

# A Revolution, If We Can Keep It: How Anti-NFT Regulations Threaten Financial Rights

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## KEY TAKEAWAYS

Blockchain technologies like NFTs offer substantial potential economic and social benefits rivalling the Internet itself.

Because blockchains could substantially replace Wall Street and social media oligopolies, they may be targeted by regulators beholden to those industries.

To realize blockchain's potential, policy-makers should treat it like they treated the Internet 30 years ago: Prosecute fraud, and otherwise stay out of the way.

By now, most Americans have heard of non-fungible tokens<sup>1</sup> (NFTs)—unique assets carried on a blockchain. Many might think that NFTs are useless, a wasteland of \$69 million collages<sup>2</sup> and cartoon apes.<sup>3</sup> But NFTs are taking off, reaching annualized sales of nearly \$50 billion.<sup>4</sup> For perspective, \$50 billion is roughly 10 times<sup>5</sup> Hollywood's entire domestic box office, and it took retail e-commerce until the Obama Administration to hit \$50 billion in sales.<sup>6</sup>

So NFTs are definitely real. And, despite their silly beginnings and uncertain future, NFTs' underlying blockchain technology offers enormous potential—arguably on the scale of the Internet itself. Blockchains could usher in a technological revolution that not only creates trillions in value, but that fulfills the early Internet's promise of a radical decentralization that gives power and autonomy to individual Americans.

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## What Is an NFT, and What Can You Do with It?

“Non-fungible” means each one is unique, and “token” means that it *represents* something. Nowadays, that something is usually a photo, video, or tweet that is verified as coming from a specific source. It could be a song from a given artist or a video of a touchdown from the National Football League. It could be an artist’s limited print that can be attached to an email. Indeed, if something can be sent by email, it can probably be made it into an NFT.

Economically, NFTs are simple and have been around a long time. Stock certificates, for example, each have a unique serial number—they are non-fungible. And, they are tokens that represent partial ownership of a company. Indeed, dollar bills are also non-fungible, being uniquely numbered, and are tokens that represent partial ownership, once of gold and now of the government-issued money supply.

Whether stocks, dollars, or digital art, the point of tokenization is to make it easier to trade: A small investor can sell her hundred-millionth ownership of Wal-Mart for \$5 in fees instead of hiring a law firm to write up a sale. Meanwhile, she can stash that ownership in a safe, give it as a Christmas gift, or carry around her Federal Reserve tokens in a purse to buy lunch.

So the core concept is old: a verified token. The NFT breakthrough is putting these on a blockchain, a kind of database that functions like a secured shopping list. Because blockchains automate the human element, they can be breathtakingly cheaper<sup>7</sup> to run than a traditional database, like those used in banks or the stock market.

These cost savings are large, comparable to email versus physical mail, or a blog with 100,000 views versus physically mailing out 100,000 articles. The cryptocurrency bitcoin, for example, showed that an entire monetary system could, in theory, be run on a pair of \$40 pocket computers<sup>8</sup> using free apps on each phone<sup>9</sup> to run balances and payments.

During the Internet’s rise, the Internet began to turn billion-dollar industries into million-dollar industries—it radically shrunk costs—with the balance going to consumers. Blockchains, similarly, can even turn trillion-dollar industries into million-dollar industries. This gives enormous consumer benefit, with the added bonus of greater security and decentralization whereby the consumer can circumnavigate fees or censorship, whether by corporations<sup>10</sup> banning conservatives or by repressive governments banning peaceful protestors.<sup>11</sup>

This blockchain architecture potentially makes NFTs orders of magnitude cheaper, and far more secure, than current methods for

exchanging unique, verified assets. These include not just trading art or video game assets—by one estimate already a \$50 billion industry<sup>12</sup>—but much wider applications in copyright licensing, supply chain management, trading and verifying legal titles like mortgages or deeds, and even replacing the stock market itself. Blockchains could, in theory, replace the entire New York Stock Exchange with a decentralized, secure version at a fraction of the human cost and without the enormous profits and political censorship that Wall Street middlemen increasingly demand.

## NFT Applications

The biggest NFT market at the moment are entertainment products: images, videos, and music. What is being sold is not the copyright, but rather one of a limited number of copies, like a limited-edition print. The copy is verified as coming from the source, which makes it unique and can give it scarcity value. People buy NFTs because they want to own a Tom Brady moment on video, because they hope to resell the item in the future, or simply because they want to support content producers like a local rock band.

Unlike limited prints of a painting, NFTs are programmable. This means that specific rights can be bundled. For example, someone could buy the right to display a digital work of art at a non-profit museum but not at a for-profit event. Or the right to display it for a few months but not forever. Or to play a song only in Canada but not the U.S. Or even to automatically pay the artist 5 percent of future re-sales—something nearly impossible to monitor and enforce today.

The easy authentication and programmable potential of NFTs alone make them a better solution for nearly any scarce digital product, from ball game highlights to a documentary or movie.

Beyond collectibles, NFT programmability could offer dramatic improvements in copyright-licensing, a nightmare today for everyone from bloggers trying to license an image to company executives trying to find music for their commercials or online content. This could substantially increase income for content production—an industry that Americans already dominate—while blockchain's decentralized nature means that cancelled content can live on, funded by fans, whether Facebook or Twitter like it or not.

## Tokenization: NFTs' Physical Nexus

While NFTs are a better mouse trap for digital content, their real potential lies in linking to the physical world. Within entertainment, this includes unduplicable concert tickets, akin to phone-based airline tickets but decentralized, or fan-only events, cameo appearances, even one-to-one fan interactions—an application that already exists.<sup>13</sup>

The big applications are outside entertainment: Cheap, verified tokens have direct applications in supply chain management, where one could verify each input as coming from a given source or process—verifying that a company used ethical suppliers, or domestic components, or that a product was handled by a given inspector, for example.

