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The Fed needs to tread carefully on road to a digital dollar

By Jodie Kelley | October 15, 2021

Everyone is talking about digital currencies. Pundits, policymakers and business leaders are gushing over the promise — or fretting over the uncertainties — of these intangible electronic dollars, and for good reason. This exciting technology holds enormous promise.

But the risks associated with these currencies are tangible and real.

Although public attention has mostly focused on the volatility of cryptocurrencies like Bitcoin, conversations about central bank digital currencies are increasingly heating up in Washington.

A CBDC is a digital form of a nation's currency, issued and managed directly by a country's central bank. According to the Bank for International Settlements, 86% of the world's central banks are exploring CBDCs, with more than one in 10 currently engaged in pilots. In June alone, Congress held four major hearings on digital currencies, and the Federal Reserve announced it will publish a report on CBDCs this fall.

At a superficial level, the rationale for adopting a CBDC seems obvious. After all, the U.S. domestic payments system is already digital. Anyone who has purchased groceries with a credit card, paid bills online, or used an app to pay a babysitter knows this. Money moves digitally all the time, and the secure, interconnected, ubiquitous systems over which it moves are innovating and improving every day.

As the Fed itself has recognized, however, with a CBDC there is a critical need to move cautiously to ensure that no action taken inadvertently does more harm than good. For example, if customers hold their CBDC outside of banks, the loss of capital could adversely affect banks' ability to lend money. Thus, depending on how it's structured, a CBDC could actually make it harder for consumers and small businesses to obtain loans.

The need to do no harm is particularly acute because the existing payments system, as Fed Chair Jerome Powell has noted, is "already safe, effective, dynamic and efficient." Within that system, new products and services are constantly being introduced to make it easier for consumers to participate. eCash, for example, allows cash-based consumers to make purchases online. DailyPay allows employees, many of whom live paycheck to paycheck, to get their hourly wages earlier than their regularly scheduled paycheck. Prepaid products, through which millions of individuals already receive government benefits, allow consumers to conduct their daily financial transactions without a bank account. And peer-to-peer services offer consumers an ever-expanding way to receive, hold and spend money.

The question becomes, what is the problem policymakers are trying to solve with a CBDC?

Some have cited China's race to develop the digital yuan as a compelling reason to create a U.S. CBDC, but that concern is overstated. The dollar is the world's reserve currency because of the size and strength of the U.S. economy, and the introduction of CBDCs by other countries does not change that. Domestically, innovation is already bringing new products and services that allow broader participation in the financial system, and it is not at all clear that introduction of a CBDC would meaningfully accelerate that trajectory.

None of this suggests that we shouldn't explore how a digital dollar might work in practice and how it might advance the national interest. Depending on design, CBDCs might introduce choice and efficiencies, with potentially interesting possibilities in the wholesale and cross-border contexts. Indeed, at my organization, the Electronic Transactions Association, we have developed seven principles that we believe should guide exploration of a potential CBDC. These principles are designed to ensure that we fully leverage the existing system, which already makes digital transactions possible for all Americans, while continuing to ensure that consumers are protected.

We must be clear-eyed, however, about what we're trying to do.

Whatever is proposed must be the best solution to the problem, and it can't unintentionally inject problems that outweigh any positives. As Fed Chair Powell said in May, "We do think it's more important to get it right than to be first, and getting it right means that we not only look at the potential benefits of a CBDC, but also the potential risks, and also recognize the important trade-offs that have to be thought through carefully." We agree.

Our existing "safe, effective, dynamic and efficient" system is already a win for American consumers and businesses. Let's ensure that any fundamental changes to that system — including a potential CBDC — actually promote financial inclusion, offer the same unparalleled protections as the current system and do not stifle innovation, weaken acceptance or undermine the sophisticated and interconnected payments infrastructure that has been developed over decades.