures which cannot be justified in terms of legal security and economic freedom. This is the balance between sovereignty and legality that is to be taken as the framework of the subsequent analysis of the case studies.

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<sup>3</sup> Somasekhar Sundaresan Das, *Crypto Taxation in India: Policy Challenges* (2022).

#### 4. India's Response

The regulation mode played in India has been first sovereignty-oriented and often unpredictable. In April 2018, the Reserve bank of India (RBI) issued a circular, which prohibited banks and other financial institutions to service cryptocurrency exchanges and companies. This especially had the propensity to freeze the crypto market in India with many start ups being forced to close or relocate to foreign jurisdictions. The move was based on the RBI issues linked to financial stability, unlawful financing, money laundering and the possibilities of losing the monetary sovereignty.

But in the case of Internet and Mobile Association of India v. In the case of reserve bank of India (2020) 10 SCC 274, the Supreme Court quashed the RBI circular and held that the ban was not in proportion and was unconstitutional. The Court emphasized that the RBI had failed to demonstrate empirical damages caused by cryptocurrency transactions. This decision was significant because it justified the principle of proportionality and the judicial role in balancing state control and the fundamental rights, in particular, the freedom of trade and business under the Indian Constitution in Article 19(1)(g).

It was after this failure that the Indian government changed its way of regulation to taxation. A 30 percent tax on crypto trading earnings and a Tax Deducted at Source (TDS) of 1 percent on all transfers of virtual digital assets (VDAs) was introduced through the Finance Act, 2022. Although this framework allowed making the crypto to have some form of legal legitimacy, by making the crypto taxable, critics claim that this form of punitive taxation keeps away retail investors, innovation and instead pushes the activity underground instead of creating a regulated market.

Similarly, RBI has launched pilot projects to roll out Digital Rupee (Central Bank Digital Currency - CBDC) and position it as one of the elements of the digitalization of the Indian payment system and the reestablishment of state control over the sphere of digital money. The CBDC has a potential to be efficient and sovereign, but issues of privacy, data surveillance, and whether it will unwillingly leave out people who are not digitally literate or who do not have access to infrastructure have been brought up.

India is an economic paradox on the socio-economic front. In spite of the restrictive policies, India has remained one of the leading countries with regard to worldwide crypto adoption, with major adoption in remittance, speculative investment, and decentralized finance (DeFi) involvement especially among the youths. Chainalysis (20223) reports put India in the global crypto adoption index top or near the top. The complexity of the Indian regulatory path is reflected through this disconnect between the issues of state sovereignty and the demands of the populace.

In India, there exist paradoxes on a socio-economic level. India is one of the most prolific in crypto adoption globally, especially in remittances and speculative investment among young people most of whom have restrictive policies. This difficulty between the state sovereignty and popular demand highlights the difficulty of regulation in India.

Case laws, including *Shreya Singhal v.*, are also part of the further. In the case of cryptocurrency, *Union of India (2015) 5 SCC 1*, it is not explicitly about cryptocurrency, but it highlights the need to have judicial restraint on the arbitrary actions of the state to restrict the digital economy. It, by analogy, underscores that state regulation in the technologically dynamically changing areas should be sensible, proportional, and proved. On the same lines, we have the principle expressed in *K.S. Puttaswamy v. The right to privacy as*

Union of India (2017) 10 SCC 1 on the right to privacy has an implication on the rollout of CBDC where surveillance and data protection is also a controversial aspect.

To summarize, the Indian cryptocurrency regulation reaction has been full of contradictions as the judiciary has defended personal freedoms and proportionality, executive and regulatory agencies have been driving policies of sovereignty-oriented practices via taxation, restrictions, and an inducement toward an India-dominated digital currency. It is probable that the direction of the crypto-system in India may depend on this tension between financial sovereignty, innovation, and demand by citizens.

### **5. The United States' Response**

The US has taken a decentralized and innovation-oriented cryptocurrency regulation. There are several jurisdictional bodies: the Securities and Exchange Commission (SEC) considers a large number of tokens securities, the Commodity Futures Trading Commission (CFTC) regulates derivatives and commodities, and the Financial Crimes Enforcement Network (FinCEN) implements the rules of AML and KYC. Also, certain states like New York have their own licensing systems, their best-known licensing system being the Bit License.

The key element has been judicial intervention. The ongoing case of SEC vs. Ripple Labs (2020) which illustrates the role of the judiciary in establishing the potential limits of regulatory powers. The role of the courts has also played a major part in deciding whether crypto assets are or are not considered as securities on the Howey Test. These interventions emphasize the case-by-case and the reactive aspect of U.S. regulation.

