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The Human Progress Podcast | Adoption of Technology

The promise of cryptocurrency

Thanks to the FTX debacle, cryptocurrency has gained a reputation as a tool for fraudsters and criminals.

But we shouldn't blame technology for the failures of humans and our institutions. All technologies can be misused, and yet, as technology has advanced, all our lives have improved.

In this episode of The Human Progress Podcast, **Jack Solowey**, a policy analyst at the Cato Institute, reminds us of the promise of cryptocurrency and explains how regulators can handle its challenges while preserving its benefits.

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Below is an edited and abridged transcript featuring some highlights from the interview.

Let's start with the big picture. What is cryptocurrency?

Cryptocurrency is an application of blockchain technology that leverages cryptography and game theory to create public digital ledgers that are highly secure and highly resistant to tampering. In its best form, cryptocurrency could replace the traditional balance sheets at institutions like banks and brokerages with this open distributed ledger. You'd have something like a bank account balance, but rather than being managed by a centralized intermediary, it's run by computers all over the world that are incentivized to maintain the database and check each other's work.

What are some of the benefits of cryptocurrency?

Crypto is relatively young, so a lot of the benefits are potential benefits. However, we do already see use cases around the world.

Vietnam is one example. The blockchain analytics firm Chainalysis publishes an annual survey of the leading countries for crypto adoption, and Vietnam has led that list for a couple of years. An interesting corollary is that 69 percent of Vietnam's population lacks access to a traditional bank. I think it's reasonable to say that cryptocurrency is filling that need.

Can cryptocurrency be a hedge against inflation?

Ultimately, this is an empirical claim that will have to be evaluated over time. There was some thinking initially that Bitcoin could be an inflation hedge because it has an ultimate cap on its supply. According to the protocol, there will only ever be 21 million Bitcoin minted. But that hasn't borne out empirically, or at least hasn't borne out yet.

With that said, there are places around the world where we've seen both national currency depreciation and relatively high crypto adoption or spikes in crypto adoption around national currency depreciation events. Examples include Turkey, Nigeria, Kenya, Argentina, and Venezuela.

There's also a class of crypto token known as stablecoins, which are designed to be pegged to the value of another asset, for example, fiat currencies like the US dollar. Stablecoins have actually been growing in popularity in some of the same countries I just mentioned as a way to access the US dollar.

What about the potential of blockchain technology to combat censorship or resist authoritarianism?

I think it's helpful to look at the tactics that are used by the totalitarian regime in George Orwell's Nineteen Eighty-Four. In that story, control was often a matter of changing and deleting the historical record. The thinking is that if there was no evidence of a free society, the idea of freedom or liberty could be extinguished.

And as we know, totalitarian regimes are not mere fiction. The Cato Institute recently awarded the Milton Friedman Prize to Jimmy Lai, who was the founder of the pro-democracy Apple Daily Newspaper in Hong Kong. When the central government in Beijing applied the draconian national security law to Hong Kong and raided the Apple Daily offices, civic and cyber activists were able to maintain a record of thousands of Apple Daily newspaper articles on a blockchain called Arweave. That is one example where blockchain technology thwarted the Orwellian authoritarian ambition.

What are some of the challenges or potential drawbacks of cryptocurrency?

Like all financial instruments, crypto can be abused by bad actors, who can use cryptocurrencies to fund terrorist activity and trafficking. However, it's important to keep this in perspective. Even high estimates of crypto-related illicit activity are an order of magnitude smaller than the UN's estimate of, for example, total global money laundering each year, and law enforcement agencies in the US acknowledge that crypto has a relatively small role in crime when compared to traditional financial technologies.

Another common critique is that cryptocurrency technology is bad for the environment.

It's worth distinguishing here between the two mechanisms underlying major blockchains. You have Proof of Work, which helps secure the Bitcoin network, and because it's compute-intensive, it's also electricity-intensive. However, there's also a different mechanism known as Proof of Stake, which has been implemented by the Ethereum blockchain, the second biggest crypto network by market cap. Proof of Stake reduces energy consumption and carbon footprint by over 99 percent. So, some of the critique needs to adapt to the changing nature of the technology.

But I also think it's important to keep in mind that this critique begins with the assumption that cryptocurrency is not worth its environmental footprint. I think the role of policymakers is to address downside risks, not to assess the benefits. Regardless of one's preferred environmental policy, it should apply uniformly and should not single out one specific class of technology.

If cryptocurrency is over-regulated, what could be the possible impact of that on the average American? What's the potential loss there?

If our policies make the US an uncommonly inhospitable place for crypto, we could lose both the potential gains from this class of technology and the competitive pressure that these innovations put on traditional institutions to improve their own products and services. Crypto is already a very useful tool for sending payments across borders quickly and cheaply.

There are two big problems with how regulators have been approaching this space. One is regulatory ambiguity. Securities laws in the US, at the federal level, are almost 100 years old. It's not hard to conceptualize how technologies that began as paper stock certificates and are now being replaced with decentralized global networks could pose challenges to existing regulations.

In the 1990s, the SEC actually had a fairly rational rule-making process to adapt laws to new technologies, what are known as alternative trading systems. Laws and rules can keep up with technology if regulators are willing to make those changes. Unfortunately, in the US, we haven't seen the SEC take the same rational approach to cryptocurrency.

In fact, we've seen a bit of gaslighting, where the agency can ask projects to register under existing laws, and the project will say, "Okay, great. Let's do it." And then SEC says, "Well, we're not really sure how to register your project." And then, a little bit later, the project faces enforcement actions for not registering. It's not a rational approach to innovation and financial markets.

As of the time of this recording, what are some of the current policy initiatives around regulating cryptocurrency? What are some of the concerns people are wrangling with?

The US is unique in that we have two capital market regulators, the Securities and Exchange Commission, SEC, and the Commodity Futures Trading Commission, the CFTC. This presents an interesting question about cryptocurrencies: should they be treated as a commodity or security?

To answer that question, my colleague Jennifer Schulp and I hone in on decentralization. Decentralization addresses some of the risks that securities regulation is intended to mitigate, which are known as managerial risks. Basically, are the issuers of an instrument going to have information that market participants don't have, and could they use that information to gain an edge over market participants? Things like insider trading and information asymmetries through disclosures. But when you have a fully decentralized crypto token project, there is no managerial body with that information. So, at a high level, crypto securities are those that are centralized, and crypto commodities are those that are decentralized.

One wrinkle here is that crypto tokens can begin life as centralized projects but evolve into more decentralized projects over time.

Say regulators get this right and allow people to realize all the potential gains of cryptocurrency. What kind of gains could people see?

In addition to the potential benefits of faster, cheaper payment methods, cryptocurrency promises a more decentralized internet and financial system. Loans could be issued permissionlessly. In the same way that you put a dollar in a vending machine to get a can of soda, you could have lending protocols that, once you put in the designated crypto collateral, you could take out a loan in crypto without some of the traditional gatekeeping by financial institutions. And that's just one example of this broader ecosystem.

[Read the full transcript](#)

