A Lion Finds Its Voice: Why the Crypto Infrastructure Bill Debate Changes Everything

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IN THIS ISSUE, WE DISCUSS:

- For most of its existence, crypto has faced existential or nearly existential threats.
- Over the years, those threats have slowly been removed. The last such threat — that the U.S. government would regulate crypto to death — may have died last week on the floor of the U.S. Senate.
- Facing a significant regulatory threat, the crypto industry found its political voice … and it was much stronger than anyone imagined.
- The implications — for crypto's future, for portfolio construction, and for institutional adoption — are significant.

In early August, Democrats and Republicans in the Senate came together to pass a $1 trillion infrastructure bill. The bill was designed to provide funding for roads, bridges, railways, and internet infrastructure, among other popular items.

A trillion dollars is a lot of money, of course, and so the bill required "pay-fors" to gain bipartisan support. Pay-fors are ways for the government to raise revenue to offset new spending.

One of the pay-fors — inserted, apparently, ***at the behest of the Treasury Department*** — focused on the crypto industry. It aimed to raise $28 billion over 10 years by increasing tax compliance from crypto brokers.

So far, so good. The crypto industry is ready for regulatory and tax clarity. It's a necessary step in crypto's move into the mainstream.

The devil is always in the details, of course, and in this case, the details weren't good. Specifically, the original wording was so broad that almost any crypto business could have been captured as a crypto broker and forced to comply with extensive (and likely impossible) demands. Read in a certain way, the provision could have made crypto miners "brokers," requiring them to issue 1099s for every transaction included in a block. Some legal observers suggested the rule could even capture software engineers, putting them on the hook for tax reporting on every transaction that used a piece of code they wrote.

These provisions, obviously, would be onerous. Interpreted broadly, they would render crypto largely impossible, forcing much of the crypto industry offshore.

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Something magical happened: Crypto found its voice.

Faced with this prospect, the markets stumbled initially. The price of bitcoin fell below $40,000, just after regaining this level for the first time in six weeks. Moods soured. The future felt ominous.

And then, something magical happened: Crypto found its voice.

CRYPTO AS COMMUNITY: A POWERFUL FORCE

One often-overlooked feature of crypto is that it's inherently social. The original bitcoin white paper, after all, was called "Bitcoin: A *Peer-to-Peer* Digital Cash System" [emphasis added].

Faced with existential threats, the crypto community has repeatedly banded together, hunkered down, and continued to develop the technology. That's what happened with the infrastructure bill ... with a scale, professionalism, and savvy that stunned observers on all sides.

The social aspect of crypto has accelerated its growth and made it resilient against threats throughout its 12-year history. It carried crypto through setbacks like the ***Silk Road*** and ***Mt. Gox*** events, the ***Tether indictment***, and more. Faced with existential threats, the community repeatedly banded together, hunkered down, and continued to develop the technology despite collapsing prices and other issues.

That's what happened with the infrastructure bill. The difference this time is that it happened with a scale, professionalism, and savvy that stunned observers on all sides, and that it took place in an arena where most observers did not expect crypto to have a serious presence.

THIS IS NOT A DRILL

As soon as the bill's language was published, the calls went out on Twitter: ***This is not a drill!***

The community response was overwhelming. Social media exploded. Lobbyists lobbied. VCs protested. Congressional inboxes filled. Call scripts were published. Campaign funds flowed. People wrote op-eds. Talking heads appeared on TV. There was even a campaign to overwhelm the Senate with pro-crypto faxes.[1]

And Congress ... listened?

For two days, all progress on a $1 trillion bipartisan infrastructure bill stalled as Senators debated the finer points of crypto consensus mechanisms.

Before long, ***a bipartisan amendment was drafted*** that would narrow the definition of "broker" in a way that reflected the realities of the industry. An alternative amendment emerged, which wasn't as well-considered, and for two days, ***all progress on a $1 trillion bipartisan infrastructure bill stalled*** *as Senators debated the finer points of crypto consensus mechanisms.*

Think about that sentence.

Flush with venture capital, infused with talent, crypto now has the money, scope, and network to compete on the national stage.

That idea would have been laughable even one year ago, but crypto's come a long way. Flush with venture capital, infused with talent, crypto now has the money, scope, and network to compete on the national stage.

It is not surprising anymore to see crypto in the financial or technology sections of all major media outlets. But reading about ***"How Cryptocurrency Became A Powerful Force***

1 Apparently, Senators must maintain a working fax for their constituents. The community seemed to relish the idea of 100 Senate offices filling up with fax after fax, a continual stream of pro-crypto commentary whirring out of 1980s technology.

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In Washington" on the front page of the Washington Post, or ***"Washington Wakes up to Crypto Influence Amid Infrastructure Fight"*** in Politico, or ***"The Industry Won Last-Minute Concessions"*** in the political section of the New York Times — *that* is new.

