



***HOW US-CHINA COOPERATION CAN  
COMBAT CRYPTOCURRENCY IN DRUG  
TRAFFICKING***

BY CLAIRE GAN

*Claire Gan ([clairegan0615@outlook.com](mailto:clairegan0615@outlook.com)) is an Emerging Leader at Pacific Forum and a senior at Basis International.*

Global efforts to address the use of cryptocurrencies in drug trafficking are critical. According to the Financial Crimes Enforcement Network, cryptocurrencies such as Bitcoin and Monero are used extensively in illicit transactions on dark web platforms, as they offer anonymity and decentralized methods in cross-border transactions.

Not surprisingly, the United States and China are among the largest players in cryptocurrency usage, and the flow of illicit funds frequently crosses their borders. According to Chainalysis, a blockchain analysis firm based in the United States, illicit cryptocurrency transactions amounted to \$14 billion in 2021, and the United States accounted for 25% of Bitcoin trading, according to a study conducted by Cambridge Center for Alternative Finance. Additionally, the United States is a major target market for synthetic drugs, including fentanyl, often manufactured and trafficked from or through China.

However, US-China political tensions, and key differences in the structure of the two countries' respective regulatory systems have made it difficult to arrive at solutions to address this problem. What, then, could be the way forward?

Before looking into what could be done, it is important to understand the differences between the US and Chinese regulatory systems.

In the United States, agencies such as the Securities and Exchange Commission (SEC) and Drug Enforcement Administration work to regulate the use of cryptocurrency in drug trafficking by tracking drug-related financial crimes. In 2020, for instance, the SEC has developed the Anti-Money Laundering and Know Your Customer policies on crypto transactions. However, according to a study conducted by the US Department of Justice in 2021, the rise of decentralized finance platforms without a central authority still makes it difficult to regulate transactions.

In contrast, China has a stricter approach. The People's Bank of China banned cryptocurrency trading altogether in 2021. Still, traffickers find ways to exploit foreign transaction platforms for illicit purposes.

Aligning and strengthening global regulations is essential, and success in this endeavor requires some level of US-China cooperation. Given US-China political differences, it is unrealistic to expect the two countries to adopt the same regulatory framework. A more promising avenue is to identify certain key regulatory aspects on which Washington and Beijing could agree despite their political tensions, while allowing differences regarding their own governmental practices.

The United States and China should consider taking the following four steps.

First, they should collaborate through international organizations such as the Financial Action Task Force (FATF) to strengthen certain existing regulations. Specifically, they should implement regulations that prevent or, at a minimum, constrain drug traffickers from taking advantage of gaps between their two systems, making it much more challenging for traffickers to achieve their goals. Focusing on filling these gaps is in both US and Chinese interests, and FATF offers a good platform to have these discussions. By establishing international standards, the neutrality of FATF allows both nations to address differences while working on a shared goal of combatting money laundering.

Second, creating an independent, third-party organization to supervise international cooperation on cryptocurrency regulation would also be helpful. While FATF and United Nations Office on Drugs and Crime serve some of this purpose, a more specialized organization with dedicated financial and human resources to combat the use of cryptocurrencies in drug trafficking could help facilitate US-China investigations. Moreover, such a third-party organization could establish new guidelines to better combat illicit trafficking. A third-party organization can facilitate discussions of these guidelines, ensuring the transparency and accountability of the protocols. This joint effort promotes understanding and trust between these two nations, which enhances international financial stability.

Third, the United States and China should adopt stricter and clearer regulations in managing cryptocurrency exchanges that are considered suspicious transactions. For instance, the United States could increase the extent of the Anti-Money Laundering requirements for decentralized finance platforms, which is currently lacking supervision. China, for its part, could develop policies that allow more control for regulated usage of cryptocurrency. Both countries could also consider policies that make it mandatory for cryptocurrency exchanges to report large transactions and provide detailed records of user identities. Doing so would increase the transparency of such transactions and facilitate the work of law enforcement agencies. Deep US-China cooperation is unrealistic, but Washington and Beijing should agree on key principles that prioritize the ban of the illicit use of cryptocurrency. A modest degree of coordination would be far more effective than acting alone.

Fourth, both the United States and China should, to the extent possible, work together to developing advanced technologies that better detect suspicious cryptocurrency transactions, and that do so in a short period of time. Washington and Beijing should dedicate funds for the development of joint blockchain analytical tools to identify the patterns of transactions associated with drug trafficking. These tools would help governments detect and intervene to

prevent illegal transactions before they are completed. Washington and Beijing should also consider making investments in artificial intelligence to help predict such transactions. Such tools could predict and mark suspicious activities on trading platforms instantly, providing time for governments to analyze and intervene. Collaborative investment in these technologies would allow both countries to improve their law enforcement capabilities without having to compromise on their regulatory differences.

Efforts to align global regulations, create a dedicated third-party organization, strengthen cryptocurrency policies, and invest in technologies to detect suspicious transactions would help both the United States and China address the use of cryptocurrencies in drug trafficking that go undetected. Full-fledged bilateral cooperation is unlikely given political tensions, but coordination work as outlined above may well be within reach and would help address this ongoing problem.

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