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Time for regulators to catch up to the digital age

Mark Calabria

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Advances in online communications have revolutionized many industries in recent years. While Uber and its impact on taxis may have garnered the most attention, similar forces have been reshaping vast swaths of the American economy. Yes, established firms have seen their positions eroded, but consumers have received tremendous benefits and, in many instances, so have the employees of these new enterprises.

All too often, however, government has sided with established incumbents, instead of consumers. Policymakers continually fail to embrace technological and entrepreneurial innovations that are a net benefit to the economy and thereby stifle efficiency and competition.

I can still recall, way back in the heady days of the first term of the Clinton presidency, when a Borders opened near my home. I've long loved strolling around bookstores (and record stores). Still do. Borders seemed to offer everything my small local bookstore was missing. But then just over 20 years ago a new player arrived on the scene, Amazon.com.

Just as Borders disrupted the small bookstores, it was later displaced by Amazon. Over the last decade alone, about a third of bookstores in the U.S. have closed. But I read more than ever and likely spend as much time browsing Amazon as I did wandering around Borders. Not to mention tracking down books I would have never been able to find. As importantly, at least for the consumer, margins have been compressed. More choice, lower prices — what's not to like?

Books and cars have not been the exception. Online travel services have greatly reduced the demand for travel agents. TurboTax has likely eliminated many a job in accounting. Hotels are being directly attacked by Airbnb and others. Wikipedia drove the last of the encyclopedia salesman out of work. Email has increasingly marginalized the Postal Service. Even college professors are under pressure from online education options.

In my own area of study, finance, greater competition has come on a number of fronts. eTrade, and others, have increased competitive pressures on stockbrokers. Apple Pay, BitCoin, PayPal and many others are shaking up the payments space. When investor advisors are not being attacked by Washington, they have to worry about online advisors like Betterment. Online installment and payday lenders are taking on banks, along with their brick-and-mortar competitors.

We are likely witnessing the greatest technological shake-up in finance since the creation of the ATM. Even ATMs are being competed against by the ability to make deposits via your phone.

Looking outside the U.S., the impact has occasionally been even more extraordinary. M-Pesa, a completely mobile-based money transfer, has changed the face of banking and commerce in Africa, while also making in-roads into Eastern Europe and the Middle East. M-Pesa has undoubtedly brought millions on the formal financial system, while also reducing crime and increasing commerce. Perhaps the most stunning fact about M-Pesa is that it didn't originate in the financial system, but was created by a telecom company.

Such would have been impossible under American-style banking regulation, which erects high walls between banking and other financial sectors of our economy.

The plight of the unbanked and the lack of competition in finance are not isolated to Africa, as it characterizes the U.S. as well. Unfortunately the response to the financial crisis has been to raise even higher barriers to entry into banking, rather than address the guarantees and resulting moral hazard that drove the crisis. Dodd-Frank's Financial Stability Oversight Council (FSOC) has already encouraged a number of large non-banks, like MetLife, to shed the banking activities they had, further reducing competition.

FSOC isn't the only barrier to competing with banks. Dodd-Frank's Consumer Financial Protection Bureau (CFPB) aims to impose bank-like supervision on non-banks. This ultimately benefits banks, as companies that lack access to federal guarantees have more difficultly meeting bank regulatory standards without the funding advantages that banks have.

This is occurring with short-term unsecured lending, such as that from installment and payday lenders. Online installment lenders, for instance, increase competition and consumer choice across state borders. The CFPB, and a number of states, are looking to impose further restrictions on these lenders that will only benefit their bank competitors, while also reducing consumer choice.

Just as governments tried to eliminate Uber, Airbnb and others, we are witnessing similar behavior among our financial regulators. There's even public evidence that some banks have encouraged the Federal Reserve to clamp down on BitCoin.

Whether intentional or not, our current system of financial regulation runs the risk of stifling innovation and competition from the digital domain. As mixing government guarantees with vigorous competition almost always results in bailouts, this is somewhat sadly understandable. But it is not inevitable. These potential entrants, such as BitCoin, online lenders, and many more, lack the government guarantees that drive moral hazard. Streamlining our financial regulatory system can ultimately serve to protect both consumers and financial stability.

Mark Calabria is director of financial regulation studies at the Cato Institute. *Thinking of submitting an op-ed to the Washington Examiner? Be sure to read our guidelines on submissions.*