

Prepare for the Coming Impact of Digital Fiat Currencies

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Amara's Law, coined by Stanford computer scientist Roy Amara, says we tend to overestimate the impact of a new technology in the short run, but underestimate it in the long run. So it was with the Internet and mobile phones. So it's likely to be with digital fiat currencies.

Since Diners Club's creation in 1950, the payments industry has waged a war on cash. While cash still accounts for a majority of payments at the physical point of sale in most countries, and is enabled online by systems like Boleto Bancário, Kobini, Pay Easy, Openbucks, and BCashy, it's been beating a slow retreat for 70 years.

Now, there's a cascade of interest in modernizing cash in central bank and private digital fiat currencies and in fiat-currency-backed stablecoins like diem. None of these is likely to materially affect the payments industry or many people's lives near-term. Over the long-haul, however, digital fiat currencies will take share from physical cash. They will also compete with reigning electronic retail, money-transfer, business-to-business, and

Launched in 2014, the world's first central bank digital currency (CBDC), Ecuador's digital U.S. dollar, failed. Today, more than 80 central banks are exploring digital currencies.

In 2020, Bahama's central bank launched a digital sand dollar pegged to the U.S. dollar, and BIS, the Swiss National Bank, and a company called Six completed a trial of a wholesale digital Swiss franc. The Peoples Bank of China is piloting a digital yuan. The Swedish central bank's governor, Stefan Ingves, advocates an e-krona. In response, the Riksbank is conducting a trial. Finally, Japan's central bank announced it would conduct trials of a digital yen in 2021.

Diem and China's digital yuan alarmed major central banks and accelerated their interest in CBDCs. For the European Central Bank, the euro's status as a weak number-two reserve currency after king dollar is an additional motivator. ECB president Christine Lagarde said she had a "hunch" the bank would launch a digital euro in the next two to four years.

The ECB, Fed, Bank of England, and Bank of Japan will coin digital euros, dollars, pounds, and yen, respectively, well within a decade.

Cash is a means of exchange, a store of value, and a unit of account. It's also a network whose utility increases the more people use it.

Digital cash's attractiveness will depend on the strength of the underlying fiat currency. Johns Hopkins economist Steve Hanke observes that "while stable money might not be everything — without it, everything is nothing." Digital dollars and Swiss francs will be desirable. Digital Zimbabwean dollars and Venezuelan bolivars, however, would have little appeal. E-money will strengthen relatively strong currencies.

E-dollars will be easier for consumers and businesses worldwide to use than physical greenbacks, and will, therefore, crush many of the world's debased fiat currencies.

E-money's utility also depends on people's ability to transact. Mobile phones enable Mastercard, PayPal, and Visa anytime, anywhere. Digital cash and stablecoins will join credit, debit, and prepaid "cards" and keys to alternative payment systems in consumers' digital wallets. As with leather wallets, consumers' payment-method preferences and use will vary.

For banks and businesses, sending an e-dollar instead of an instant credit or initiating a debit will be an option. As with consumers, banks' and businesses' preferences and use are likely to vary.

E-currencies will boost the tech giants' role in payments. They have quotidian engagement, want to be consumers' portal for payments and financial services, and have e-wallets from which digital currencies will be used. Tech titans, however, will be happy to leave the distribution and issuance of e-money to regulated financial institutions.

In most countries, banks will distribute CBDCs. In some they may issue e-currencies, possibly handled by networks processing their credit, debit, and prepaid payments.

But physical cash isn't going away. It enjoys advantages. It's anonymous and doesn't require electronic devices or connectivity. A decade hence, digital fiat currencies will be in the payments mix planetwide. They could have a tectonic impact.

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