CATO INSTITUTE | Center for Monetary and Financial Alternatives

July 5, 2022

Diane Farrell
Deputy Under Secretary for International Trade
1401 Constitution Ave. NW
Washington, DC 20230

Re: Developing a Framework on Competitiveness of Digital Asset Technologies
Docket No. 220509-0112

Dear Ms. Farrell,

My name is Nicholas Anthony and I am a policy analyst at the Cato Institute's Center for Monetary and Financial Alternatives. I appreciate the opportunity to provide input to assist the International Trade Administration and the Department of Commerce in its effort to establish a framework for enhancing U.S. economic competitiveness in digital asset (commonly known as cryptocurrency) technology.[1] The Cato Institute is a public policy research organization dedicated to the principles of individual liberty, limited government, free markets, and peace, and the Center for Monetary and Financial Alternatives focuses on identifying, studying, and promoting alternatives to centralized, bureaucratic, and discretionary monetary and financial regulatory systems. The opinions I express here are my own.

In my comments below, I will focus my responses on questions 2, 7, and 14.

(2) What obstacles do U.S. digital asset businesses face when competing globally? How have these obstacles changed over the past five years and are any anticipated to disappear? Are there clearly foreseeable new obstacles that they will face in the future? What steps could the U.S. government take to remove, minimize, or forestall any obstacles?

Cryptocurrency businesses face unique legal obstacles within the United States that undermine their ability to compete globally. Just last year, Congress passed two provisions within the Infrastructure Investment and Jobs Act (Infrastructure Act) that set a de facto ban on legal cryptocurrency mining and exposed over 60 million Americans to new felony crimes.[2] Numerous

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[1] International Trade Administration, Department of Commerce, "Developing a Framework on Competitiveness of Digital Asset Technologies," Notice and Request for Comment, May 19, 2022, https://www.federalregister.gov/documents/2022/05/19/2022-10731/developing-a-framework-on-competitiveness-of-digital-asset-technologies.

[2] Nicholas Anthony, "The Infrastructure Investment and Jobs Act's Attack on Crypto: Questioning the Rationale for the Cryptocurrency Provisions," Cato Institute, November 15, 2021, https://www.cato.org/briefing-paper/infrastructure-investment-jobs-acts-undue-attack-crypto.

proposals have been introduced to amend the provisions, with the latter provision having already received a legal challenge from Coin Center.[3] However, both provisions are still set to go in effect soon and leave much of the industry on uncertain ground.

With that said, obstacles existed long before the Infrastructure Act. For example, capital gains taxes act as a deterrent to cryptocurrency use in a number of ways. First, capital gains tax rates are structured to incentivize long-term holding, which clearly discourages what is generally considered "currency use." Second, the complexity of administering the tax creates an additional burden on would-be users of cryptocurrencies. Where a sales tax is usually a flat percentage added on to the bill, capital gains taxes require a cryptocurrency user to report the sales price, cost, timeline, and gain or loss for each transaction to the Internal Revenue Service (IRS). Specifically, users must record this information on Schedule D of Form 1040 to calculate the tax owed for each purchase of goods and services.

To deal with these obstacles, there are a number of steps the U.S. government could take. First, the cryptocurrency provisions (Sections 6045(c)(1) and 6050I(d)) in the Infrastructure Act should be removed. At the very least, the Treasury Department should issue guidance that clarifies the application of the new law such that miners, software developers, and the like are excluded from being required to report financial activity to the IRS. Second, capital gains taxes should be removed, at least, where cryptocurrencies are used for transactions.

These small changes could go a long way in helping cryptocurrency businesses in the United States gain the foothold they need to compete globally.

(7) What impact, if any, will global deployment of central bank digital currencies (CBDC) have on the U.S. digital assets sector? To what extent would the design of a U.S. CBDC (*e.g.*, disintermediated or intermediated, interoperable with other countries' CBDCs and other domestic and international financial services, etc.) impact the sector?