Perhaps the most valuable application is using NFTs to represent legally binding documents. These could include contracts, loans, mortgages, and titles to any property from equities to bonds to custom debt instruments. Such tokenization of real-world assets could transform industries, from small ones like title searches or mortgage insurance to entire stock markets, which could be replaced with decentralized versions. Over \$170 billion is traded on stock markets per day, and trillions of dollars are locked up in illiquid assets that cannot easily be traded or even verified. With NFTs, these could all become vibrant decentralized markets, without middlemen or corporate censors.

To illustrate: A conservative business could issue shares as NFTs, crowd-funding its startup without having to ask Wall Street for permission. This could usher in a fundamental democratization of financial markets, doing for finance what the early Internet did for content. Moreover, decentralization of blockchain-based finance could become increasingly urgent as conservatives, disfavored industries, and moderates continue to be censored or debanked by a left-leaning Wall Street.

## Regulatory Threats

At this stage, whether NFTs and blockchains change the world depends on regulators. Up to now, people trade NFTs freely, akin to buying and selling at auction or on eBay. But regulatory threats come from the clumsy application of existing financial regulations to an innovation that does not cleanly fit any category.

Securities and Exchange Commission (SEC) Chairman Gary Gensler recently assured Congress that he is pushing for more regulations against blockchain-based digital assets, which would include NFTs, characterizing

the industry as the “Wild West.”<sup>14</sup> Securities designations would subject NFTs to registration under the Securities Act of 1933—costing potentially hundreds or thousands of dollars per NFT.<sup>15</sup> It could require registration of sellers as broker-dealers, and marketplaces as regulated securities exchanges under the Securities Exchange Act of 1934. One can only imagine what eBay or Etsy would look like if every hand-made Christmas ornament or used sewing machine had to be a registered security sold by a registered broker-dealer.

Meanwhile, the Commodity Futures Trading Commission, which regulates commodities rather than securities, is pushing to consider blockchain-based digital assets a commodity. This could require NFTs to be traded on officially registered derivative exchanges,<sup>16</sup> controlled by centralized financial institutions, shutting down today’s person-to-person exchanges that are open to all. Next, the Financial Crimes Enforcement Network (FinCEN), which regulates currencies and thus sees blockchain technology as a type of currency, has placed NFTs on its priority list, threatening to extend anti-money laundering (AML) mandates that, again, could strangle the industry in its crib. FinCEN has already shown its hand by extending such requirements<sup>17</sup> to the art market in 2020 and appears hungry for more. Given the abject failure of existing AML mandates, which cost hundreds of billions in compliance for a handful of prosecutions,<sup>18</sup> FinCEN should instead repeal AML rules altogether.

Finally, each state has myriad laws regulating all three categories—securities, commodities, and currencies—and the very fact that blockchain-based assets do not fit into any one could be used as an excuse to kill these industries on behalf of powerful local lobbies. This is akin to how the U.S. Postal Service (USPS) tried to ban email in the 1990s, arguing that it had a monopoly over mail. Fortunately the USPS failed, but Wall Street has much more power than USPS did in 1990. Some states already have new restrictions. New York, home to Wall Street, requires a restrictive “BitLicense” for crypto-related firms to operate in the state and has already prosecuted firms<sup>19</sup> that do not toe the line. Other states, such as Delaware (credit cards) and California (Big Tech), may follow suit, given that they host large firms threatened by decentralized digital assets that they do not control.

In sum, with NFTs as with blockchain more broadly, the regulatory molehill threatens to destroy the mountain of a possible Internet-scale innovation that could benefit millions of Americans and substantially return financial power to the people. The current regulatory feeding frenzy threatens to erect a gauntlet that can kill not just NFTs and blockchain-based assets but all financial innovation that threatens any existing firm with political muscle.

What should be done instead? Policymakers should take the same approach they did with the early Internet: Prosecute outright fraud, and otherwise allow it to function as a de facto safe harbor so that a promising new industry can develop before regulators kill it. Crypto-friendly SEC member Hester Peirce has proposed just this, limiting regulatory intervention to the minimum<sup>20</sup> needed to punish genuine fraud, and otherwise allowing the industry to flourish, innovate, and serve customers without asking regulators' permission. Every regulator or legislator should ask of each proposal to suppress blockchain technologies: "Does this expand or deplete the economic freedom of the American people?"

## Conclusion

While NFT and blockchain applications are already worth billions, the technology is still in its infancy—closer to the Internet in 1990 than the Internet today. Because blockchains threaten to replace powerful incumbents like Wall Street and social media oligopolies, they could face a much more difficult regulatory environment than that of the early Internet.

The prospect of a peer-to-peer stock market or crowdfunded mortgage industry is something that Wall Street would love to strangle in the crib, and politicians or regulators may respond accordingly. Recent efforts to censor comedian and podcaster Joe Rogan<sup>21</sup> for COVID-19 wrongthink show that many on the Left would love to choke off free expression and any technology that enables it. In Canada, the Trudeau regime's recent suppression of vaccine-mandate protests<sup>22</sup> by choking them off financially shows the critical importance of financial decentralization to defending individual liberty.

If Americans are to benefit from the revolution that blockchains offer, regulators and legislators will have to take a page from the 1990s Internet and make a conscious decision to punish outright fraud but otherwise remain hands-off. If they do, blockchains could transform the world, both economically and politically, finally giving power to the individual, rather than a centralized "walled garden" controlled by the powerful and their regulatory minions.

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