Digital Dollars Will Boost King Dollar

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Physical bills aren't going away anytime soon, but e-dollars are coming.

LAST year, Congress mauled Facebook's proposed digital currency, Libra. Because Libra would be backed by a basket of currencies and securities, some lawmakers viewed it as a competitor to the dollar. In a letter to Facebook co-signed by House Financial Services Committee chairwoman Maxine Waters, and calling for the project to be put on hold, five Democrats worried that Libra products "may lend themselves to an entirely new global financial system that is based out of Switzerland and intended to rival US monetary policy and the dollar".

So Facebook pivoted. Libra 2.0, announced in April, will include multiple coins, each backed by a national currency (i.e., Libra dollars, Libra euros, and so on). What Representative Brad Sherman derided as the "Zuck buck" has become a digital buck, and it won't be the only one. Visa, which withdrew from the Libra project following regulatory pushback, has applied for its own digital-currency patent, and a few banks have put their toes in the water as well. Even the Fed is flirting with the idea of introducing a digital dollar

Rather than seeing digital dollars as a threat, economic policymakers should embrace them as a means of expanding access to the greenback globally. With 2.6 billion users, Facebook is well-positioned to encourage the use of Libra dollars on and off its platform. Visa, the world's largest retail-payment network, could support electronic dollars issued by banks and facilitate use worldwide. These coins would work in tandem with rather than against the dollar.

Since the 1944 Bretton Woods Agreement, the dollar has been the world's preeminent currency. It dominates foreign-exchange reserves, foreign-currency-denominated debt, foreign-exchange turnover, and cross-border interbank payments.

The dollar accounted for 61 percent of the world's foreign-exchange currency reserves as of the fourth quarter of last year, far surpassing the euro's 21 percent share and the Chinese renminbi's paltry 2 percent. A whopping 74 percent of the $16 trillion in foreign-currency debt is denominated in dollars, and most international trade, including oil, is invoiced in dollars.

Having the world's dominant currency confers advantages. The Fed makes a profit (seigniorage) because the cost of creating dollars (paper and printing, primarily) is minimal compared with a face value accepted worldwide. Additionally, it's a foreign-policy tool. Washington, arguably, has abused the privilege. Most cross-border payments are ultimately cleared in dollars through American correspondent banks. Washington effectively has veto power over use of the world's near-monopoly interbank cross-border payment-messaging network SWIFT. American sanctions have denied access to the world's dollar-centric financial system to firms such as Russian aluminum producer Rusal and pariah states such as the Islamic Republic of Iran. In the same vein, Washington has banned U.S.-domiciled payment systems Visa, Mastercard, PayPal, American Express, and Discover from operating in states such as Iran, North Korea, and Syria

While Brussels and Beijing resent the dollar's dominance, foreigners worldwide love dollars. They circulate widely outside the U.S., for licit and illicit purposes. About 60 percent of U.S, currency and 75 percent of $100 bills are held abroad. Dollars are used officially in Ecuador, Panama, El Salvador, and Zimbabwe. In Costa Rica, the greenback circulates in parallel with national currency. Hong Kong, for the time being, pegs its currency to the dollar.

A more convenient means of exchanging dollars will only strengthen this dominance. E-dollars in digital rather than leather wallets will soon circulate along with physical greenbacks planet-wide.

Indeed, Federal Reserve officials appear to see the merits of digital dollars. Testifying on February 11, 2020, to the House Financial Services Committee, Chairman Jerome Powell said the Fed wanted "to understand the costs and benefits and trade-offs of a central-bank digital currency." It's easy to think that Fed staff will find the idea irresistible.

Digital Fed dollars could be based on direct retail accounts at the central bank, competing head-to-head with banks it regulates. That would be revolutionary, creating instant and irrevocable payment and bypassing the existing bank deposit–money-based credit system and clearing and settlement. It would be better however, to have Fed e-dollars distributed through banks rather than directly and competing with them.

Distributing Fed e-dollars through banks would be a model similar to that being tested by the Chinese and Swedish central banks, with their pilots for an e-yuan and e-krona, respectively. Choice between competing regulated delivery systems would improve digital dollars' performance and march to global ubiquity.

Banks' digital dollars haven't, thus far, attempted to compete with physical cash or Visa, Mastercard, and PayPal. Chase's JPM Coin and Signature Bank's Signet support business-to-business payments.

E-dollars will make it easier for billions of people abroad to transact in dollars online and by using mobile phones in restaurants, bars, and grocery stores, in lieu of national fiat currencies. That will lower transactions costs, curb many governments' ability to debase their currencies, and enable increased financial inclusion.

Still, physical dollars have advantages and are not going away. One-hundred-dollar bills are anonymous, and they don't require electricity, connectivity, and electronic devices to use. Nonetheless, e-dollars are coming.

Digital dollars will help consumers and merchants, while increasing King Dollar's powerful network effects and global dominance.

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