Congress Should Keep the Fed Out of the Digital Currency Space

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The Fed is America's central bank, paramount financial-system regulator, and a payments operator. It's studying and socializing developing a general-purpose central bank digital currency (CBDC). As a general proposition the Fed and government shouldn't undertake payment activities unless there's a significant problem that the private sector is unable to adequately address. There is, however, no compelling need a Fed CBDC would address. And, if there's demand, private-sector banks and payment systems are more than capable of providing digital dollars.

The U.S. payments system is already highly efficient and the most competitive and innovative in the world. Banks transact in central-bank money. Federal Reserve notes (cash) too are central-bank money – Fed liabilities. But American consumers and businesses rely primarily on electronic commercial-bank money.

CBDC advocates such as Fed governor Lael Brainard contend it would be safer than private alternatives, increase financial inclusion, the ability to disburse relief and welfare payments, prevent foreign CBDCs from undermining King Dollar, and promote innovation and competition in payments.

The leading private-sector alternative is stablecoins -digital tokens, issued by banks, perhaps with partners, backed by DDAs, loans, and securities. They'd be regulated. Moreover, given $250,000 in FDIC insurance they shouldn't be riskier than central-bank money.

The percentage of unbanked households in America is small and declining. In 2019 5.4% of households were unbanked, of whom 75.1% said they did not want a bank account. Competing banks, neobanks, and fintechs delivering ever-improving banking and payments, are whittling down the remaining sliver of unbanked. Champions of public policies to boost financial inclusion should press to reduce barriers to entry in financial services, promote competition, and, push to eliminate price controls on debit-interchange fees, which fund fee-free banking.

CBDC advocates call out the putative threat of China's digital yuan. It's hard to imagine, however, that non-Chinese businesses and consumers would want to transact in PBOC accounts. Furthermore, worldwide dollar reserves and dollar-denominated debt and trade are already electronic.

A Fed CBDC would stifle, not promote, private-sector payments competition and innovation. No bank or private-sector payment system would be keen to compete with the central bank, which enjoys unlimited resources and is in many cases their regulator.

Public discussion and congressional hearings on digital dollars have assumed the Fed is the indispensable actor. It doesn't have to be.

For much of America's history private banknotes were money. There are already private, limited-purpose de facto digital dollars. Circle's USD Coin and Tether's USDT are stablecoins, backed by dollars and dollar-denominated assets at regulated banks. To date they've been used primarily to trade in and out of cryptocurrencies. Chase and Signature Bank have stablecoins, JPMCoin and Signet, respectively, supporting instant payments between client businesses. Dollar stablecoin Diem (originally branded Libra) will be issued by Silvergate Bank. Presumably, it will first be rolled out across Facebook platforms, since the social media giant was the Diem's initial architect.

The private sector has delivered virtually all payments and money innovation in America. Government fiat money is the notable exception, if one can call that an innovation.

If there are needs for digital dollars on top of electronic retail, person-to-person, billing, and interbank payment systems, thousands of competing banks, partner fintechs, and payment systems like Mastercard, Visa, interbank payment processor the Clearing House, and worldwide interbank payment network Swift, are well-suited to identify and serve them. The continually-improving US payments system works well. But demand for dollars is global. Dollar stablecoins managed from digital wallets accessed from mobile phones anywhere anytime could be used for cross-border remittances. Additionally, they might displace weak national currencies and payment systems, boosting King Dollar.

In stark contrast with any centrally-engineered Fed solution, competing private systems self-correct. To the extent a particular flavor of bank-issued dollar stablecoin satisfied a need, more resources would be applied to delivering and enhancing it. If, however, a dollar-stablecoin model was judged inadequate or not useful by consumers and businesses, resources would be reallocated to higher-value activities.

To issue dollar stablecoins banks need legal and regulatory certainty. Congress, not the Fed, OCC, and FDIC, should provide it.

The Fed doesn’t have the authority to develop a CBDC without Congress’s authorization. Congress needs to assert its prerogative. It should specify a regulatory framework for bank-issued digital dollars. Citi’s Tony McLaughlin suggests they could be issued against any regulated liability. Digital-dollar law should be technology-agnostic, providing regulated space where competing banks and partners could innovate.

Commercial banks rather than the Fed should issue general-purpose digital dollars.