At Stake in the US Midterms: The Future of Money

Michael J. Casey

November 4, 2022

With abortion, voting rights and other weighty issues top of mind, "normies" could perhaps be forgiven for dismissing as self-obsessive any crypto commentator's claim that Tuesday's midterm U.S. elections are monumentally important for how they'll shape the regulation of blockchain technology and digital assets.

Regardless, that's where I'm going with this. All of us – not just crypto natives – have a great deal at stake in how the next Congress enacts new crypto laws.

Of the five federal electoral cycles that this industry has now been through – I count the first as the 2014 midterms, which coincided with a debate spurred by the U.S. Financial Crimes Enforcement Network's (FinCEN) initial 2013 guidance on regulating "virtual currencies" – this one matters the most. That's not just because crypto exchanges, decentralized finance (DeFi) developers and non-fungible token (NFT) platforms and issuers have their profitability riding on some key regulatory bills. It's because they could define the future of money.

Whether we like it or not, money is going digital – truly digital, not Zelle- or Venmo-on-banking digital – which means the age-old system through which human beings generate, record and exchange value is about to undergo radical change. It's vitally important for all of us that the laws that define how that change evolves are drafted and deliberated over in an open way so that, once enacted, they take humanity's best interests into account.

So, with that lofty stage-setter out of the way, let's look at two equally impactful bills under consideration.

Until a few months back, progress on both was generating hope that the crypto industry would this year enter a new age of regulatory clarity. In the end, political divisions over core issues, as well as the distractions of other priorities on Capitol Hill, pushed them beyond the post-election "lame duck" period to make them the next Congress' responsibility.

That means that next week's vote, which will determine who gets to define the leadership and makeup of the committees overseeing these bills, will indirectly shape their course – and, by extension, the future of money.

The DCCPA

The first is the Senate Agriculture Committee's Digital Commodities Consumer Protection Act (DCCPA). Given the losses people suffered with the collapse of crypto lending platforms such as Celsius Network and Voyager Digital, the bill's intent seems reasonable: It would impose greater accountability on such providers and set strict rules for protecting customers' assets.

Also, the DCCPA explicitly defines crypto tokens as "digital commodities," which puts the Commodities Futures Trading Commission (CFTC) in the primary oversight spot. That's consistent with what many critics of the Securities and Exchange Commission's hardline approach to the industry have been pushing for.

But, as always, the devil is in the details. Many are concerned that the sweeping requirements, laid out in an initial one-pager, that "all digital commodity platforms register with the CFTC," could render DeFi operations unworkable.

A draft of the bill shows a recent amendment adding an exemption for any person who "develops or publishes software" from the bill's covered category of "digital commodity broker." While that's a relief for crypto developers, concerns still exist that overly vague wording could leave some key DeFi operators liable and so suffocate DeFi's entire open-access, decentralized software-driven ecosystem of interconnected, composable protocols.

Why does this matter to the average voter? Because, as the Cato Institute's Jennifer Schulp and Jack Solowey argue, this open, composable structure of DeFi is necessary to remove the "intermediary risk" of traditional finance – the very issue at the heart of the collapse of centralized (CeFi) custodians Voyager and Celsius that the bill intends to address.

Also, as Schulp and Solowey point out, in obviating the need for intermediating authorities, DeFi creates a "permissionless" environment for developers to innovate around smart contract- and collateral-based models that can expand financial access for people and businesses excluded from the traditional system. If you insert licensing rules and a regulating authority into that system, much of that powerful "permissionlessness" could disappear.

One of many examples of valuable innovation that could be stymied if licensing rules are too sweeping: the social impact-focused DeFi projects now blossoming across sub-Saharan Africa, which we discussed last year in a Money Reimagined podcast episode with two Nigerian entrepreneurs.

Beyond Africa, it's in all our interests to cultivate a more decentralized system where the interest rates, service fees and insurance premiums that factor into the cost of everything aren't set by a regulation-privileged oligopoly of financial middlemen. In the U.S. alone, the financial service sector's revenues – the price that banks and other institutions charge us for their intermediation – ran to $4.85 trillion in 2021, or 7.4% of GDP.

Stablecoin legislation

Then there's the House's work-in-progress stablecoin bill, which Rep. Patrick McHenry (R-N.C.), one the lead proponents, described as "a pretty ugly baby" on account of all the competing matters that opposing lawmakers have tried to reconcile.

One such issue is the question of which federal agency should regulate stablecoin issuers. As currently designed, the proposal appears to fall short of demanding that stablecoin issuance be limited to regulated banks and instead would subject non-bank issuers to strict regulation by either the Federal Reserve or some other special purpose watchdog. The distinction matters because it could dictate whether stablecoin issuers gain access to federal backing such as the Fed's lending facilities or deposit coverage from the Federal Deposit Insurance Corporation.

Depending on how it lands, the wording on this agency/financial backstop matter could have huge positive or negative ramifications for competing U.S. stablecoin issuers. These include Circle, which does not currently have a banking license; Paxos, which has a federal trust charter from the Office of the Comptroller of the Currency; and Custodia Bank, which is licensed under Wyoming's digital asset banking regulation.

The debate over whether the Fed should steer the process also bleeds into the big question of whether it should pursue its own central bank digital currency (CBDC) in parallel with, or instead of, stablecoins. That question opens up others on the kind of privacy people can expect when they transact in digital dollars and how fluidly those dollars can flow into and out of foreign jurisdictions.

Backers of a private sector-driven stablecoin model, in which blockchain-based dollar tokens can move peer-to-peer between wallets anywhere in the world, rightly portray it as a way to provide financial inclusion to everyone and to spur global innovation around money. It's an appealing counterpoint to the idea of a centrally managed and monitored CBDC, such as China's, which crypto advocates describe as the makings of a totalitarian dystopia.

But as I've discussed elsewhere, a regulatory green light for stablecoins could also result in a world awash with dollars, undermining the monetary sovereignty of other nations in ways that could become politically contentious. Moreover, if that model were to allow a private company like Circle to exploit network effects that turn it into, say, the Google or Facebook of money, we may have a different, private sector version of the same Big Brother problem.

Done right, regulation of both these areas could address such risks and create the right balance between innovation, customer protection, competition and geopolitical stability. Done wrong, legislators could do a great deal of harm.

So, yes, the crypto impact of next week's election matters – to everyone.