PUBLIC INTEREST COMMENT

RECOMMENDATIONS FOR ADVANCING U.S. COMPETITIVENESS IN THE GLOBAL DIGITAL ASSET SECTOR

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Developing a Framework on Competitiveness of Digital Asset Technologies
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I appreciate this opportunity to respond to the US Department of Commerce's May 19, 2022, request for comment (RFC) "Developing a Framework on Competitiveness of Digital Asset Technologies." The RFC offers an opportunity for the public to provide relevant input and recommendations for enhancing US competitiveness in the global digital asset market.

The Mercatus Center at George Mason University is dedicated to bridging the gap between academic ideas and real-world problems and to advancing knowledge about the effects of regulation on society. This comment, therefore, does not represent the views of any party or special interest group. Rather, it is designed to help the Department of Commerce consider the current US regulatory landscape that affects the US digital asset sector's competitiveness in the global market.

Executive Order 14067, Ensuring Responsible Development of Digital Assets, outlines several policy objectives with respect to the US digital asset sector, including reinforcement of US leadership in technological and economic competitiveness and support of technological advances that promote responsible development and use of digital assets. This comment offers recommendations to achieve these objectives and to position the United States as a leader in technological and economic competitiveness in the digital asset sector. To achieve the stated policy objectives, the United States should do the following:

1. Modernize the regulatory landscape for digital assets by using multiagency task forces to reduce and streamline regulatory requirements.
2. Adopt a privacy-centric regulatory approach to the development of digital asset technologies.

The ideas presented in this document do not represent official positions of the Mercatus Center or George Mason University.

REDUCE AND STREAMLINE DIGITAL ASSET REGULATORY REQUIREMENTS

As a threshold issue, the federal government should understand the heavy regulatory burden that US digital asset businesses bear in developing, marketing, and raising funds for the creation of novel technological products and services. Over the course of its lifespan, a digital asset business may have to interact with the Securities and Exchange Commission (SEC); the Commodity Futures Trading Commission (CFTC); the Consumer Financial Protection Bureau; the Federal Trade Commission; the Federal Reserve (Fed); the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation (FDIC); the US Department of the Treasury, including the Financial Crimes Enforcement Network (FinCEN), the Office of Foreign Assets Control, and the Internal Revenue Service; and, if unlucky or unwise, the US Department of Justice (DOJ), including the DOJ's National Cryptocurrency Enforcement Team.[1] In addition to federal regulations, digital asset businesses must also comply with state and international regulations, which are highly specific yet evolving and which vary on a jurisdictional basis.[2] There are also global standards created by intergovernmental bodies, such as the Financial Action Task Force, with which digital asset businesses must comply.

Complying with this regulatory morass is expensive. Underfunded digital asset entrepreneurs and startups face the difficult decision to develop their innovative products and services in the face of potential subpoenas, investigations, or fines or to give up control of their company to raise funds from investors to cover legal fees and the cost of compliance. Digital asset startups that are unsuccessful in their fundraising attempts may never see their innovations reach the point of commercialization, which otherwise may have had a net positive effect on the US and global economies and the welfare of society in general. This current regulatory landscape for digital asset businesses is incompatible with innovation and growth.

Innovation in the digital asset sector is important because the underlying distributed ledger technology has the potential to optimize business processes, create new opportunities for entrepreneurs to raise capital, reduce transaction fees, inspire new markets, and shift control from institutions to individuals.[3] Though digital assets are often met with skepticism, there are several use cases that illustrate how distributed ledger technology creates positive socioeconomic effects. For example, individuals who live in countries that have experienced long-term hyperinflation, such as Brazil, South Africa, and Venezuela, use cryptocurrencies as a form of payment that is resistant to government interference or corruption.[4] Distributed ledger technology also facilitates remittances and humanitarian aid,[5] which are a lifeline for families and countries that are cut off from the global financial system.

1. Murphy and McGonigle, "Digital Asset Regulation in the United States: An Opportunity for Progress or a Threat to Innovation?," *US-Israel Legal Review* (2021): 84–88.
2. Susannah Hammond and Todd Ehret, *Cryptocurrency Regulations by Country* (New York: Thomson Reuters, 2022).
3. Julie Stitzel, "Promoting Innovation: The Promise of Digital Assets," Center for Capital Markets Competitiveness, US Chamber of Commerce, accessed June 27, 2022, https://www.centerforcapitalmarkets.com/promoting-innovation-the-promise-of-digital-assets/.
4. Gemini, *Global State of Crypto Report*, 2022; Aloysius Uche Ordu, ed., "Technological Innovations: Creating and Harnessing Tools for Improved Livelihoods," in *Foresight Africa: Top Priorities for the Continent in 2022* (Washington, DC: Brookings Institution, 2022): 84–101.
5. Moises Rendon, "How Open and Public Cryptocurrencies Can Help Venezuelans," *Critical Questions*, Center for Strategic and International Studies, April 13, 2021; Ananya Kumar and Nikhil Raghuveera, "Can Crypto Deliver Aid amid War? Ukraine Holds the Answer," *New Atlanticist*, Atlantic Council, April 4, 2022.