AN IMPERFECT END

This story doesn't have a perfect ending.

Through relentless public pressure, the two amendments were reconciled and consolidated into ***a single amendment which was positive for crypto***. There was broad bipartisan support for the combined amendment, ***including explicit support from the Treasury department***.

Sadly, the popular amendment was ***scuttled in an act of personal pique by retiring GOP Senator Richard Shelby of Alabama***. Frustrated that the Senate wouldn't consider his own amendment calling for $50 billion in additional Defense spending, Shelby voted against the crypto amendment ***despite expressing support for its goals***. If I can't have my amendment, you can't have yours.

Even with this setback, however, officials clawed back a victory for crypto.

Frustrated with Shelby's destructive selfishness, ***a bipartisan group of Senators took to the floor for a colloquy to explain the limited intent of the crypto provisions***. The Treasury, facing down the crypto lobby, ***began preparing guidance clarifying the restricted goals of the provision*** as well. The ***IRS, for its part, is discussing limited enforcement***. And there is also a chance the House will take up the bipartisan crypto amendment before it passes the full bill. (Both ***The Washington Post*** and ***The Wall Street Journal*** suggested as much in official op-eds.) Even if the House does not manage to act, the new rule will not become effective before 2023 at the earliest; until then there's time to try again for a better outcome in Congress or even fight the bill's crypto restrictions in the courts.

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WHAT THIS MEANS FOR CRYPTO LONG-TERM

> *Faced with a dire regulatory threat, the industry responded with a lobbying and public comment effort that overwhelmed the Senate and changed the resulting policy.*

The infrastructure bill debate was a crossing-the-Rubicon moment for the crypto industry.

Faced with a dire regulatory threat, the industry responded with a lobbying and public comment effort that overwhelmed the Senate and changed the resulting policy. It did so by relying on the increasingly professional network of think tanks, lobbying groups, and engaged crypto users that has evolved over the past years. The size, speed, and effectiveness put Washington on notice: Crypto is not to be trifled with.

As an industry, this suggests that crypto will weather the coming regulatory storm (discussed in our ***June 2021 Notes from the CIO***) and emerge intact or better. This would be a huge unlock for crypto, helping to bring in reluctant institutional investors and paving the way for crypto and DeFi to increase their impact on the traditional financial world.

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As an investment, the implications may be even bigger. One of the biggest fears among professional investors I speak with is that the U.S. will try to regulate crypto out of existence. This fear has kept many on the sidelines, and many more from allocating to the space at more than a nominal level.

But when bipartisan groups of Senators work overtime to ensure that Congress doesn't accidentally strangle a growing industry … when a debate on crypto can slow the passage of a hugely popular infrastructure bill for two days … when the crypto-skeptical Treasury department goes out of its way to ensure that new regulation doesn't accidentally hamstring the industry's growth … the existential threat starts to look a little less scary.

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Going forward, the crypto industry is going to face many more regulatory challenges in the coming years, and its success or failure in responding to these issues will determine how quickly it can fulfill its full potential.

After what we just witnessed, I'm pretty excited.

ABOUT BITWISE

Based in San Francisco, Bitwise is one of the largest and fastest-growing cryptoasset managers. As of July 31, 2021, Bitwise managed over $1 billion across an expanding suite of investment solutions. The firm is known for managing the world's largest crypto index fund (OTCQX: BITW) and pioneering products spanning bitcoin, ethereum, DeFi and crypto-focused equity indexes. Bitwise focuses on partnering with financial advisors and investment professionals to provide quality education and research. The team at Bitwise combines expertise in technology with decades of experience in traditional asset management and indexing, coming from firms including BlackRock, Blackstone, Facebook and Google, as well as the U.S. Attorney's Office. Bitwise is backed by leading institutional investors and asset management executives, and has been profiled in Institutional Investor, CNBC, Barron's, Bloomberg and The Wall Street Journal. For more about Bitwise, visit ***www.bitwiseinvestments.com***.

ABOUT MATT HOUGAN

Matt Hougan is one of the world's leading experts on crypto, ETFs and financial technology. He is the Chief Investment Officer for Bitwise Asset Management, the world's largest provider of cryptocurrency index funds. He was previously CEO of ETF.com and Inside ETFs, where he helped build the world's first ETF data and analytics system, the leading ETF media site, and the world's largest ETF conference. Matt is co-author of two publications for the CFA Institute Research Foundation: "A Comprehensive Guide to Exchange-Traded Funds" and "Cryptoassets: The Guide to Bitcoin, Blockchain and Cryptocurrencies for Professional Investors." He is a crypto columnist for Forbes, a three-time member of the Barron's ETF Roundtable, a member of ETFdb's ETF Hall of Fame, and the eighth person to receive a Lifetime Achievement Award from ETF.com for contributions to the ETF industry.