Stablecoins Risky Like ‘Wildcat’ Bank Practices of 19th Century, Gorton and Zhang Write

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If left unchecked, the world of stablecoins could evolve into one reminiscent of the 19th century’s free banking period in the U.S., according to two prominent financial experts.

Yale economist Gary Gorton and U.S. Federal Reserve attorney Jeffery Zhang said there existed systemic risk to the financial system by a “digital form of privately produced money” pegged one-to-one with “safe” assets.

In an academic paper titled “Taming Wildcat Stablecoins” released Saturday, the pair describe similarities they see in stablecoins with that of privately issued “wildcat” bank money in the past.

Gorton and Zhang liken stablecoins to a time in U.S. history when private banks issued their own notes in order to meet growing consumer demand, making it harder to transact as a result of fluctuating prices.

Private banknotes were also uninsured. The threat to the financial system posed by bank runs was very real, and at times, devastating. Privately produced monies, they argue, are not an effective medium of exchange because they are not always accepted at face value and are subject to bank runs.

“If policymakers wait a decade, stablecoin issuers will become the money market funds of the 21st century – too big to fail – and the government will have to step in with a rescue package whenever there’s a financial panic,” the paper reads.

Additionally, preserving the monetary sovereignty of the government is critical for establishing monetary policy, they wrote. “Policymakers should learn from history and not make the same mistakes again.”

Therefore, regulating stablecoin issuers as banks and issuing a central bank digital currency, so as to have one uniform currency, is the way forward to combating those risks, the authors said.

Yet, George Selgin, Senior Fellow and director of the Cato Institute's Center for Monetary and Financial Alternatives, said Gorton and Zhang's view is misleading.

Selgin argues the sovereignty demands of the state exceeded that of the consumer's and was critical in establishing a financial monopoly by the banks and those that manage them.

"Even the decision to establish a uniform U.S. currency during the Civil War also had nothing to do with consumers' preferences: if it had, there'd have been no need to a punitive 10% tax to force state banks to quit issuing their own notes."