US Daily: The Fed's New Central Bank Digital Currency Report (Mericle)

- The Federal Reserve recently issued a report on digital money and payments systems that discusses the benefits and risks of a potential US central bank digital currency (CBDC). While the report offers a balanced perspective, we read it as sympathetic to introducing a US dollar CBDC.
- Last year, Fed officials debated whether it made more sense to introduce a CBDC or to instead confine the Fed's role to regulating private stablecoins. In that light, two specific arguments for a CBDC in the new report seem significant. The first is that it is important for the public to retain access to some central bank liability as everyday use of physical currency declines. The second is that a digital central bank liability that is free of liquidity and credit risk would provide a firmer foundation for innovation in the digital payments space than private stablecoins.
- The Fed will only introduce a CBDC if it concludes that the benefits outweigh the risks and if it has the support of the White House and Congress, ideally in the form of an authorizing law. If the Fed does move forward, its CBDC would be accessed via private financial service provider intermediaries. Fed researchers are still experimenting with the underlying technology and are considering both relying on existing systems and using newer technologies such as blockchain.

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The Fed's New Central Bank Digital Currency Report

The Federal Reserve recently issued a report on digital money and payments systems that discusses the benefits and risks of a potential US central bank digital currency (CBDC). While the report offers a balanced perspective and is only a first step, we read it as sympathetic to introducing a US dollar CBDC.

The Fed's report follows a report on stablecoins issued last November by the President's Working Group on Financial Markets, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. That report called on Congress to enact legislation to fill in gaps in regulatory authority and subject payment stablecoins to a federal prudential framework by requiring stablecoin issuers to be insured depository institutions and requiring custodial wallet providers to be subject to oversight.

In three earlier reports, we discussed the implications of a US CBDC for the financial system and for monetary and fiscal policy, provided a status report on CBDCs around the world that examined other countries' design choices and approaches to managing key risks, and recounted the debate among Fed officials over whether to introduce a CBDC or to instead leave digital payments innovation to the private sector and simply ensure that private stablecoins are well regulated.

Vice Chair nominee Brainard has been supportive of a Fed CBDC and has expressed concern about the risks posed by private forms of money. Chair Powell has been more neutral but also appeared sympathetic to the idea that a CBDC could crowd out private stablecoins and cryptocurrencies. Former Vice Chair for Supervision Quarles did not see a need for a CBDC and preferred to instead leave digital payments innovation to the private sector, but he left the FOMC before the new report was issued.

In the context of that debate, two specific arguments for a CBDC in the new report seem significant because they appear intended to answer the question of why the Fed should be involved.

The first argument is that it is important for the public to retain access to some central bank liability that is free of credit and liquidity risk. A CBDC would ensure that a Fed liability remains available even if use of physical currency for everyday transactions declines to the point where cash becomes inconvenient.

The second, related argument is that a digital central bank liability that is free of credit and liquidity risk would provide a firmer foundation for private sector innovation in the digital payments space than private stablecoins, which require mechanisms to reduce those risks that the reports says are inevitably "imperfect." The report is enthusiastic about potential technological advances such as programmable money, micropayments made possible by much lower transaction fees, and increased transaction throughput. But it argues that using a form of money free of credit and liquidity risk would make it easier and cheaper for firms to develop these technologies and less risky for the public to adopt them.

The report also runs through the standard list of benefits and risks of a CBDC, which we have discussed in the past. It notes that a CBDC could ease cross-border payments, support the international role of the US dollar, and increase financial inclusion. But if designed poorly, it could raise risks such as depriving banks of deposit funding, making bank runs easier during crises, and facilitating criminal activity.

The report notes that if the Fed does decide to introduce a US CBDC, it would be widely available to members of the public, who would access it via private financial service provider intermediaries, not via direct accounts at the Fed. It would also be privacy-protected, widely transferable, and identity-verified, rather than fully anonymous like cash. The report also notes that Fed researchers are still experimenting with multiple options for the underlying payments clearing technology, including both existing systems and newer technologies such as blockchain.

While we see the Fed's new report as sympathetic to a possible CBDC, it is still unclear if the Fed will ultimately introduce one. The report says that the Fed will only proceed with a CBDC if it concludes after further analysis and input from the public that the benefits outweigh the risks and that a CBDC is the most effective option for achieving those benefits. In addition, the Fed would need the support of the White House and Congress, ideally in the form of an authorizing law.

David Mericle

Disclosure Appendix

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