

Beware the Regulatory Storm over FTX

The bankruptcy of the cryptocurrency exchange FTX and the alleged fraud by co-founder Sam Bankman-Fried, which has cost customers millions, is tailor-made for anyone who already wants the power of government to expand, especially in the area of financial privacy. For that reason I think it would be useful to take a 30,000-foot view of the matter. I offer these considerations as someone with no more than a layman's knowledge of the cryptocurrency phenomenon. (I found this *Reason* video helpful.)

First, fraud is illegal. If a firm accepts money from clients and uses it in violation of the contractual terms, that is already against the law and the victims have legal recourse. So right off the bat we should be highly doubtful about calls for new laws and regulations or expanded regulatory oversight.

Second, regulation can create a moral hazard. That's what happens when a sense of security provided by insurance or government regulation unintendedly encourages the very bad thing that one sought to avoid. Think of the massive stock fraud perpetrated by Bernie Madoff. Madoff was a well-connected investment insider who defrauded highly sophisticated individuals and charities. He didn't prey on naive widows. Madoff had even worked with the Securities and Exchange Commission (SEC). Isn't it plausible that the existence of the regulatory regime worked to Madoff's advantage? Imagine if no such regime had existed and investors had not been led to rely on an SEC "watchdog," with all the classic bureaucratic deficiencies, to protect them. Would they have been such easy marks? I think not.

Fraud is always possible no matter the regulatory environment. Thus a false sense of security is worse than none at all.

Critics of markets denigrate the *buyer beware* principle, but when compared to the alternative — *trust state bureaucrats* — it looks pretty good. To the extent that regulators weaken *buyer beware*, they do a disservice to the public while posing as benefactors. *Buyer beware* is necessary in any legal environment. If you were you're looking for a new doctor, would you be content simply to throw a dart at a list of government-licensed physicians? Or would you ask around?

Third, the alleged criminality of FTX should not impugn cryptocurrency per se any more than Maddoff's criminality impugned the stock market per se. If, as appears to be the case, a bad actor harmed a lot of people, he should have to compensate his victims. (Of course, that may not come close to making them whole.) But Bankman-Fried's wrongdoing must not be used to demonize cryptocurrency as inherently suspect and illegitimate or to drive it out of existence. No reasonable person concluded that we should not have a stock market

because Madoff used it to fleece lots of people.

Fourth, some powerful people are out to get cryptocurrency precisely because it can help regular people maintain some privacy. Those with a fetish for government power have pushed and often attained measures designed to abolish financial privacy. For example, through the government's "Know Your Customer" rules, banks are obliged to inform regulators about their depositors' behavior even if no evidence of criminality exists. Regulation of the government-cartelized banking industry is so extensive that bureaucrats can make virtually any demand and the unwitting depositors whose privacy is compromised have little or no recourse. In a competitive banking industry with market-based money, banks would perhaps offer different assurances about privacy and consumers would freely decide what level they valued at what price. That's how it should be.

If people believe that financial privacy matters only to those who have harmful activity to hide, they need to get over it. Financial privacy and privacy in general are simply implications of self-ownership and should matter to everyone. It is obviously important in authoritarian and totalitarian countries, where governments freely confiscate people's wealth, but it's also important here. We can't know exactly what the future holds. Remember what happened to protesting truckers' bank accounts in Canada? Let's also not forget PayPal's threat, since rescinded, to fine customers for spreading alleged misinformation. And the war on drug sellers and users can't be a good reason for denying financial privacy because the so-called drug war should be abolished.

No one who cares about individual freedom should stand by and let the FTX scandal become a pretext for expanded government power and the destruction or nationalization of cryptocurrency.