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Impact Analysis of Stablecoin on National Economic Sovereignty

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Abstract:

Stablecoins have grown from experimental digital assets into globally significant financial instruments that challenge the foundations of national economic sovereignty. While early studies emphasized their efficiency and role in financial inclusion, recent research highlights their disruptive effects on sovereign debt markets, monetary and fiscal policy, and governments' monopoly over currency issuance. This paper will analyze stablecoins disruptive effects on sovereign debt markets, monetary and fiscal policy, and governments' monopoly over currency issuance detail. First, it finds that stablecoins compete with national bonds as alternative safe assets, with issuers like Tether already holding $33.1 billion in U.S. Treasuries, thereby reinforcing U.S. financial hegemony and raising borrowing risks for smaller economies. Second, stablecoins undermine monetary and fiscal policy by creating parallel liquidity channels and tax blind spots, which has led regulators ban interest payments on stablecoins, restrict transaction volumes, and prohibit redemption fees. Third, stablecoins erode the right of governments to issue currency, a challenge that can be met through the design and adoption of central bank digital currencies (CBDCs). The findings suggest that while stablecoins present risks to sovereignty, carefully designed policies can transform them into tools that strengthen national bond markets, preserve monetary stability, and modernize state monetary authority.

Keywords: Stablecoin; Crypto Currency; Economic Policy.

1. Introduction

Stablecoins, a class of digital assets designed to maintain stable value by pegging to a fiat currency or a basket of assets. It has quickly become a defining feature of the cryptocurrency ecosystem. Unlike volatile cryptocurrencies such as Bitcoin, stablecoins combine the technological advantages of blockchain with the stability of traditional money, making them attractive for payments, foreign remittances, and as collateral in decentralized finance (DeFi) [1]. The rapid adoption of stablecoin extends far beyond the

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cryptocurrency market, carrying systemic implications for national economies. By offering a private and borderless form of money, stablecoins increasingly compete with state-issued currencies and debt instruments. This leads to the central topic of this research: How does stablecoin challenge on national economic sovereignty and potential solutions. Addressing this question is essential for understanding not only the risks but also the potential opportunities stablecoins create for states in a rapidly digitalizing global economy.

Existing research on this topic presents a growing concern over the potential of stablecoins. Baker argues that dollar-pegged stablecoins reinforce U.S. financial hegemony by redirecting capital flows away from weaker economies [2]. Zashchypas shows that the integration of stablecoins into financial systems alters the structure of money supply, creating blind spots for policymakers [3]. Khawaja points out the role of stablecoins in fragmenting the international monetary system [4]. Finally, De Silva and Yoonseung emphasize that states are responding through explorations of CBDCs and resistance to private stablecoin dominance [5,6]. Together, these research shows both the depth of risks stablecoins affect sovereignty and the policy innovations proposed to address them.

Building on the research above, this paper examines the effects of stablecoins on three core dimensions of national economic sovereignty: demand for national bonds, the conduct of monetary and fiscal policy, and the state's right to issue currency. It analyzes how stablecoins disrupt these domains and considers how governments can adapt through regulations and digital currency innovation at the same time. Practically, the paper provides policy-oriented recommendations such as linking stablecoin reserves to domestic bonds, regulating their operations, and developing CBDCs that can help governments transform stablecoins from destabilizing factors into instruments that reinforce economic independence. This study emphasizes the importance of proactive governance in shaping the future of digital currency and safeguarding economic sovereignty in the modern world.

2. Effect Analysis

2.1 Effect on National Bonds

Stablecoins have started to produce influence on the demand for and pricing of sovereign bonds, especially in emerging economies. Traditionally, for long time demand for sovereign bonds relied on currency stability and central bank credibility. Yet the rise of U.S. dollar–pegged stablecoins creates an alternative safe-haven asset that competes with national bonds as a store of value. For countries with weaker fiscal reputation, this raises a challenge: investors abroad may prefer holding stablecoins instead of local government debt instruments, which seem less volatile and more liquid. This reallocation of capital can lead to higher yields on sovereign bonds, increasing borrowing costs and worsening debt sustainability risks. Baker points out that stablecoins reinforce U.S. financial hegemony by diverting capital away from local instruments toward dollar-backed digital assets, weakening the ability of developing nations to finance deficits through traditional bond markets [2]. In another hand, the liquidity advantages of stablecoins intensify the competition against national debt securities. Stablecoins have the characteristic of instant cross-border transferability and deep integration into decentralized finance (DeFi). As Khawaja notes, the outcome may be a kind of financial fragmentation in which sovereign bonds lose their status to borderless private assets in the current finance world [4]. This tendency reduces governments' fiscal flexibility, particularly in times of crisis when issuing bonds becomes essential for stabilization. Therefore, even if stablecoins do not change the payment landscape directly, they threaten to hollow out the foundational role of national bonds in securing government financing and maintaining sovereign creditworthiness.

