Cato Institute's Mark Calabria: 'Expect Another Crisis Within the Next Decade'

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CoinTelegraph spoke with Mark A. Calabria, the Director of Financial Regulation Studies at Cato Institute, about the institute's views on Bitcoin and the impact of burdensome regulations on cryptocurrencies and the U.S. economy as a whole.

CoinTelegraph: What do you think about Bitcoin and its underlying blockchain technology?

Mark A. Calabria: While I'm an economist, not a tech guy, I'm very excited about Bitcoin, as I am about alternative currencies in general, and perhaps even more interested in the blockchain. Whether Bitcoin succeeds or not, the decentralized ledger offers tremendous potential in a number of areas, from land title to electronic payments. I am optimistic that both Bitcoin and the blockchain technology offer avenues to disrupting our current financial system, which I believe is badly needed.

CT: Many would argue that the mission of Cato Institute is almost identical to that of many Bitcoin advocates. What is Cato's position on Bitcoin and cryptocurrencies?

MC: Well Cato itself does not take positions, its scholars do. But that said, pretty much everyone at Cato, to varying degrees, is supportive of Bitcoin. A number of Cato staff own Bitcoin, as well as a few other alt-currencies. Sure there's some skepticism about whether Bitcoin is "the one" but there's a strong desire to see it given a chance and a concern that the financial regulators may hamper its further development.

CT: What was the reason for the '08 crash, in your view? What do you see as the fundamental problem in today's financial system?

MC: The '08 crash was certainly large by any measure, but its causes were not that uncommon as far as crises go. At the risk of oversimplification, we had an asset boom, largely but not exclusively in the property market, driven by loose monetary policy in the U.S. and large global flows of capital into the U.S. As those funds increased demand in an environment of relatively inelastic supply, particularly in housing markets like California, prices shot up. As with any boom, the momentum attracted fraud and resulted in a general reduction in underwriting standards.

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All of this was made especially fragile by government guarantees, both explicit and implicit, that increased leverage and reduced market discipline. While booms occurred across property types, U.S. housing policy resulted in our single family housing market being far more leveraged than other property markets. So while office, retail and apartments boomed to the same degree, they were not as leveraged and not as interconnected to our capital markets as was single family housing. Lots of really bad policy choices over the years, few of which have been reversed, some of which have been made worse. I certainly expect another crisis within the next decade or so. The fundamental problem facing our financial markets today is a lack of market discipline.

CT: What do you see as the potential solution?

MC: Foremost we need to eliminate the various government guarantees of risk-taking in our financial markets, including deposit insurance, Federal Reserve rescues of too-big-to-fail companies, and guarantees in the mortgage market, such as Fannie Mae and Freddie Mac. We need to deregulate our land markets, so that housing supply becomes more elastic, reducing the size and frequency of booms and busts. It is not a coincidence that California was ground zero for the crisis, while prices didn't move much at all in Texas. You only get booms and busts when demand and supply can become disconnected. And last but not least, we need a rational, rules-based monetary policy.

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CT: You have a lot of experience working in Washington DC, having served as a senior staff member on the U.S. Senate Committee on Banking, Housing and Urban Affairs. How was that experience, and is there interest within the government to reform the financial system?

MC: Working in the Senate was certainly educational, if not a little disheartening. Most members of Congress have little understanding of financial markets or even basic economics. Perhaps even worse, they don't want to even have that knowledge. You have a large contingency in the middle that feels the status quo is mostly OK, and sizeable minorities on the left and right that feel the current system is deeply in need of reform.

The problem, of course, is that those who feel the system is broken do not necessary agree on how it is broken and what the appropriate remedies are. Hence, the mushy middle continues to set policy. Ultimately one reason I left the Senate was I felt there was not a lot of leadership there. Politicians are understandably risk averse. They are essentially followers. You have to get the public there first, which in a democracy, is a good thing, even if a little frustrating sometimes.

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CT: How much interest in cryptocurrency is there within the government?

MC: At this point it is really more a curiosity than anything else, with a few exceptions. Bitcoin has benefited with an association with the tech community — that'll help insulate it from attacks from the left (with a few exceptions like Paul Krugman). While there's been some concern expressed by banks, regulators have so far been relatively restrained. That may well change if regulators start to see cryptocurrencies as a real competitive threat to banks.

