TL: DR, what are your proposals?

After today's call, which saw a presentation on tokenomics, I have drafted a proposal describing the direction I think Secret Network should take to support future growth sustainably. At a high level, this would involve:

- A four-year inflation plan that reduces inflation from 9.0% to 6.0%

- A "tax" distributed directly to validators equal (or up to) a fixed dollar value

- "Switching off" the Community Pool tax by decreasing the parameter to 0.0% tax

- Sending $75k from the Community Pool to a Liquidity Fund alongside a 1.5% tax

- Sending the remainder from the Community Pool to Secret Network Foundation (with SCRT Labs matching the value in USD)

The overall impact on staker APR from these proposals will be as follows (assuming a 50% bonding ratio):

- Staker APR remains flat in the first year with a nominal change in total taxes from 2.0% to 2.3%

- Reduction in APR from 18.0% to 11.7% in Year 4 before accounting for the impact of an SNF tax.

I am not seeking to rush this proposal through but would like to open the conversation for as long as we can.

Inflation and staking APR adjustments:

Proof-of-Stake blockchains use inflation to primarily incentivise validators but also delegators. This helps validators offset their operating costs and attracts delegators to stake their tokens to secure the Network. I have suggested several changes that will impact inflation and APR to stakers.

Reduction in inflation:

The Secret Network community passed a proposal to reduce inflation from 15% to 9% per year in November 2023. This is a significant reduction and it is likely the community would be wary to enact any further large decreases in inflation. It is important to note that even with this sizeable reduction in inflation, the bonding ratio has remained above 50%. The "recommended" bonding ratio of 67% has never had any significant rationale for its application.

I propose a four-year plan that sees inflation reduce from 9% per year to 6% per year. As a point of reference, the current leading proof-of-stake chains by market cap including BNB Chain, Solana and NEAR Protocol all target inflation rates between 5% and 7%.

I would also remove any reference to bonding ratio when calculating inflation (i.e., the situation where sustained periods of high bonding ratios would lead to natural decreases in inflation).

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Chart

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The above chart shows the difference in total supply over the four years under the suggested inflationary model. Inflation over the four years decreases from 9.00% to 7.00% to 6.33% and finally to 6.00% ([Desmos | Graphing Calculator](#)).

Direct emissions to validators:

Drawing inspiration from Nois Network, I suggest that a portion of inflation is emitted directly to validators to support continued operation and maintenance. This will have positive ramifications for the Network including:

- The ability to further reduce inflation while maintaining validator sustainability; and

- The ability for validators to reduce commission fees to support price competition.

Validators that are loss-making long-term may exit the active set. While this is natural, we should seek to retain a threshold number of validators to prevent the concentration of voting power in a small number of validators. Personally, we should look to ensure that the top 60 validators are well-positioned to make a profit, and thus ensure long-term retention.

I propose an annual stipend of $1,000 is distributed to validators through this mechanism. At present, the current 60th-ranked validator, Secret University, is estimated to earn $1,662 at current prices and commission rates per year.

To avoid large complexity, a monthly adjustment proposal be passed in line with the monthly price change. This means

when the price of $SCRT increases, the percentage of inflation directed to this tax decreases.

To protect stakers, a "floor price" should be used for $SCRT for these calculations. If the price of $SCRT is below this floor price, the floor price is used. This will reduce the dollar value of the payout to validators but will ensure that delegators are not overly diluted and treated equitably.

I suggest a floor price of $0.35 for this calculation. At the current price of $0.40, this would be equal to a tax rate of 0.75%. At the floor price, this would increase to 0.50%. As a reference point, at $1.00, the necessary tax rate would be 0.30%.

Liquidity fund:

As people would have seen in the earlier Secret 2.0 forum post from late 2022, there was a discussion around the creation of various structures to help support the Growth of the Network. I maintain this position and believe that it would be appropriate to include it in this proposal to support the application layer.

I propose the Community Pool makes a one-off $75k contribution to bootstrap this fund alongside a 1.50% tax for the four years. It is important to note that while the fund exists to grow the application layer, it is not a trading firm and therefore should not take excessive price risk relative to $SCRT.

I am not making any recommendations for who should sit on the DAO managing the liquidity fund, nor do I seek to sit on the DAO myself. However, I would strongly suggest that we use DAO DAO and use its veto feature which would allow Secret Network's L1 to pass an emergency proposal (1 day) to veto a spend being proposed by the council. In the interest of effectiveness, this should be used as a "ragequit" function. If a proposal is vetoed, the council should immediately take steps to wind up its affairs and return all assets to the Community Pool.

I do not think this should be used to disseminate incentives to individual protocols, but rather deploy liquidity. Protocols will likely desire incentives early in their lifecycle and it will create significant amount of work to be comfortable with a product, its viability and safety (i.e., smart contract risk).

Secret Network Foundation:

The Secret Network Foundation will likely need resourcing to support future efforts through a tax. For this reason, I have sought to keep taxes low and use the Community Pool which has historically been used sub-optimally.

I suggest that the remainder of the funds in the Community Pool (over that referenced in the liquidity fund section) be distributed to Secret Network Foundation to support its operations. Based on the current value of the Community Pool, this distribution would be c.$250k.

