Digital Fiat Currencies Should Come From the Private – Not Public – Sector (Part One)

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Digital fiat currencies are coming. Bitcoin and the more than 5,000 cryptocurrencies it inspired have ignited the interest of the Federal Reserve, the European Central Bank, and the Peoples Bank of China, as well as that of private-sector players like Visa and Facebook, in digital currencies tied to dollars, euros, yuan, and other national fiat currencies.

Consumers' and merchants' increasing reluctance to transact in cash because of Covid-19 will further whet the interest of these major financial players. The world could soon have Fed, Visa, and Libra digital dollars.

Who takes the lead in this, and how, matters.

Central banks are monopolies and are inherently political. The private sector is competitive, accountable to users, and continuously self-corrects. The greater, therefore, the private sector's role—within regulators' guardrails—and the more modest the public sector's role, the better for nonpoliticized digital fiat currencies, innovation, and enduring value for consumers and businesses.

Regulators are hostile to digital money not tied to fiat currencies. In 2018, then ECB board member Benoît Cœuré derided Bitcoin as "the evil spawn of the financial crisis." In 2019, France's finance minister, Bruno Le Maire, declared Facebook's proposed global digital currency and payment system, Libra, "unacceptable," and a threat to national sovereignty. He added that its proposed governance was "unconscionable."

Also in 2019, U.S. House Financial Services Committee Chair Maxine Waters worried Libra might be intended "to establish a parallel banking and monetary system to rival the dollar." President Trump weighed in, tweeting

“We have only one real currency in the USA” and that “Facebook Libra’s ‘virtual currency’ will have little standing or dependability.”

Instead, governments are increasingly keen to develop electronic fiat currencies. Eighty percent of 66 central banks responding to a 2019 survey by the Bank for International Settlements said they are working on wholesale and/or general-purpose digital currencies.

The first central bank digital currency (CBDC), Ecuador’s dinero electrónico, launched in December 2014, failed. Based on dollar accounts at the central bank, the currency had as its stated intention to help the unbanked. The state mobile phone operator, CNT, enjoyed a monopoly in processing payments for consumers and merchants.

The dinero electrónico never achieved critical mass. Ultimately, only 41,066 accounts were ever used to pay for goods and services. Lack of trust in the government and a lack of competition proved fatal. It was decommissioned in 2018.

To improve payments efficiency, the Peoples Bank of China is rolling out a digital-currency pilot. The four largest state-owned banks are participating. The PBOC also is keen to reduce anonymous cash. It’s not unique in that regard. CBDCs could be anonymous like cash, or not. Thus far, no central bank has introduced an anonymous digital currency. Nor is any likely to.

The ECB is assessing a CBDC’s costs and benefits. Its president, Christine Lagarde, cautioned that “central bank initiatives should neither discourage nor crowd out private market-led solutions for fast and efficient retail payments in the euro area.” That’s a legitimate worry. No bank or private payment system wants to compete with its regulator or a central bank with unlimited resources.

As the International Monetary Fund’s managing director, Lagarde floated the idea of a digital-currency “public-private partnership,” with banks and startups focusing on client interface and innovation and central banks focusing on back-end settlement. If central banks offer digital currencies, Lagarde’s idea may be the least-bad model.

The Swedish central bank’s digital krona embraces this public-private-partnership approach. CBDCs can be based on direct accounts or distributed digital ledgers, and delivered directly or through third parties like banks. The Riksbank is piloting a permissioned distributed-digital-ledger-based e-krona distributed through banks and licensed representatives.

It will issue e-krona tokens to banks in exchange for reserves at the central bank. From digital wallets, users will make deposits and transfers and make and receive payments.