Digital asset innovation has not been limited to the financial sector or private industries. Distributed ledger technology is being used to enhance visibility and accountability across the food supply chain and across healthcare systems,[6] including vaccine distribution networks.[7] Furthermore, governments around the world have tested the application of this novel technology with regard to land registration and identity management.[8]

The US regulatory landscape for digital assets has expanded over the past five years and is anticipated to continue growing. Both the SEC and the CFTC are seeking additional statutory authority from Congress to regulate the digital asset sector.[9] The SEC is in the process of doubling the Division of Enforcement's Crypto Assets and Cyber Unit.[10] Since January 2021, over 70 bills and resolutions that address the digital asset regulatory landscape have been introduced in Congress.[11] Continued expansion of regulatory oversight that may be a poor fit for the still-evolving digital asset sector will stifle innovation.

The US government can take steps to minimize the constraints of overregulation by encouraging a culture of interagency collaboration and communication so that regulators can share expertise, create new cross-regulatory perimeters, condense compliance requirements, and eliminate ambiguous or counterintuitive definitions and regulatory interpretations. CFTC Commissioner Caroline Pham and SEC Commissioner Hester Peirce have recently called for joint roundtables hosted by the CFTC and SEC.[12] Other government agencies should do the same, especially where their jurisdictional focuses might be closely related. In addition to roundtables, the US government should host multiagency proposed rulemaking and multiagency regulatory audits to eliminate existing, potentially outdated or nonessential regulations. These actions would serve the public interest by reducing government inefficiency and leveraging public input to develop new and better ways to address the very problems that the government seeks to address. Though some cryptocurrency businesses and investors have recommended that the United States create a new cryptocurrency regulatory agency,[13] this approach would further expand the federal

6. "IBM Supply Chain Intelligence Suite: Food Trust," IBM, accessed June 28, 2022, https://www.ibm.com/products/supply-chain-intelligence-suite/food-trust; "Blockchain Healthcare and Life Sciences Solutions," IBM, accessed June 28, 2022, https://www.ibm.com/blockchain/industries/healthcare.

7. "Trusted Vaccine Distribution Enabled with Blockchain," IBM, accessed June 28, 2022, https://www.ibm.com/blockchain/industries/vaccine-distribution.

8. "Land Records," Centre of Excellence in Blockchain Technology, National Informatics Centre, accessed June 28, 2022, https://blockchain.gov.in/landrecords.html; "Blockchain Strategy," European Commission, last updated June 7, 2022, https://digital-strategy.ec.europa.eu/en/policies/blockchain-strategy; "eIDAS Regulation," European Commission, last updated June 7, 2022, https://digital-strategy.ec.europa.eu/en/policies/eidas-regulation.

9. Toby M. Galloway and Gavin Fearey, "SEC Expands and Renames Cyber Unit to 'Crypto Assets and Cyber Unit,'" *National Law Review* 12, no. 124 (2022): 1–3; Daniel L. Stein, Matthew F. Kluchenek, and Anna R. Easter, "CFTC Advocates for Expansion of Cryptocurrency Market Jurisdiction," *Reuters*, June 21, 2022.

10. Securities and Exchange Commission, "SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit," press release no. 2022-78, May 3, 2022, https://www.sec.gov/news/press-release/2022-78.

11. "Search Results (US Legislative Search about 'Cryptocurrency' OR 'Blockchain' OR 'Digital Asset' OR 'Virtual Currency' OR 'Tokenization' OR 'CBDC')," LegiScan, accessed June 28, 2022, https://legiscan.com/gaits/search?state=US&keyword=%22cryptocurrency%22+OR+%22blockchain%22+OR+%22digital+asset%22+OR+%22virtual+currency%22+OR+%22tokenization%22+OR+%22CBDC%22.

12. Caroline D. Pham and Hester M. Peirce, "Making Progress on Decentralized Regulation—It's Time to Talk about Crypto Together," *The Hill*, May 26, 2022.

13. Lauren Feiner, "Coinbase Says U.S. Should Create a New Cryptocurrency Regulator," CNBC, October 14, 2021; Lauren Feiner, "Prominent Silicon Valley VC Firm Andreessen Horowitz Embarks on Major Crypto Policy Push in Washington," CNBC, October 13, 2021.

government, lead to government bloat, duplicate existing agency authority, and incentivize further overregulation. An alternative solution is to create multiagency task forces that have three main goals: (a) creating regulatory consistency and clarity, (b) encouraging transparency in regulatory rulemaking and enforcement, and (c) reducing and streamlining compliance burdens. These multiagency task forces should be nimble enough to reevaluate regulations as the digital asset sector and underlying technology advance.

