THE FINANCIAL PAGE

HOW LONG WILL THE TRUMP CRYPTO BOOM LAST?

As a pro-crypto Administration prepares to take power and crypto investors cheer, there are some parallels with the dot-com boom of the late nineties.

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Last week, after Donald Trump announced that he would nominate Paul Atkins, a cryptocurrency advocate, to head the Securities and Exchange Commission (S.E.C.), the price of a Bitcoin topped a hundred thousand dollars, and crypto enthusiasts celebrated. The mood in the crypto markets reminded me of the dot-com boom, along with its inevitable bust, which I chronicled in a book more than twenty years ago. There was the same giddy excitement, the same predictions that prices could still go higher, much higher, and the same uneasy feelings among some longtime market participants and observers, me included.

To be sure, there was ample reason for excitement among crypto investors, crypto entrepreneurs, and pro-crypto donors who gave hundreds of millions of dollars to pro-crypto politicians ahead of November's election. Investing in Trump's victory and the defeat of some prominent crypto skeptics, including the Democratic senator Sherrod Brown, of Ohio, has already paid off. The S.E.C. is the nation's leading investor-protection agency. Under the leadership of Gary Gensler, whom President Joe Biden nominated as chair in 2021, the agency had taken an aggressive approach toward an industry that Gensler described as rife with fraud and scams. The S.E.C. filed lawsuits against numerous crypto firms, including the crypto exchange Coinbase and the digital-payment network Ripple.

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But, under Atkins, a conservative lawyer who served as an S.E.C. commissioner during George W. Bush's Administration and who now co-chairs the Token Alliance, a crypto lobbying group, the agency's ongoing lawsuits and other cases would presumably be put on hold. And, over all, the S.E.C. seems likely to adopt a more friendly stance to issuers of crypto assets, such as currencies and tokens—a prospect that alarms critics of the crypto industry. "For crypto assets, the fundamental rules that have protected investors for decades are going to be greatly weakened, and the industry is going to be allowed to expand with very little regulation or accountability," Dennis Kelleher, the president of Better Markets, a Washington-based financial-reform group, told me. "It's going to be like the nineteen-twenties—caveat emptor." Crypto leaders hailed the choice of Atkins as a landmark. "We're witnessing a paradigm shift," Michael Novogratz, the founder and chief executive of the crypto outfit Galaxy Digital, told Reuters. "Bitcoin and the entire digital asset ecosystem are on the brink of entering the financial mainstream."

In the late nineteen-nineties, the major paradigm shift that underpinned the dot-com boom was the rise of online commerce, which led to the creation of startups that issued stock on the Nasdaq, such as Amazon, eBay, Pets.com, and Webvan. Speculative digital assets, including Bitcoin, Dogecoin (a cryptocurrency that Elon Musk has promoted), and the crypto tokens issued by the Trump family's new venture World Liberty Financial, can't be directly compared to the startups from the nineties, which offered the prospect of some of them generating large profits at some point, even if many of them turned out to be worthless. (Amazon is now worth about $2.4 trillion. Webvan, an online grocery chain that promised rapid home delivery, raised $375 million in a 1999 I.P.O., and filed for bankruptcy in 2001.)

But regardless of the objects of speculation, as I was writing about the Internet stock bubble, I concluded that big speculative episodes rest on four legs: a new technology that gets investors pumped; an efficient method they can use to communicate; the active participation of the financial industry; and a supportive policy environment.

With respect to crypto assets, the invention of Bitcoin and the blockchain—a secure and decentralized digital ledger—and the rise of social media, satisfied the first two requirements, but Wall Street and policymakers remained suspicious of the sector. These two factors were sufficient to keep investing in crypto a minority pursuit. In the most recent crypto bust, in 2022-23, the price of Bitcoin fell more than seventy per cent, and some big crypto firms, including Sam Bankman-Fried's FTX, collapsed. The broader stock market and the U.S. economy survived unscathed.

With the election of Trump, it seems like all four conditions are now in place, laying the foundation for a broader bubble that pulls in a lot more people. Blockchain technology is still being developed, and its promoters are still claiming it's about to upend the banking system, or revolutionize the international payments system, or have some other transformative effect. On Musk's X, crypto enthusiasts have a huge social platform they can use to tout crypto assets and to flame doubters. But the key development is that policy and Wall Street are now also aligning with the crypto world.

With Atkins in charge, the S.E.C. will probably shift its position on the core legal issue of whether crypto assets are securities, like stocks and bonds, which means they are subject to the full force of the nation's securities law, or whether they are more like physical commodities like gold and silver, which are regulated more lightly partly because they're considered uniform items that are easier to identify and assess. (If you buy a gold bar, you know what you are getting.) During Gensler's tenure, the S.E.C. argued that many crypto assets are securities, the issuers of which face extensive registration and disclosure requirements. The agency accused Coinbase of running an unregistered securities exchange, and it accused Ripple of organizing an unregistered security offering in selling its XRP cryptocurrency. Both companies denied the charges. Earlier this year, a federal judge ruled that most of the case against Coinbase could proceed, which was widely interpreted as a win for the S.E.C. But the Ripple lawsuit ended with a ruling that the company did not violate securities law by selling XRP to retail investors on an electronic exchange, which Ripple hailed as an important victory.

