Leave E-Money to the Private Sector

By Eric Grover

Digital Transactions

July 1, 2023

The case for the Fed running digital dollars is at best unclear, at worst unwise.

Like many central banks, the Federal Reserve has been studying, and socializing, the idea of issuing digital currency, which in some form might be held and used by individuals, firms, banks, and other central banks. In 2022, the Fed published a thoughtful white paper, "Money and Payments: The U.S. Dollar in the Age of Digital Transformation."

On its own prerogative, however, the Fed can't issue a digital dollar. It's a creature of Congress. On March 8, testifying to the House Financial Services Committee, Fed Chairman Jerome Powell reiterated that the Fed would require statutory authorization from Congress to issue a retail central bank digital currency (CBDC). He noted a wholesale CBDC might not require it.

Powell said a Fed e-dollar would be distributed by the private sector (through banks), rather than directly as many partisans of a greater state role in the financial system had hoped.

CBDC advocates contend it would promote financial inclusion, increase economic efficiency, foster payments and money innovation, address the threat of China's digital yuan, and defend

King Dollar. While sounding like mom, God, and apple pie, these assertions don’t bear scrutiny.

The U.S. payments system is substantially digital, has network critical mass, works well, and is continuously improving. Most consumers and businesses transact with commercial-bank—not central-bank–money, using private-sector payments systems. There isn’t a burning need that an electronic greenback would fix.

Today, there are two forms of central-bank money. The Fed issues physical cash distributed by banks, and banks transact in central-bank accounts.

Money is a network. The greater the number of people willing to transact in it, the greater its value. Absent a mandate coercing consumers and businesses to accept Fed e-dollars, their path to network critical mass would be difficult.

In 2011, 8.2% of U.S. households were unbanked. Banks compete fiercely for new customers. With mobile phones, banking and electronic payments are available any time, anywhere. By 2021, only 4.5% of U.S, households were unbanked, of which 4% were long-term unbanked.

Of the unbanked, 34.1% cited privacy concerns as a reason, 33% said they don’t trust banks, and 29.5% said bank fees were too high. Some 32.8% of the unbanked use prepaid cards, and 18.1% use nonbank online-payment services. For those in the gray and black economies, operating in cash is a plus.

Traditional and challenger banks continue to bring people into the system. But if policymakers wanted condition-free, fee-free bank accounts to be more available, they would repeal debit-interchange price controls.

The e-Yuan Dud

The e-Yuan Dud

China’s e-yuan bogeyman thus far has been a dud. As of December 2022, it was a paltry .005% of M2—cash, coins, demand-deposit accounts, and other liquid deposits. Mobile-payments giants Alipay and WeChat Pay, and payment-card-network monopoly China UnionPay, provide convenient, ubiquitous retail, bill, and peer-to-peer payments. The greatest uptake has been by the state and state-owned enterprises.

The yuan isn’t freely convertible. The digital yuan is a tool of surveillance. Its share of foreign-currency reserves, and trade and foreign-debt denominated in yuan, is de minimis compared with King Dollar.

Looking at other parts of the world, the first CBDC, Ecuador’s dinero electrónico, failed. Early CBDCs such as the Bahamas’ sand dollar, Jamaica’s JAM-DEX, and Nigeria’s e-naira, have disappointed.

The Fed’s Full Plate

A Fed digital dollar would discourage banks and fintechs from innovating in digital payments. No firm wants to compete with the central bank, which is the financial system’s paramount regulator and enjoys unlimited resources.

Fears that a Fed e-dollar would be used to track and limit how and where money was used, however, should be put in context. If you use a credit card to buy a cup of coffee, it’s not private. PayPal bans users from paying for legal firearms purchases.

While Powell assured Congress an e-dollar would ensure privacy, and would likely have more built-in privacy protection than the e-yuan, it wouldn’t be anonymous.

The central bank has more on its plate than it can handle. It's responsible for executing monetary policy subject to its congressional mandate. It's the financial system's paramount regulator. And, it operates payment systems that compete with the private sector.

The Fed's monetary and regulatory competence is overrated. Since its 1913 birth, prices have been anything but stable, in contrast with the preceding century. There have been multiple financial crises and recessions. In recent years, the Fed's easy money was a major cause of the financial crisis—which the Fed didn't see coming. And it was asleep at the switch when Silicon Valley Bank failed.

Evangelists contend CBDCs would be risk-free in contrast with private-sector digital cash. Nothing is risk-free, but electronic banknotes, where deposits are insured by the government, are hardly risky. Digital dollars, public or private, would, however, have plausible benefits. In some respects, digital currencies are simpler than reigning payment systems. Payment and settlement are one transaction.

An e-greenback could improve cross-border payments for consumers, businesses, banks, and central banks. Private and/or public digital dollars would naturally supplant debased national currencies, enabling greater wealth creation in countries with untrustworthy money.

If there's a compelling case for digital dollars, and only the Fed is capable of issuing them, Congress should instruct it to issue an e-greenback. But the argument for a digital dollar is at best unclear. With light but clear regulatory oversight, banks, fintechs, and private payment systems are capable of developing and supporting digital banknotes.

—Eric Grover is principal at Intrepid Ventures.