Digital asset technology is difficult to understand, and federal rulemaking can be a cumbersome process, so the United States may not see the culmination of a desired regulatory framework in an expeditious way. Nevertheless, the US government has other immediate opportunities to encourage innovation and technological advances in the digital asset sector. For example, steps need to be taken to promote competition in the sector and promote the convergence of digital asset technology with other sectors. One recommendation is that the US government facilitate commercialization by investing in research and development through grants and by creating strong and effective tech transfer partnerships with universities and private businesses. Another recommendation is to deregulate truly decentralized services and products, such as self-hosted wallets, to promote competition in various industries. One way to do this responsibly is to provide a universal, low-burden regulatory safe harbor for digital asset businesses. The Token Safe Harbor Proposal 2.0,[14] which would provide developers with a three-year grace period to develop decentralized networks that are exempt from certain federal securities laws, is one example that works toward this objective. Deregulatory initiatives, such as safe harbors, would promote competition, capital flow, and investment in this sector.

PRIORITIZE PRIVACY

In addition to recommending the reduction of the regulatory burden of digital asset businesses, this comment also recommends that the US government support and encourage the development and adoption of privacy-preserving features of digital asset technologies to protect the core democratic values of liberty, democracy, equality, and control over one's life and dignity. Thus far, there is encouraging discussion at the federal level regarding the importance and necessity of privacy-enabled digital asset technologies. For example, the Fed's *Money and Payments: The U.S. Dollar in the Age of Digital Transformation* discussion paper identifies privacy as a core design feature of a potential US central bank digital currency (CBDC).[15] From a global standpoint, prioritizing privacy in the design for a US CBDC sends a strong signal to the rest of the world that the United States values individual and financial freedom, contrary to repressive regimes like China.[16]

Although the Fed's focus on prioritizing consumer privacy with regard to a US CBDC is a proactive step in the right direction, the US government's policy goals should go beyond discussion and focus on the development of new technologies that defend and promote privacy objectives that do not compromise our national security. One recommendation to meet this difficult balance is to establish a FinCEN innovation laboratory, which was proposed in the recent bipartisan Lummis-

14. Hester M. Peirce, "Token Safe Harbor Proposal 2.0," Securities and Exchange Commission, April 13, 2021, https://www.sec.gov/news/public-statement/peirce-statement-token-safe-harbor-proposal-2.0.
15. Board of Governors of the Federal Reserve System, *Money and Payments: The U.S. Dollar in the Age of Digital Transformation*, January 2022.
16. James A. Dorn, "China's Digital Yuan: A Threat to Freedom," *Cato at Liberty*, August 25, 2021.

Gillibrand Responsible Financial Innovation Act.[17] A FinCEN innovation laboratory would be established to increase dialogue between regulators and the digital asset technology sector and to pilot technologies that enable law enforcement to mitigate illicit activity without compromising the privacy of law-abiding American citizens. Another recommendation is to erect strong due process measures to hold the US government accountable for unnecessary or mass surveillance.

Prioritizing privacy as a core feature of the digital asset sector would also serve other policy objectives, such as financial inclusion. The 2019 FDIC report *How America Banks: Household Use of Banking and Financial Services* presents results from the 2019 FDIC Survey of Household Use of Banking and Financial Services, which illustrate that over one-third of unbanked households do not have bank accounts because of privacy reasons.[18] The survey results also show that one of the main reasons the unbanked choose not to open bank accounts is because they distrust banks.[19] Privacy-enhanced digital asset technologies, such as self-hosted wallets, may be an attractive resource for unbanked US households to store assets digitally outside of the traditional banking system. Therefore, the US government should avoid regulations that impede the digital asset technology sector from developing innovative products and services that enhance consumer and individual privacy rights, especially given that a bipartisan federal data privacy bill is on the horizon.[20]

CONCLUSION

Reducing and streamlining regulatory compliance would counter the slippery slope of overregulation of this nascent technology sector. In doing so, lower regulatory burdens would prevent digital asset businesses from moving offshore and would avoid overwhelming American entrepreneurs, including those who are underfunded or lack access to traditional fundraising mechanisms. Furthermore, prioritizing privacy as a fundamental component of digital asset technology would meet an unaddressed need for the unbanked; be a forward-thinking, strategic step to address forthcoming privacy regulations; and protect the core democratic values of American citizens.

17. Lummis-Gillibrand Responsible Financial Innovation Act, S. 4356, 117th Cong. (2022).
18. Federal Deposit Insurance Corporation, *How America Banks: Household Use of Banking and Financial Services*, 2019.
19. Federal Deposit Insurance Corporation, *How America Banks*.
20. Rebecca Kern, “Bipartisan Draft Bill Breaks Stalemate on Federal Data Privacy Negotiations,” *Politico*, June 3, 2022.