It is important to note that if a tax is implemented for Secret Network Foundation in the future, funds would be received slowly over time and therefore may create cash flow issues/timing issues for Secret Network Foundation. It is for this purpose that I have suggested this one-time distribution.

Moreover, it is important to note that $SCRT is a relatively illiquid asset at present and the vast majority of Secret Network Foundation's expenses are denominated in $USD. My recommendation would be that SCRT Labs, as a well-resourced entity driving the growth of Secret Network forward, would support this effort and match the community's contribution in $USD.

This would provide a great platform for the Foundation. It would also prevent large supply-side pressure on $SCRT compared to if the Foundation was required to fund costs through $SCRT only (which would also be more costly).

For the purpose of clarity, an on-chain proposal cannot bind SCRT Labs to complete a specific action. However, it will be clear to see if this term can be included in a final proposal during the discussion period.

Community Pool:

After these actions have been taken, the Community Pool tax parameter will be reduced to 0.0%. It will continue to exist to be able to receive assets from the liquidity fund if necessary.

The Community Pool has been found to be quite sub-optimal in its resource deployments. With growing efforts from SCRT Labs to issue grants to projects and the continued effort of Secret Network Foundation, it would make sense to transition away from the Community Pool for operational spends and place some trust in the effectiveness of the aforementioned entities.

With the funds that are distributed from the Community Pool to Secret Network Foundation, it is likely that the Foundation will also need to take responsibility for continuing long-term initiatives such as the Testnet Committee and the Support Committee. Relative to the distribution made to it, these spends will be quite immaterial but should be factored into future budgets or requests made by the Foundation.

Distribution of inflation:

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Chart

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The above chart shows the stakeholders that receive inflationary emissions in each of the four years. As can be seen, the total taxes (pre-Secret Network Foundation tax) are especially minimal. As noted above, this is done intentionally to provide room for a Secret Network Foundation tax which is likely an exercise that is being worked on separately.

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Chart

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cdn.com/standard17/uploads/enigma1/original/2X/7/7874a10cf6a89f8760b01d44ee337eb0328dbf6d.png)

As can be seen in the above chart, stakers would retain a healthy amount of real yield by staking (through redistribution of inflation from non-stakers to stakers). It is important to note that we are not seeking to compete on real yield with traditional finance products. Any attempt to compete on income will likely have negative impacts on capital gains.

For reference, the bonded ratio at 15.0% and 9.0% inflation was 60.0% and 50.0% for long periods of time. We can assume that the bonded ratio will not increase subsequent to any future inflationary reductions. This means that real yield to stakers will initially equal 8.6% and reduce to 5.7% over the four years.

To provide some additional guidance to the community on "room" for tax, the below table shows the impact on real yield once some hypothetical SNF tax rates are overlaid. Real yield has been calculated as staking APR less inflation.

Year 1

Year 2

Year 3

Year 4

0% Tax

8.6%

6.7%

6.0%

5.7%

5% Tax

7.7%

6.0%

5.4%

5.1%

10% Tax

6.8%

5.3%

4.8%

4.5%

15% Tax

5.9%

4.6%

4.1%

3.9%

20% Tax

5.0%

3.9%

3.5%

3.3%

Minimum commission:

This conversation has surfaced multiple times within the immediate community as well as the wider Cosmos community. While it has passed on many chains, it is important to note that the goals for the commission have generally been surrounding revenue and not stake decentralisation.

Consequently, my suggestions concerning inflation adjustments seem to resolve that better than a minimum commission could. By providing a base income to validators, validators can more easily reduce their commission percentage and therefore be able to compete on price more effectively than they previously could.

The community is also free to read an older post of mine from September 2022 where I talk about a minimum commission floor not being a viable solution to solving stake decentralisation.

docs.google.com

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](https://docs.google.com/document/d/1EKBCeHgAIXLUs_6MDRX9i-ylrlrl62zWVXHx-GhTIwE/edit?usp=sharing)

Cosmos Hub - State of the Ecosystem

This Doc is private

Closing remarks:

I have not elaborated on the Skip Block SDK within this proposal, but I think it is clear from a rough consensus that the community would like to see this implemented. This would be ratified in the future through an on-chain governance proposal (likely during an upgrade). Therefore, I have not opined on this but will re-iterate that I am in support of implementing the Skip Block SDK.

My overall direction for inflation would be very similar to NEAR Protocol which sees a fixed level of inflation each year (which for Secret Network may be keeping it at 6% after Year 4) and burning all transaction fees. This would mean that at higher levels of adoption, net inflation would decrease.

Several questions need to be answered to understand the viability of this proposal:

- Would SCRT Labs be willing to contribute in line with the Community Pool's contribution to Secret Network Foundation?

- Is the Secret Network Foundation able to accept one-off contributions from these entities?

- Is SCRT Labs comfortable with the dev work necessary to facilitate this proposal (namely the validator splitting that Nois Network uses and reaching

There are also other questions such as the operational readiness and confidence that the community has in Secret Network Foundation. These would need to be raised and resolved before any proposal.

I will try to keep myself available to answer any questions you may have on this proposal.

I will not look to impede this proposal by submitting it as a spend proposal. However, should the community pass this proposal (or a similar variation), I will submit a spend proposal of $3,000 thereafter.

If any of the well-funded entities on the Network would wish to speak to me on this matter, please do get in touch.