

NATIONAL REVIEW

Crypto's Legal White Space: Fact or Fiction?

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The recent spat between Coinbase and the Securities and Exchange Commission has brought into public view the cryptocurrency industry's attitude toward regulation, as well as the disjointedness of the efforts to regulate crypto within the United States. Consider some details. Coinbase, perhaps the most prominent player in the crypto world, has underscored its willingness to play ball with regulators. SEC chairman Gary Gensler has decried the lack of protections in the world of crypto, and his agency has declared Coinbase's proposed interest-paying Lend product to be a security so that the SEC might assert its jurisdiction.

Indeed, all parties appear to want regulation for crypto — but an apparent impasse remains because of the mistaken belief that crypto exists in a legal white space. In truth, cryptocurrency is already subject to the existing laws and regulations of finance; it would be an affront to the rule of law for regulators to behave otherwise. It is time for all involved to give up the pretense that crypto transactions require substantively new rules.

In multiple venues, the field of crypto produces objects that are meant to be used like money; it also intermediates interest-bearing transactions between borrowers and lenders, holds objects out as financial-investment opportunities, and organizes the trading of such objects on exchange-like platforms. We tend to call such media money, loans, deposits, and securities, and the entities who deal in them banks, broker-dealers, and exchanges. Significant regulatory expectations attach to all these entities, and for good reason: Huge sums are at stake. Whether the current body of financial regulation is optimally written and administered is a separate issue.

Though they walk and quack like ducks, players in the crypto field insist that they are birds of a different feather. We have heard this story before: Uber is neither a taxi dispatcher nor an employer, and Airbnb is not a hotelier, though both may appear as such to the untrained eye. Indeed, fast-moving technology companies wield the letter of the law against the spirit of the

laws with a skill and alacrity that would make Montesquieu's head explode. This dismissiveness of the law reaches its apotheosis in the world of crypto. When Coinbase asks for clear regulations, it is asking for new, special regulations that apply only to its not-loans of not-money, and trades of not-securities on its not-exchange.

For nearly a decade, U.S. regulators have been unable to slice through this Gordian knot of obfuscation, forcing them to play catch-up with the accelerating ecosystem of crypto. Why? In broad terms, the SEC has jurisdiction over securities and exchanges, the Commodity Futures Trading Commission covers commodities and commodity-trading venues, and the Federal Reserve and the U.S. Treasury's Office of the Comptroller of the Currency are responsible for issues concerning money and banking. Before any of these agencies can address what crypto *does*, they must assert what crypto *is*. By focusing its ire on the SEC's decision to categorize Lend as a security, Coinbase stokes these interminable turf battles that often open the doors of regulatory arbitrage, while shifting attention away from the matter at hand: Coinbase's users will lend at interest without a clear understanding of their rights in the event that neither the borrower nor Coinbase can guarantee repayment of their principal.

Efforts to sort out overlapping and competing jurisdictions in the U.S. financial-regulatory structure have distracted lawmakers and regulators from careful thinking about two more essential questions. First, what interest does the United States have in fostering a parallel financial system that competes directly with its successfully regulated dollar-based system? And second, why would regulators "reward" the costly and generally sincere compliance efforts of players in the regulated financial system by ratifying the practices of an industry purpose-built to evade those requirements?

In recent years, a high regard for the rule of law has slipped — even in some conservative and libertarian circles — on the belief that free markets and freedom of choice alone can produce prosperity. But scholars in the classical-liberal canon are clear that free markets depend on the rule of law, as well as the human institutions that stand behind it. Nobelist Friedrich Hayek, for example, observed that liberty does not exist as such; rather, it must be constituted by law. Furthermore, laws that support liberty and competitive markets are, among other things, universal in application and enforced equally.

With its disdain for the law and human institutions, crypto strikes at the heart of the market order. In a world in which the only governing institutions are coded protocols with ambiguous authorship, there would be truly no backstop for market exchange, whether in the law or in the more diffuse and human "bourgeois virtues."

Crypto proponents will say that this is precisely the point, and that their system is needed because the human institutions of the government and the financial system cannot be trusted. Whatever the merits of such a view in the abstract might be, such reasoning should fall on the deaf ears within government. The government itself *must* be completely invested in the continued existence and improvement of its institutions. Government must, therefore, force crypto into the existing rubrics of its laws and regulations, based on the functions for which crypto is manifestly used. Anything less would grant the crypto industry an enormous privilege in the true sense of the word and make a sham of the rule of law.

Likewise, “rewarding” the heavily regulated financial system by granting a lightly regulated parallel system its imprimatur would be a performative contradiction for the government. If a protection is necessary, then everyone must comply. Substance must prevail over form.

In U.S. tax law, the substance-over-form doctrine established in *Gregory v. Helvering* holds that when a “transaction upon its face lies outside the plain intent of the statute,” to respect the form of the transaction over its obvious economic substance “would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.”

Will the United States deprive its own laws of all serious purpose by allowing the crypto industry to assert that its activities do not entail the production and lending of money and trading of financial instruments? Will we make fools of everyone who follows the law in order to build a new financial system around a lawless form of money and property?

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