Looking ahead, the international law firm WilmerHale said in a recent client alert that, in the second Trump Administration, the S.E.C. "could propose tailored rules that take into account the differences between crypto assets and traditional securities." That is exactly what the crypto industry wants. Meanwhile, on Capitol Hill, Republicans could pass legislation that enables many crypto issuers to escape the attention of the S.E.C., partially at least, by expanding the reach of the Commodity Futures Trading Commission (C.F.T.C.), which has a much smaller budget and enforcement division. Earlier this year, the House passed a Republican-sponsored bill that would empower the C.F.T.C. to regulate digital assets as commodities as long as the blockchain on which they rely is decentralized. Gensler objected to the bill, saying it would weaken investor protections and allow crypto issuers to self-certify that their products are digital commodities rather than securities. Given that Republicans have won control of the Senate, similar legislation may be proposed there and make its way to the President's desk.

The soon-to-be Crypto Booster-in-Chief has already promised to turn the United States into the "crypto capital of the planet." Crypto enthusiasts will be looking for Trump to fulfill his campaign pledge to create a "strategic national

Bitcoin stockpile." They received further encouragement last week when he named the venture capitalist David Sacks, an associate of Musk, as his "White House A.I. and Crypto Czar."

In theory, the Federal Reserve could put a damper on the crypto party by restricting financial leverage, hiking interest rates, or both. But, when the speculative juices are flowing and asset prices are soaring, such measures are unpopular. During the late nineteen-nineties, the then Fed chair Alan Greenspan, after initially warning of "irrational exuberance," stood aside and let the Nasdaq rip. (Between January 1998 and March 2000, the tech stock index tripled.) Right now, the prospect of a Fed intervention to deflate crypto assets seems remote. The central bank is moving to bring down interest rates, rather than raising them, and last week its chair, Jerome Powell, compared Bitcoin to gold as an investment asset —an argument that many promoters of cryptocurrencies have made.
Finally, Wall Street is embracing crypto. After losing a key court case in 2023, the S.E.C., at the start of this year, approved the launch of Bitcoin exchange-traded funds (E.T.F.s), which track the value of the cryptocurrency and which retail investors can purchase. BlackRock, Fidelity, and Franklin Templeton are among the giant financial firms that already offer these products, while Charles Schwab offers a "Crypto Thematic ETF," an index fund which seeks to track the prices of a number of crypto assets and companies. Since the election, the value of the Bitcoin E.T.F.s has jumped by roughly forty-five per cent. That's sure to encourage other financial firms to launch similar products.

Put all these things together, and it's not surprising that crypto assets are rising in value or that some observers are getting nervous. Eswar Prasad, an economist at Cornell University and the author of "The Future of Money: How the Digital Revolution Is Transforming Currencies and Finance," said he worries that recent developments could give many ordinary Americans the impression that crypto assets represent a safe investment, rather than an extremely volatile and speculative one. "It seems like the U.S. government is going to approve a whole range of crypto products, and it is going to implicitly endorse crypto as an asset class," Prasad told me. "That could really inflate the crypto bubble. And, if something happens that pricks the bubble, we could end up with a pretty bad outcome."

How bad? That could depend on how interconnected crypto assets become with the rest of the financial system. The dot-com bubble encompassed hundreds of startups and the stocks of many larger companies. After it burst in 2000, many startups went out of business, the Nasdaq tumbled more than seventy per cent; the economy entered a relatively mild recession, which lasted less than a year. Later in the two-thousands, the bursting of a real-estate bubble had a more calamitous effect, because it turned out that the banking system was heavily exposed to sub-prime mortgage assets. When their value vaporized, it nearly brought down the entire financial system, and the economy plunged into one of the deepest recessions since the nineteen-thirties.

Until now, federal banking regulators have tried hard to keep crypto confined to its own world by encouraging banks to take a cautious approach in dealing with crypto businesses and discouraging them from holding any crypto assets on their balance sheets. "It is important that risks related to the crypto-asset sector that cannot be mitigated or controlled do not migrate to the banking system," the Fed, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency wrote, in a joint statement last year. In his comments last week, Powell reiterated the Fed's goal not to let any interactions between crypto and banks threaten the banking system.

But Dennis Kelleher reminded me that recent history isn't entirely reassuring. During the crypto bust of 2022-23, which coincided with a spike in interest rates, three banks with ties to the crypto industry failed: Silvergate, Silicon Valley, and Signature. Kelleher predicted that Trump would appoint bank regulators with a more laissez-faire approach, adding, "You are going to see crypto moving like water into the crevices of the financial system. . . . I think that, with the election of a second Trump Administration, the clock on the next financial crash has begun."

A full-on financial blowup is a worst-case scenario, but one thing I learned in the nineties is that large speculative episodes tend to take on lives of their own. And, as Prasad pointed out, a new crypto bubble would be officially endorsed. When I asked the economist if he could think of a historical analogy, he pointed to the Chinese government encouraging its citizenry to invest in real estate. As students of China know, that hasn't ended well, either. ♦

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