THE HILL

The Fed wants to replace private cryptocurrencies with its own

By Bryan Bashur

August 25, 2022

The Federal Reserve's academic publications and statements make it apparent that it intends to expand its regulatory authority over stablecoins. This concentration of power at the Fed relegates accountability to Congress and favors a framework where bureaucrats will substitute privately issued stablecoins with a central bank digital currency (CBDC) run by the federal government.

Employees at the Fed have proposed policy recommendations that threaten to wipe out privately issued stablecoins — digital assets backed by the U.S. dollar or bonds. One proposal, according to a paper co-authored by an attorney at the Fed, is to "introduce a central bank digital currency and tax private money out of existence."

In one footnote, the paper comments that this recommendation is "essentially the route the Peoples Bank of China has taken with respect to cryptocurrencies." China banned private cryptocurrencies so that its citizens would adopt the state-run central bank digital currency. The Fed is not opposed to pursuing the same heavy-handed policy that will crowd out private cryptocurrencies, limit options for consumers and consolidate control over Americans' payment transactions with the central bank.

The establishment of a central bank digital currency could provide the Internal Revenue Service with another tool to increase tax enforcement. The Fed's report states that "governments could use a CBDC to collect taxes." A study by Zijian Wang concludes that if a "CBDC offers less anonymity than cash" then the IRS would be able to more easily interfere in the lives of American taxpayers. Although Americans should pay what they owe in taxes, the IRS could use central bank digital currencies to target small businesses and abuse taxpayers' right to privacy.

The Fed also wants control over nonbank stablecoin issuers. The minutes of the Fed's July meeting of the Federal Open Market Committee stated that there was discussion around "the need to strengthen the oversight and regulation of certain types of nonbank financial institutions."
The President's Working Group on Financial Markets recommended circumventing Congress to regulate nonbank issuers of stablecoins. A report issued in 2021 explicitly encouraged the Financial Stability Oversight Council to use its authority under Dodd-Frank (a drastic expansion of the federal government in its own right) to designate certain stablecoin payment activities and capital requirements as "systemically important" without any input from Congress.

This egregious policy shifts power from elected representatives in Congress to unelected bureaucrats in the executive branch. Instead of being funded by congressional appropriations, the

Fed is primarily funded from the interest it earns on the securities that it owns. This will make it difficult for Congress to shape future policies affecting stablecoins.

The Fed also wants to drag money market funds and nonbank stablecoin issuers under the same regulatory framework as banks. In effect, only depository institutions would be able to issue stablecoins. This restrictive approach assumes that stablecoins, like money market funds, are destined to cause financial distress. This is misleading. While there were over 800 money market funds in operation in 2007, only one fund's net asset value fell below the $1-per-share price during the Great Recession. Additionally, Supreme Court precedent has clarified that money market funds, and by extension nonbank stablecoin issuers, cannot be regulated by the Fed under the Bank Holding Company Act.

A lighter touch and more transparent framework for the stablecoin market have already been proposed. The Cato Institute wrote language that offers investors more transparency into a stablecoin's reserve assets, but also requires an adequate, but not overbearing, level of collateral requirements.

Consumers need transparent disclosures, not impediments that will make it harder to pick and choose investment options that best suit their preferences.

To avoid costly litigation, regulators will ultimately need to wait for Congress to act on stablecoin regulation. The Supreme Court's majority ruling in West Virginia v. EPA endorses the major questions doctrine and limits regulators' authority to unilaterally pursue rules of great economic and political significance without congressional authorization. Considering that one in five Americans invest in, trade or use cryptocurrencies, and that there are likely numerous applications for digital assets that have yet to be discovered, Congress will need to act first.

Increasing the regulatory powers of the Fed could sound the death knell for private stablecoins. Future consideration of policies should enable both banks and nonbanks to utilize the innovative technology unhindered by excessive government intervention. This can best be achieved by offering a clear legislative framework that continues to enable members of Congress to have a direct say in future regulation, instead of handing off the job to unelected bureaucrats with no accountability to the American people.