Here’s why the Fed should stay out of real-time payments

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The Fed has amassed enormous—in practice, unaccountable—power, and taken roles natural to government and to the private sector. It’s the central bank, paramount financial-system regulator, and a payments operator. It shouldn’t, however, undertake activities better and naturally performed in the private sphere.

The latest example: On its own prerogative, the Fed announced Aug. 5 it was introducing “FedNow,” a real-time interbank payments system, expanding its role in processing that the private sector is well-equipped to handle. Critically, Congress didn’t instruct it to do so. Moreover, the Fed’s entry will deter private-sector competition.

With its Faster Payments Task Force, which met from 2015 to 2017 and comprised 400-plus largely private-sector members, the Fed believed it saw a U.S. banking industry behind other countries in faster payments. So it socialized the idea the central bank can and should ride to the rescue. Its 92-page justification for FedNow **touted the FPTF’s request that the Fed provide faster payments**. But the FPTF didn’t have the authority to instruct the Fed to act. The Fed is a creature of Congress, not a free agent. If Congress wanted it to take an increased payments operating role, it could so legislate.

The Fed developed its own, facially reasonable criteria for developing a new payments service, holding that the service must recover costs, “yield a clear public benefit,” and be one that “other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity.” By the Fed’s own criteria, FedNow doesn’t pass muster. Even if it did, that would only be sufficient for determining what the central bank wants to do, not what it should or is permitted to do.

Viewing it as more efficient, many countries have only a single interbank payment-processing utility. The United States, however, has long recognized and preferred, in most spheres, the ingenuity and self-correcting power of competitive free markets over centrally engineered and managed utilities. The Fed, rightly on this score, notes that having a single provider and concomitant lack of competition would be undesirable.

The market is primed to be competitive. Large banks' cooperative, the Clearing House, launched a real-time payments system in 2017. In addition to TCH, Visa, Mastercard, and processors Fidelity National Information Services (FIS) and Fiserv, leveraging their card-delivery systems, provide real-time payments, and have ample wherewithal to do more. Mastercard is the United Kingdom's sole real-time payments processor. TCH uses that technology.

While misguided, the Fed's initiative could garner support on Capitol Hill from those who understand robust competition ensures maximum value and innovation, and worry TCH might monopolize the market. It could also draw backing from those on the Left who are keen for government to take an ever greater role in the economy. Politics makes for strange bedfellows. TCH's large-bank shareholders, moreover, aren't politically sympathetic on either side of the aisle.

Many businesses are only too happy for government to intervene or participate directly in the market, if they calculate they can profit, generally at the expense of other private-sector actors.

Tech behemoths **Google, Amazon, and Apple**, **goliath retailers Walmart and Target**, and PayPal, all support the Federal Reserve providing faster payments via its FedNow service, slated for introduction by 2024. Each of them, however, would howl in protest if Washington proposed competing with their business or helping would-be competitors.
Fearing The Clearing House will dominate the market, community banks, too, want the central bank to provide an instant-payments system. In contrast, large banks' objections to FedNow have been muted. The Fed is their regulator.

The Fed contends it “would provide the safest and most efficient method for interbank settlement of faster payments…” Why, however, presume the central bank would be safer or more efficient, much less more innovative, than marquee private-sector payment systems like Mastercard, Visa, TCH, Fidelity National Information Services (FIS), and Fiserv?

The central bank is a quasi-government entity whose track record has been atrocious. It has, however, been politically adept, successfully cultivating public trust and an aura of being above politics. Economist Milton Friedman didn’t buy it. He observed “No major institution in the U.S. has so poor a record of performance over so long a period as the Federal Reserve, yet so high a public reputation.”

The Fed has failed miserably at its most important role: maintaining stable prices. From 1792 to 1912, U.S. prices rose 3%. From the Fed’s 1913 creation to 2013, prices rose a whopping 2,380%. Further, on its own prerogative, the Fed in 2012 started targeting 2% inflation, flagrantly flouting its mandate to pursue stable prices. Stable prices means zero inflation, not prices doubling every 35 years.

Moreover, the Fed failed to anticipate the financial crisis. In March 2007, Fed Chairman Ben Bernanke told Congress the subprime mortgage crisis was “contained.” That May, Bernanke declared “We believe the effect of the troubles in the subprime sector on the broader housing market will likely be limited, and we do not expect significant spillovers from the subprime market to the rest of the economy or to the financial system.” Reality intruded.

Likewise, the Fed’s assiduously nurtured notion that only it can ensure ubiquitous and equitable faster-payments access is a chimera. Interoperability and competition will ensure both. TCH is slowly expanding its reach. Mastercard and Visa directly and indirectly connect with most banks. Both global networks could provide ubiquitous real-time payments. Additionally, Fiserv and FIS serving thousands of U.S. banks could be formidable providers of faster payments.

Furthermore, FedNow’s announcement will slow faster-payments adoption by causing many smaller banks to wait. The central bank says it will be available in 2023 or 2024. Worryingly, FedNow will discourage private-sector payment systems from investing and more vigorously competing in instant payments.

In faster payments, at least a handful of competing, interoperable, private-sector real-time payment systems, dynamically marked to market, would be the best outcome. Chair Jerome Powell should use his bully pulpit to encourage more private-sector competition and consider spinning off the Fed’s existing ACH, Fedwire, and check-processing operations rather than expanding its payment-processing footprint.

The Fed should stay out of activities properly and better handled by the private sector. And Congress should circumscribe its payments role.

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