The deployment of a U.S. central bank digital currency (CBDC) will likely harm the cryptocurrency sector. The sector is already rife with competition, but the entry of a U.S. CBDC would be the entrance of a different sort of competition. The Federal Reserve's (Fed's) status as a competitor *and* a regulator means that it is able to play the game, write the rules, and act as the referee. Therefore, the entrance of a CBDC would result in an immediate tilt in the playing field that would put the private sector at a disadvantage—both domestically and globally.

Recent history has shown how this privileged status can distort markets. For example, the announcement of FedNow resulted in a temporary halt of private-sector developments in faster payments services.[4] The Fed's entrance as a regulator of and a competitor to private-sector

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[3] Nicholas Anthony, "Cryptocurrency in the Shadow of the Infrastructure Act: An Update," Cato Institute, June 13, 2022, https://www.cato.org/blog/cryptocurrency-shadow-infrastructure-act-update; Nicholas Anthony, "New Legislation May Fix Cryptocurrency Provisions," Cato Institute, November 19, 2021, https://www.cato.org/blog/new-legislation-may-fix-cryptocurrency-provisions.

[4] George Selgin, "Facilitating Faster Payments in the U.S.," Cato Institute, September 25, 2019, https://www.cato.org/testimony/facilitating-faster-payments-us; Norbert Michel, "The Federal Reserve Should Not

payments services sent a clear message to the financial industry: despite billions of dollars of investment, years of development, and a network near completion, the future of private-sector payments services was in question. In fact, since then, the risk became even more apparent when Custodia (a cryptocurrency-focused bank) sued the Federal Reserve because of the 19-month delay over its application for a master account.[5] In other words, for 19 months, the Fed has denied Custodia access to the full financial system.

Regulation aside, the Fed is also a competitor that does not need to worry about earning a profit—that is, earning revenue above its costs—like its private-sector counterparts. Technically speaking, the Depository Institutions Deregulation and Monetary Control Act of 1980 restricts the Fed from going beyond its means, but the Fed is only required to cover its costs over some unspecified long run. Even then, the Fed has ways to circumvent those constraints. Combine those factors with the general condition that the Fed has the full backing of the U.S. government, and we are left with a competitor that does not have to worry about going out of business.

Considering the Fed would have such an unfair advantage, it should be little surprise if the introduction of a CBDC in the United States leads to the cryptocurrency sector moving overseas.

(14) According to the FDIC's 2019 "How America Banks" survey, approximately 94.6 percent (124 million) of U.S. households had at least one bank or credit union account in 2019, while 5.4 percent (7.1 million) of households did not. Can digital assets play a role in increasing these and other underserved Americans' access to safe, affordable, and reliable financial services, and if so, how? What role can the Federal government and the digital assets sector play to ensure that underserved Americans can benefit from the increased commercial availability of digital assets?

The cryptocurrency sector can play a role in increasing access to financial services for Americans, banked and unbanked, alike. Notably, as described in the Federal Deposit Insurance Corporation's (FDIC's) 2019 survey, two of the top three reasons that the unbanked avoid having a bank account are a lack of trust and a concern about financial privacy (figure 1).[6] For some people, cryptocurrencies may be exactly what is needed to better protect their privacy. Despite the fact that cryptocurrencies are not completely anonymous, users are still offered a heightened level of financial privacy because decentralized cryptocurrencies (e.g., Bitcoin) offer the opportunity to remove intermediaries from the equation. Therefore, there is no third party to pressure for information if the bitcoins in question are held in a self-hosted wallet. If a government wishes to access the information in such a wallet, it must go through the traditional legal system to secure a

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Compete with Private Firms," Forbes, December 16, 2018, https://www.forbes.com/sites/norbertmichel/2018/12/16/the-federal-reserve-should-not-compete-with-private-firms/?sh=7e3c0ab67f42.

