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Can Stablecoins Be Self-regulating?

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A storm of regulation has descended on the crypto world. Much of this has had to do with speculative investing and trading. Is a crypto token a security, a commodity, or a currency? What sorts of laws and regulations should apply. We are looking at the issue of [whose rules will crypto follow](#) being worked out in the courts. Part of this is because Congress has failed to rise to the occasion. Part has to do with simply figuring out how to make crypto investments and payment systems safe as they become more widely adopted. An interesting question in terms of regulation arises in regard to stable coins. Can stablecoins be self-regulating?

Stability of Currencies Is Important For Commerce

For a currency to be widely adopted it needs to be reasonably stable. This stability must manifest itself in its purchasing power and in its interchangeability with other currencies. Bitcoin was invented with the idea that it would be a practical medium of exchange, a digital currency. However, Bitcoin soared in value and become an investable and speculative asset. With Bitcoin acting more like gold bullion, it ceased being a practical way to buy and sell, lend and borrow. The place of Bitcoin as a means of payment was inherited by fiat currency-backed stablecoins like Tether.

Importance of Keeping Currencies Stable

The reason that the US Federal Reserve raised interest rates at the beginning of 2022 was because of the worst inflation in four decades. Inflation takes away the purchasing power of a currency. And, unless all currencies are subject to inflation at the same time, it makes the currency less valuable compared to those of other nations. A classic example of the risks of currency inflation was the Weimar Republic. After World War I Germany adopted a democratic government, the Weimar Republic. This experiment lasted only a few years as the government dealt with its debts by printing more and more money. It is said that at the end of this failed experiment it took a wheelbarrow full of currency, Deutschmarks, to buy a loaf of bread. The collapse of Germany's currency in the 1920s is part of what led to the rise of Adolph Hitler and National Socialism. This led to World War Two and 15 million military personnel dead plus roughly 38 million civilian deaths. It also led to the Holocaust in which roughly 8 million innocent people were rounded up by Hitler's government and murdered. The point being that governmental and currency stability is important!

How to Keep Stablecoins Stable

When the US dollar is threatened by inflation, the US Federal Reserve steps in and raises interest rates. When there is a recession the Fed and other world central banks lower interest rates and perform other financial gymnastics to preserve the value of the currency and keep commerce flowing. What happens to privately issued stablecoins when they are at risk of rising or falling? So long as they are tied to the dollar, euro, yen, etc. by sufficient financial reserves they will follow that currency. What happens if reserves fall or if there is a run on the currency like a run on a bank's assets are depleted? There is no crypto Treasury or Federal Reserve to

bail them out. A suggestion was made by the Bank for International Settlements in a 2020 working paper about [stablecoin potential and risk](#). Build regulation into the coding of the stablecoin itself. This could be done using existing technology, namely smart contracts.

Imbedded Smart Contracts for Stablecoin Self-regulation

Smart contracts already provide security in financial transactions. What the position paper suggests is that code could be imbedded in the system of a stablecoin. This code would facilitate reports like the volume of financial transactions without divulging who bought or sold, borrow or lent what. Then those who eventually regulate and oversee the security of the overall crypto financial system will have the same sorts of warning signs that are currently imbedded in the traditional financial system and overseen by the US Treasury and Federal Reserve in the US and similar institutions in other nations.

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