The private sector can and should do the lifting for digital currencies

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At the Consensus 2020 virtual conference on May 11, European Central Bank board member Yves Mersch said the bank is focused on a retail central bank digital currency, or CBDC, that would be “accessible to all" and "would be a game changer.” None of more than 5,000 cryptocurrencies has yet made a dent in the mainstream as a means of payment, unit of account or store of value. They have, however, spurred central banks’ interest. Eighty percent of 66 central banks responding to a BIS survey are engaged in CBDC work. Ten percent are developing pilots.

The first CBDC, Ecuador’s dinero, electrónico went live in December 2014, with a stated intention of helping the unbanked. It was based on dollar accounts at the central bank. The state mobile phone operator CNT enjoyed a monopoly processing payments for consumers and merchants. Lack of trust in the government and of competition were critical problems. It never achieved critical mass and was decommissioned in 2018.

The Peoples Bank of China is rolling out a digital currency pilot in four cities: Shenzhen, Suzhou, Chengdu and Xiong’an. The PBOC wants to increase payments efficiency and to reduce anonymous cash.

ECB President Christine Lagarde said it’s assessing “the costs and benefits of issuing a CBDC.” She cautioned “central bank initiatives should neither discourage nor crowd out private market-led solutions for fast and efficient retail payments in the euro area.” Mersch worries, rightly, if the central bank took direct retail deposits it would disintermediate banks and decentralized market decisions on optimal resource allocation.

Lagarde floated the idea of a digital currency “public-private partnership” with banks and startups focusing on client interface and innovation, and the central bank on back-end settlement. That would avoid the state competing with banks.

Sweden’s CBDC embraces Lagarde’s public-private partnership model. The Riksbank is piloting a permissioned distributed-digital-ledger-based e-krona distributed through banks and licensed representatives. The e-krona, like cash, would be a claim on the state. The Riskbank will issue e-krona tokens to banks in exchange for reserves at the central bank. Digital wallets will enable users to make deposits and transfers and make and receive payments.

In the U.S., law professors Morgan Ricks and John Crawford and lawyer and former regulator Lev Menand propose that the Fed provide direct banking “FedAccounts" to consumers and businesses. Their proposal is ambitious and dangerous. FedAccounts would be government banking on a massive scale. Economist Larry White estimated an account-based digital currency would require the Fed to increase its workforce twentyfold.

Fed Chairman Jerome Powell has been circumspect about the Fed launching a digital currency. Testifying Feb. 11 to the House Financial Services Committee, Powell said “it’s very much incumbent on us and other central banks to understand the costs and benefits and trade-offs associated with a possible digital currency.”

The Fed is socializing the idea, much as it socialized developing its instant interbank payments system FedNow. And, as with FedNow, if the Fed decides to develop a digital currency it’s likely to give Congress a courtesy briefing rather than seeking express authorization.

Banks are already in the digital currency arena.

Signature Bank and Chase have token-based digital currencies Signet and JPMCoin focused on B2B payments, backed by dollars on deposit. Wells Fargo Digital Cash will support cross-border payments, substituting tokens for the fiat currencies being transferred.

Nonbanks also want to offer digital currencies.

In 2019 Facebook provoked a firestorm from politicians and regulators with its proposal to build global cryptocurrency and payment system Libra. Facebook and the Libra Association scaled back the plan. The retooled approach keeps Libra's transaction ledger permissioned, making it less likely bad actors will get access. And Libra stablecoins will be backed by each jurisdiction's national currency, rendering them akin to electronic banknotes. That won't threaten government monopolies creating money.

Like Libra 2.0, private-sector stablecoins Tether, TrustToken's TrueUSD, Circle's USD Coin, DAI and the Universal Protocol Alliance's UPUSD and UPEUR are tied to fiat currencies, and don't threaten central banks.

If private-sector digital currencies tied to fiat currencies were allowed to compete with payment systems like Mastercard, Visa and PayPal, and physical cash – which is anonymous and doesn't require electricity – it would ensure payments innovation and that consumers and businesses are well served. If central banks provide digital currencies, they should do so through banks – the Riksbank or Lagarde rather than the Ricks model.