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Will the Crypto Crash Beget a Better Crypto Future?

The candlestick chart of the cryptocurrency Terra Luna with the sell-off can be seen on the screen of a computer in an office. Silas Stein/picture alliance

IDEAS

BY **ESWAR PRASAD**

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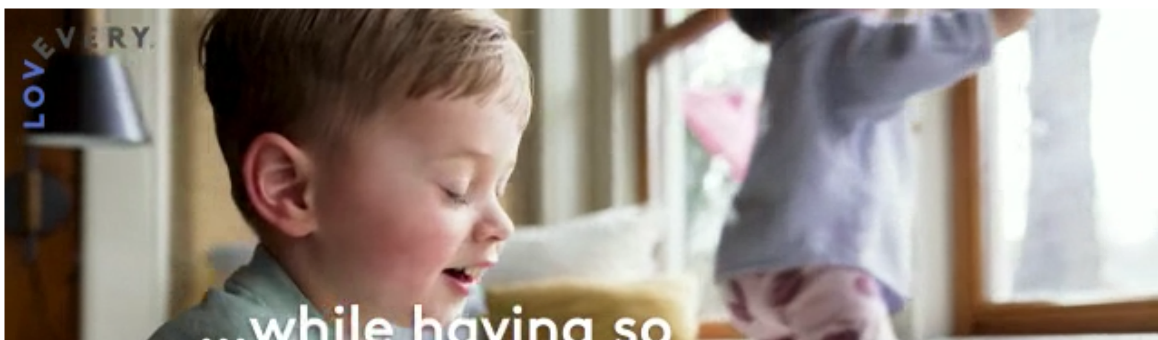
Eswar Prasad is the author of the book, The Future of Money: How the Digital Revolution is Transforming Currencies and Finance. He is also a professor at Cornell University and a senior fellow at the Brookings Institution.

The cryptocurrency winter, with prices of most crypto assets tumbling in recent months, has shone a harsh light on the fragility of Bitcoin and other crypto assets as stores of value. The notion that, unlike other risky assets, they will prove immune to changes in interest rates or serve as protection against inflation has been dashed. Stocks have certainly taken a beating recently but the cryptocurrency crash has been even more drastic. The price of Bitcoin has fallen by about two-thirds from its peak in November 2021 and the total market value of all cryptocurrencies has plunged from about $3 trillion to less than $1 trillion. Even stablecoins, cryptocurrencies that are ostensibly backed by reserves of dollars and other financial assets that should help keep their value stable, proved fragile amid the downturn.



Does this portend the beginning of the end for the crypto revolution? Probably not. In fact, the cryptocurrency shakeout might benefit the sector by tamping down some of the rampant speculative aspects and helping to focus on the beneficial elements of the technology. Could government regulators, who were already bearing in on the crypto industry and will no doubt redouble their efforts in light of recent events, choke off innovation? If designed properly, regulatory oversight could actually prove beneficial to this sector as it would confer greater stability and legitimacy.

The cryptocurrency revolution promised to democratize finance by reducing the power of large banks and other traditional financial institutions while broadening access to basic financial products and services so that less-wealthy

households could benefit from them. The reality, however, is that many of these benefits remain unrealized.

The new technologies have created products that could not have been imagined before, including digital playthings that are often of little practical value, such as nonfungible tokens and meme cryptocurrencies. But there are also some useful ones such as smart contracts that allow financial assets to be bought and sold directly without the intervention of traditional intermediaries. This should, at a minimum, lower costs and improve efficiency by creating competition for entrenched institutions.

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BY GUNDRYMD

There are downsides to the cryptocurrency revolution that have become glaringly obvious in recent months. The lure of easy money to be made by investing in cryptocurrencies proved seductive to many investors. Ownership of many crypto assets quickly became concentrated among well-heeled investors, threatening to widen already massive disparities in wealth. The plunge in crypto asset prices has taken a toll, as usual, not so much on sophisticated, wealthy investors who can handle the volatility but rather on unsophisticated retail investors who might have gotten taken in by the razzle-dazzle of the flashy new digital products and not understood or ignored the risks.

Even the disruption to finance is far from assured. Big banks and other traditional institutions are co-opting the new technologies in ways that might entrench their influence. For instance, a

consortium of large banks is using blockchain technology to more efficiently handle transactions between themselves, which could even disadvantage smaller banks, not to mention limit new competition.

What’s the future of cryptocurrencies?

First, we will see a lot more regulation focused on investor protection, transparency, and limits to risk-taking. Financial literacy remains a major challenge. While retail investors should be free to invest their hard-earned savings in whatever way they choose, at a minimum they should go in with their eyes open. Crypto promoters, and their celebrity accomplices who often mask their own financial interests in the products they tout, should be restrained from making inflated promises of high returns with few risks.

Second, as the technology matures and operates within regulatory guardrails, it could start playing a role in improving the workings of

the financial system. In particular, the technology has the potential to make certain elements of finance, including payments, more efficient.

In developing countries, particularly ones where the domestic currency is not widely trusted, customers and small businesses are gaining easy access to low-cost digital payment systems. International payments are becoming cheaper and quicker, helping exporters and importers and even economic migrants sending remittances back to their home countries. Some of these changes were already taking place through simple mobile phone payment apps but now they are being supercharged through blockchain technologies and access to cryptocurrencies in countries where the domestic financial system is not meeting the needs of consumers and businesses.

Improved domestic regulation as well as coordinated international regulation will help ensure that these new payment channels confer benefits to households and

businesses and do not simply became conduits for financing illegal activities such as money laundering and drug trafficking.

Regulation is also necessary to ensure that cryptocurrencies do not sow more financial instability. Even stablecoins, which were ostensibly just meant to make payments more efficient within and across national borders, have proved financially fragile. Stablecoins have in effect become similar to money market mutual funds or deposit-taking institutions while not being regulated as either. There are concerns about the amounts and quality of collateral that they hold, which exposes them to risk of collapse in the event they are faced with a large number of redemption requests.

Regulatory clarity could actually benefit such innovative products by reducing the risks that they could engender financial instability or facilitate illicit transactions. While innovations in payments and other aspects of finance should not be limited by government intrusion,

there is a legitimate role for regulators to prevent misrepresentation of the safety of what are touted as just payment tools but are in fact perceived by many users as financial assets.

The U.S. government has the opportunity to take the lead, if it acts fast, in setting standards for this industry and guiding international cooperation. It is also essential to make a push for digital and financial literacy that makes investors, who might get carried away by the technology, better aware of the risks. The industry itself will need to acknowledge various types of risks rather than wave them off and engage with regulators instead of merely offering to police itself. For instance, stablecoin issuers need to accept being regulated as issuers of financial products rather than just payment services, and they should also require customer identification to limit illicit financial transactions. In fact, regulatory oversight might help the technology gain legitimacy and enable it to truly disrupt the

existing financial system by fixing its many inefficiencies.

For an industry that was meant to circumvent the government, a well-designed dose of Big Brother could be just the right tonic.

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