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The House Stablecoin Bill Should Foster Innovation And Competition, Not Squash Them

Norbert Michel

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Rumors of a deal between House Financial Services Committee Democrats and Republicans on a new stablecoin bill have been swirling for months, and last week Coindesk reported that the bill is unlikely to make it for a vote in 2022. Regardless of the timing, it's a good sign that the staffs for both Rep. Maxine Waters (D-CA) and Rep. Patrick McHenry (R-NC) are still trying to hammer out a bill.

The situation would be much worse, for instance, if Waters had decided to simply craft legislation that enacts the Biden administration's proposal (from last November) to restrict stablecoin issuers to federally insured banks. The administration's approach is completely misguided and would likely shut off beneficial innovations in the U.S. payments system.

Virtually all crypto innovation—just like most other advances in U.S. payments technology—has been taking place *outside* of the banking sector. Preventing everyone outside the banking sector from issuing stablecoins removes a major threat of competition from the banking industry, and that's not a win.

Competition is a key driver of technological improvements and advancement, even in financial markets.

Hopefully, the committee will craft a plan that fosters competition and innovation, one that provides incentives for more issuers of multiple types of stablecoins. A light-touch, disclosure-based framework can provide such incentives and foster diverse options for consumers and investors, thus strengthening the resiliency of financial markets.

Sadly, that approach is the opposite of the one U.S. regulators have taken throughout financial markets over the last 100 or so years.

The typical view, captured nicely by the Washington Post editorial board, is that the federal government must provide guarantees that stablecoins are stable. The problem is that this approach amounts to protecting consumers against losing money and dictating exactly who can issue which kinds of stablecoins. It empowers federal regulators to pick winners and losers rather than allowing a broader set of choices and experiments to determine what works best. (The 2010 Dodd-Frank Act uses this failed approach in multiple titles.)

It is the wrong approach because it creates poor incentives and results in a less diverse financial system than would otherwise exist. A robust financial system requires more options, not less, so that it is able to better withstand singular (and even multiple) negative shocks.

The post-2008 money market mutual fund rules provide a great example of why this approach is misguided. Those rules helped shrink a once vibrant commercial paper market, forcing more risk out of well-diversified (short-term) capital markets and into the banking sector and government funds.

The opposite approach is needed with stablecoins, and Cato scholars have offered multiple alternatives that would result in a more diverse payments sector. Senator Pat Toomey (R-PA) has even introduced legislation that would help achieve the same outcome.

All that is needed is to regulate the most common types of stablecoins (those backed by cash and short-term securities) with a straightforward set of basic rules based on preventing fraud and promoting transparency. This approach is entirely compatible with a free-enterprise system based on the principles of limited government. (It is also the approach needed for regulatory frameworks throughout financial markets, but that's a broader topic).

Saddling Americans with even more intrusive, complex regulation that favors large incumbent firms is bad public policy. Hopefully, members of the House who are working on the new stablecoin bill will acknowledge this fact and recognize that federal officials have no special knowledge regarding the best way to serve financial firms' customers or investors.

It's probably even worth waiting till 2023 for that kind of bill.

Norbert Michel is Vice President and Director of the Cato Institute's Center for Monetary and Financial Alternatives.