On the right the concerns have mostly been about terror finance and money laundering, but since neocons have far less influence than they used to, these concerns have largely been checked. All of the proceeding can change and hence it is important for the Bitcoin community to engage and educate policymakers. I wished we lived in a world where that didn't matter, but we don't.

CT: Are you working with any Bitcoin organizations in DC (e.g., the Digital Chamber of Commerce)?

MC: Cato tends to have a, not surprisingly, "go it alone" culture. So we do occasionally interact and work with Bitcoin organizations but I'd say we aren't as deeply involved as some of them and we do not, yet, have any staff committed to these issues exclusively. That said, we did launch in the fall our Center for Monetary and Financial Alternatives and plan to become far more engaged with policy issues surrounding cryptocurrencies.

CT: What's your take on the IRS's classification of bitcoin as a taxable commodity?

MC: I'm not a fan of it. It's obviously not a commodity in the strictest sense. There is an argument for subjecting it to capital gains taxes, in the same manner you'd apply to a stock or bond, but I do worry that the IRS's decision will complicate and slow acceptance. If its value relative to the dollar stabilizes, this becomes less of an issue. Of course if lots of users start to use any capital losses to offset other income, I wouldn't be surprised if the IRS reconsiders. I hope with a future administration this gets reversed.

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CT: What about the SEC's position?

MC: Not as bad as I'd normally expect, but then the SEC is deeply divided at the commissioner level, and Chair Mary Jo White has been more restrained that I might have initially feared. You don't quite have as much curiosity among SEC commissioners as you do with, say, CFTC Commissioner Mark Wetjen. I should be clear that even under our expansive securities laws: I don't see Bitcoin as a security. I'm far more worried about what the Consumer Financial Protection Bureau might do.

CT: Do you think the government is following a planned strategy here, or are they scratching their heads with regards to this disruptive tech?

MC: It's more a head scratching. There's no coordinated DC approach to Bitcoin. Some of that is a result of the fact that regulators still have their hands full with Dodd-Frank. Some of it has arisen from a lack of pressure from Congress. There's also been little public demand, so far, to "do something" about Bitcoin. So far, it has really been driven by distinct individuals in key policy roles.

There's still a lot of opportunity, and need, to educate policymakers. Those individuals will move on at some point. There's no guarantee that future appointees will not be hostile. I don't think the Bitcoin community should be complacent about the current regulatory environment. The potential to get a lot worse is definitely there.

CT: What do you think about regulating Bitcoin? Should or can it be regulated, under the NY BitLicense, for example?

MC: Setting aside any practical politics, as an economic matter, I'd prefer we not regulate Bitcoin at all. My experience has been that regulation generally just creates barriers to entry and protects established incumbents. That said, private exchanges should adopt rules that protect users. We do not know ex-ante what the right set of rules are going to be, so I think it's critical we have some room here for experimentation. Does that mean some people will lose some money? Absolutely. But then Bitcoin isn't for the faint hearted, at least not yet.

CT: You studied how policy changes in Washington affect low- and moderate-income households. What kind of impact have recent policies had on these households, compared to the higher classes? Do you think cryptocurrency has the potential to democratize money and offer a more egalitarian financial system for the public?

MC: The post-crisis financial reforms have unfortunately raised the costs of credit to lower income families, while also reducing its availability. If these reforms resulted in a more stable economy, then that might be a tradeoff worth making, but unfortunately they do not. And of course the post-crisis monetary policy we've had has largely benefited higher income families, as easy money has driven up the stock and property markets. Regulatory changes, for instance, have done tremendous harm to the flow of remittances, which for many emerging economies are a crucial source of capital and income.

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Cryptocurrencies already helped there, but have considerable potential to do more. The same is true for other types of payments. Of course, like most technologies, the first movers have been and will be the non-poor. That's best, since these first-movers are able to shoulder any losses.

But as we build to greater scale and separate out the good from the bad, there can be a tremendous benefit for moderate and low income families. It's especially for that reason that we need to be cautious on the regulatory front. Misguided and harmful regulations almost always weigh heaviest on the poor, as they are least able to avoid them. The rich can always move to Monaco, or transfer their dollars into Swiss Franc.

Technology can be a great disrupter of the establishment, toppling entrenched incumbents. Accordingly I hope we allow cryptocurrencies considerable room to develop.