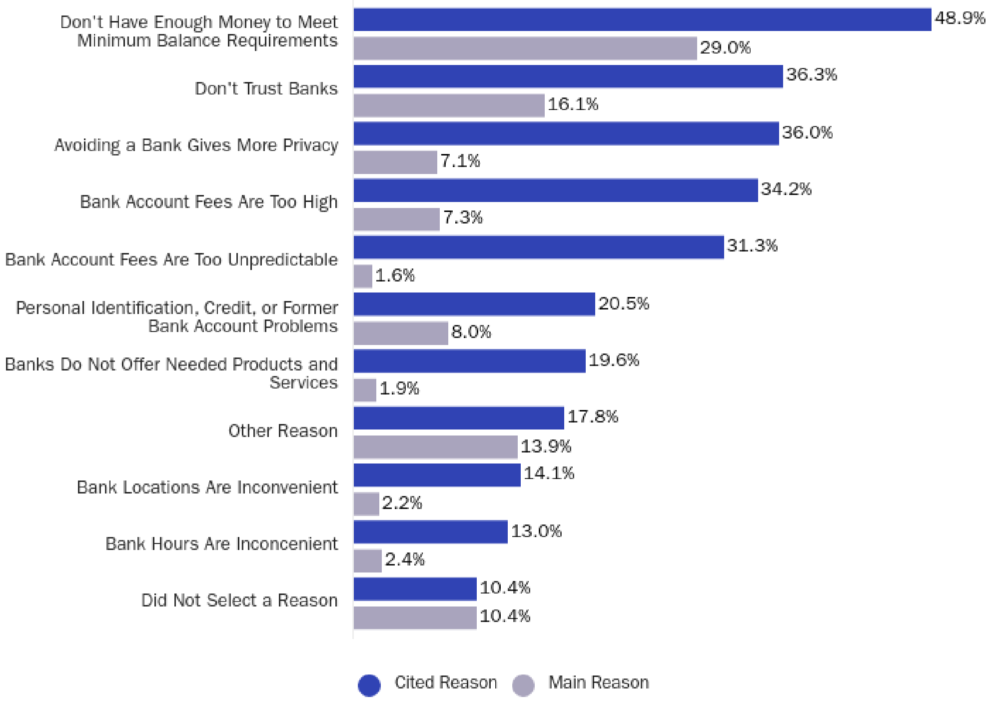
[5] Michael del Castillo, "Bitcoin Bank Custodia Sues Federal Reserve, Demanding Decision On Master Account," Forbes, June 7, 2022, https://www.forbes.com/sites/michaeldelcastillo/2022/06/07/bitcoin-bank-custodia-sues-federal-reserve-demanding-decision-on-master-account/?sh=30bf37fb5f72; George Selgin, "A 'Narrow' Path to Efficient Digital Currency," Cato Institute, February 9, 2022, https://www.cato.org/briefing-paper/narrow-path-efficient-digital-currency.

[6] Federal Deposit Insurance Corporation, "How America Banks: Household Use of Banking and Financial Services," October 2020, https://economicinclusion.gov/downloads/2019_FDIC_Unbanked_HH_Survey_Report.pdf.

warrant. That idea, of course, is precisely what underlies the Fourth Amendment to the U.S. Constitution and should be the norm.

FIGURE 1

Reasons for not having a bank account, among unbanked households in 2019 (Percentages)



Source: FDIC 2019

In addition to financial privacy considerations, cryptocurrencies also offer the opportunity to lower some of the costs and fees that have been a barrier for the unbanked. The banking industry rarely sees new competition these days. There used to be between 90 and 200 new FDIC-insured commercial bank charters each year.[7] However, the entire decade following the Great Financial Crisis saw just 37 new bank charters in total. Encouraging new entrants into the space may be exactly what is needed to spur new innovations, deliver better quality, and encourage lower prices.

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Thank you for the opportunity to share my perspective regarding the Department of Commerce's effort in developing a framework on competitiveness of digital asset technologies.

Sincerely,

Nicholas Anthony
Policy Analyst
Center for Monetary and Financial Alternatives
Cato Institute

[7] Statista, "Number of New FDIC-Insured Commercial Bank Charters in the United States from 2000 to 2021," 2022, https://www.statista.com/statistics/193052/change-in-number-of-new-fdic-insured-us-commercial-bank-charters/.