2.2 Effects on Monetary and Fiscal Policy

Stablecoins' impact on monetary and fiscal policy is one of the most direct and consequential challenge to national economic sovereignty. Central banks rely on controlling liquidity, setting interest rates, and influencing credit conditions, but circulation of stablecoins creates parallel monetary channels outside their reach. By facilitating dollarization in digital form, policy transmission becomes weaker, especially in emerging markets where currency credibility is already fragile. Zashchypas shows that once stablecoins enter the system, the structure of money supply shifts and a kind of "black market" appears for policymakers trying to monitor and adjust liquidity [3]. In real world scenarios, when households and firms increasingly transact and save in stablecoins, domestic actions—like raising interest rates to curb inflation—become less effective, because part of the economy operates in a dollarized environment separated to local central bank actions. At the same time, government fiscal policy is also affected: tax bases may erode as transactions move into stablecoin ecosystems with lower traceability and compliance. Reliance on stablecoins further enables rapid flight from local currency into dollar-backed digital assets during instability, which results in severe capital outflows for the country. This has a negative impact on the maintaining national macroeconomic stability. According to Huterski, European consumers already show skepticism toward Big Tech-issued stablecoins, fearing they weaken govern-

ments' role in economic management [7]. Yet in regions with weaker institutional credibility the opposite trend appears, where individuals actively embrace stablecoins as more trustworthy than state money. This asymmetric adoption not only complicates monetary sovereignty but also creates inequities in fiscal capacity across countries. Ultimately, stablecoins do not simply supplement existing policy tools; they leave governments with diminished capacity to stabilize economies and respond to shocks.

2.3 Effects on the Right to Issue Currency

Another significant threat that stablecoins pose to national sovereignty is their interference into the state's exclusive authority to issue currency. Since the dawn of modern nation-states, the right to issue legal tender has been both a practical instrument for economic management and a symbolic expression of sovereignty. Stablecoins, however, privatize this function by offering widely accepted currencies that compete directly with national money. As De Silva discusses regarding CBDCs, governments are exploring technological alternatives precisely because the credibility of their currency monopoly is under threat [5]. If individuals increasingly transact, save, and contract in stablecoins, the legal status of national currencies will go down, and the significance of government's role in shaping the financial system decreases. The reduction is not only domestic but also geopolitical. Yoonseung argues that U.S. dominance in the digital monetary order is sustained not through a CBDC but through dollar-pegged stablecoins, which raises American influence worldwide [6]. For smaller states, this will cause currency sovereignty to be undermined by reliance on private issuers, often subject to foreign jurisdictions. Moreover, the public-private shift in currency issuance raises accountability concerns: unlike central banks, stablecoin issuers are not democratically accountable and may more focus on profit over macroeconomic stability. Loss of seigniorage revenue is another possible consequence as widespread stablecoin adoption displaces demand for domestic cash and deposits. As conclusion, the rise of usage of stablecoins goes beyond technological innovation; it is a structural reconfiguration of monetary authority. Unless governments respond through regulation or development of CBDCs, their long-standing authority to issue currency risks being progressively displaced by privately issued digital money.

3. Suggestions

3.1 Pegged with National bond

One direct way for governments to answer the pressure stablecoins put on sovereign bond demand is to build rules that tie issuance to national debt markets. A practical approach is to require stablecoin companies to keep part of their reserves in domestic government bonds, not only in U.S. Treasuries or cash-like assets with high liquidity. There is already precedent: Tether, the largest issuer, reportedly holds about $33.1 billion in U.S. government bonds, making it one of the biggest buyers of short-term Treasuries [8]. Purchases at that scale add liquidity will increase the demand, which will lead to a higher price. This will result in a reduction of yields, borrowing gets cheaper and the government's fiscal burden goes down. Smaller and emerging economies could copy this model by mandating that issuers operating locally allocate a set share of reserves to domestic sovereign bonds.