Cryptocurrency has turned polarizing at the political level. Other lawmakers like Senator Elizabeth Warren focus on consumer protection and systemic risk, whereas others advocate the pro-innovation models to help maintain U.S. leadership in financial technology.

U.S. has not officially introduced a CBDC, but talks about a Digital Dollar persist. The Federal Reserve has been hesitant with reference to privacy issues and requiring Congressional approval. In the meantime, the global crypto markets are controlled by private stablecoins like Tether (USDT), USD Coin (USDC), and many others, which casts additional questions of sovereignty.

This is a disjointed but very dynamic model which promotes innovation, however it is not very clear or predictable. At the rule-of-law level, it does not satisfy the criteria of clarity and stability as advocated by Raz, although it safeguards the individual economic freedoms.

### **6. The European Union's Response**

The most harmonised model of regulations is the European Union. The Markets in crypto-assets regulation (MiCA) which is the first package of cryptocurrencies legislative texts was formally adopted by the EU in 2023. MiCA mandates service providers to license and have consumer protection and regulate stablecoins.

Through sharing sovereignty, the EU does not need to experience the regulatory arbitrage that plagues fragmented jurisdictions. MiCA is a product of the overall EU ideology of integration, similar to previous systems such as the General Data Protection Regulation (GDPR). Both are an expression of the way in which EU is exercising collective sovereignty with regard to borderless technologies.



The European central bank (ECB) also has a pilot of a Digital Euro, but it is claimed as a complement product of cash and not a substitute. The advocates believe that it will improve financial inclusivity and financial monetary sovereignty. However, critics also caution that MiCA can deter innovation since the compliance costs would be high, especially to small startups.

However, EU approach enhances the legal certainty to its maximum. Investors, businesses and consumers also enjoy predictability in rules applied in 27 member states alike. The given model is an example of the equilibrium between sovereignty and the values of rule of law.

## **7. Comparative Analysis**

The comparison of the three jurisdictions indicates that there is a difference in philosophies of governance. India uses a sovereignty-first approach, in which the priorities are state control at the cost of innovation and legal predictability. The United States is the first in the innovation-first model whereby decentralized regulation and judicial intervention provide flexibility at the expense of predictability. The European Union represents an integration-first approach, which aims at harmonising the rules so as to maintain sovereignty, collectively, and in the least way possible in the maximisation of legal certainty.

In the view of sovereignty, India and the EU are two extremes: unilateralism and shared powers. The U.S. on the other hand demonstrates how the federal fragmentation can erode the sovereignty despite promoting the dynamism of markets.

The EU stands out as the most powerful based on the rule of law. Its predictability is achieved through its clear, proportionate, and harmonised laws. By comparison, the U.S. and India are also alternating in terms of overreaching and ambiguity.

CBDCs are all three united behind a sovereign countermeasure. CBDCs are a sign of states understanding that they cannot leave the digital economy completely to the private sector, whether in the case of India and its Digital Rupee, the EU and its Digital Euro or the debate over a Digital Dollar.

The Global South is also subject to these comparisons. The lack of regulatory ability in countries that do not have a powerful regulatory body leaves them vulnerable to being arenas of unregulated crypto activity, as well as being exposed to systemic risks at the cost of reduced sovereignty. On the other hand, excessive regulation can push the innovation to the overseas market. The dilemma is to devise balanced structures that can capture the local requirements and at the same time meet global expectations

## **8. Conclusion**

Cryptocurrency also goes against sovereignty because it weakens central banks, taxation, and regulation. The United States, India, and the European Union provide different answers within restrictive taxation, fragmented enforcement, and codification respectively. The EU has clarity whereas India and U.S. lack it in terms of rule-of-law.

Three forces are likely to influence the future of cryptocurrency regulation, including the emergence of CBDCs, the increasing level of transnational collaboration between regulators via institutions such as the G20 and FATE, and socio-economic stressors of mainstream adoption. In the case of states, it is not the issue of controlling cryptocurrencies only but maintaining sovereignty and maintaining the rule of law.

The most possible sovereign response is CBDCs, as it incorporates both innovation and legitimacy. Having been designed in a transparent, private, and proportionate way, they would provide states with the means to take monetary control back without strangling the fruits of digital finance. This way, they can be the sequel to the history of sovereignty and legality in the digital era.

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