This upside also resolves the problem of the capital flight into dollar stablecoins. Although certain investors may favor digital dollars instead of local currency bonds, governments that implement stablecoin regulations effectively can make the technology to their advantage. If reserves must be partly in debt, stablecoins become a demand for national securities instead of a substitute. Baker argues that the U.S. financial dominance extends because issuers mostly rely on treasuries, creating continuous outside demand [2]. In practice, bond-linked reserves could stabilize local markets, anchor long-term yields, and provide a more predictable financing channel. However, this still depends on whether regulators actually enforce the rules and whether issuers show transparent compliance. Without careful applications, the opposite may also happen. Khawaja mentions that the global system is fragmenting, reserve requirements can anchor stablecoins back to national finance [4]. Issuers may resist lower returns versus U.S. paper, so coordination at regional level can reduce arbitrage and make such policies standard. By turning reserves from a competitive threat into a stabilizing force, governments reinforce the central role of sovereign bonds for economic sovereignty.

3.2 Restrictions and Transparency

Stablecoins weaken monetary and fiscal policy because they open parallel channels of liquidity and taxation outside the state's control. A response to restrict the riskiest practices while increasing transparency is desired. In the United States, regulators have moved toward strict limits on some operations—banning redemption fees, prohibiting stablecoins from paying interest, and enforcing tight daily transaction limits [9]. The no-interest rule stands out most: if stablecoins could pay interest like deposits, large volumes might leave banks, and interest-rate policy would lose traction. Martino emphasizes that monetary sovereignty in the digital era depends on regulating stablecoins' convertibility and limiting features such as interest-bearing [10]. By blocking these features, governments keep

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control over the savings–lending channel where monetary transmission happens.

Transparency should go up at the same time. Mandatory, more frequent reserve disclosures and real-time reporting to central banks would make stablecoin circulation visible, reducing the "blind spots." Clearing these potential blocks help signal that stablecoins complement rather than replace sovereign authority. On the fiscal side, blockchain-based compliance such as automated tax-reporting triggers for high value transfers which can protect revenues and cut incentives for evasion, especially where capacity is weak. The methods of implementation are important. Indeed, if a country can domestically license and fully supervise issuers, stablecoins may also improve payments, lower remittance costs, and even raise compliance. But without such governance, the risk is hollowing out fiscal capacity and credibility of monetary authorities. This is one of the reasons of sovereignty now depends less on outright bans and more on smart co-optation. The national finance system should keep innovation but restrict it inside the central bank's system and supervision so it cannot destabilize capital flows, inflation control, or fiscal integrity etc.

3.3 Advancing CBDCs

The most fundamental response to the challenge against the state's monopoly to issue money is developing CBDCs. Unlike private stablecoins, a CBDC keeps the state as the sole legal-tender issuer while still delivering the tech benefits—instant settlement, low fees, cross-border reach. De Silva notes many governments push CBDC work exactly because private money is encroaching on that monopoly [5]. A well-designed CBDC acts like a public option in digital money which is credible, widely accepted, and reduces reliance on private coins. Programmable features could even support fiscal policy, targeted stimulus directly to households. This can be achieved while maintaining traceability for taxation. To match real needs, designs can include privacy tiers for small payments, offline capability for resilience, and prudent holding limits so retail CBDC does not drain deposits from banks.

To avoid disintermediating banks, many designs use a two-tier model: the central bank issues the currency, while private banks and payment firms distribute it and handle KYC. At geopolitical level, regional CBDC linkages can build interoperability and offer alternatives to dollar-backed stablecoins, giving smaller states tools in a fragmenting system. On the other side, guardrails on programmability such as banning arbitrary freezes without due process and defining clear monetary policy limits protect trust and credibility. Public dashboards on reserves, issuance, and usage can help legitimacy.

4. Conclusion

This paper has examined how stablecoins affect national economic sovereignty and identified possible responses for governments. The analysis focused on three dimensions: their impact on national bonds, monetary and fiscal policy, and the state's exclusive right to issue currency. The findings show that stablecoins compete with sovereign bonds as alternative safe assets, weakening demand for domestic debt in some countries while reinforcing U.S. financial dominance. They also reduce the effects of monetary and fiscal policy by creating parallel liquidity channels, eroding tax bases, and enabling rapid capital outflows. They also threaten the monopoly of governments to issue money by offering borderless private currencies. In response, this paper proposed three strategies: requiring issuers to hold part of their reserves in national bonds to strengthen domestic debt markets, regulating stablecoin operations through restrictions such as banning interest payments and improving transparency to preserve monetary stability, and developing CBDCs to reclaim sovereign control in the digital age.

The possible limitation of the study is also, particularly its reliance on secondary sources and and recent policy debates without extensive quantitative data or cross-country comparisons. This limits the empirical depth of its findings. Also, as stablecoin a new technology, its markets evolve rapidly. Meaning that the regulatory and economic implications discussed here may change significantly within a short period.

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