Central Bank Digital Currencies Are About Control – They Should Be Stopped

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Last week I participated in an online forum called *US CBDC—A Disaster in the making?* It was hosted by Sustany Capital's Christian Kameir, and we had a very productive discussion about the *policy* aspect of central bank digital currencies (CBDCs).

While our panelists agreed that there is very little chance the Fed will launch a fully functional CBDC in the next year or two, we did not necessarily agree on whether that was good or bad.

I believe that the Fed should not launch a CBDC. Ever. And I think that Congress should amend the Federal Reserve Act, just to be on the safe side. (Kudos to Rep. Emmer (R-MN).) That position puts me at odds with the army of consultants who have been churning out papers and proclamations on CBDCs, most of whom seem only to question *when* the Fed will launch a CBDC.

So, I was elated that our panel focused on the pure policy questions related to whether the Fed should launch a CBDC. And the experience only strengthened my resolve to keep writing about why the Fed should not. So, here goes.

As a starting point, I want to distinguish between a wholesale CBDC and retail CBDC.

With a wholesale CBDC, banks can electronically transact with each other using a liability of the central bank. Because that is essentially what banks do now, transact and settle (electronically) using reserve accounts held at the Fed, there aren't very many new and interesting wholesale CBDC policy issues. (Basically, the Fed has had a wholesale CBDC for decades.)

But *retail* CBDCs are another animal altogether.

Retail CBDCs allow members of the general public to make electronic payments of all kinds with a liability of the central bank. As the Fed's recent CBDC report states:

While Americans have long held money predominantly in digital form—for example in bank accounts recorded as computer entries on commercial bank ledgers—a CBDC would

differ from existing digital money available to the general public because a CBDC would be a liability of the Federal Reserve, not of a commercial bank.

This feature–making electronic transactions using a liability of the Federal Reserve–is central to why Congress should make sure that the Fed never issues a retail CBDC. The problem is that the federal government, not privately owned commercial banks, would be responsible for issuing deposits. And while this fact might seem like a feature instead of bug, it's a major problem for anything that resembles a free society. (Paper currency is also a liability of the Fed, but that fact means very little with freely circulating fiat money, especially when private banks issue deposits.)

Some CBDC supporters argue that privately issued money can coexist with a CBDC, but this view is extremely short-sighted. Even most central banks fear that providing accounts directly to consumers risks disintermediating the financial system, a fear that surely helps explain Jay Powell's public stance on retail CBDCs. It also helps explain the Fed's fascination with an "intermediated" CBDC, whereby private banks have the privilege of servicing the consumers' needs even though the liability remains with the central bank. Ultimately that system is no better. (At best, it would slow the disintermediation while entrenching a group of privileged firms).

Regardless, the two forms of money cannot peacefully coexist *unless* the government hands out special privileges or subsidies. The two electronic mediums would be near perfect substitutes, and the main difference for consumers and merchants is that the Fed's version would automatically come with zero credit or liquidity risk. Private firms can't compete on that dimension, and they (unlike the Fed) have to recover their costs to stay in business.

The Fed's report even acknowledges this high degree of substitutability:

Banks currently rely (in large part) on deposits to fund their loans. A widely available CBDC would serve as a close—or, in the case of an interest-bearing CBDC, near-perfect—substitute for commercial bank money.

The only problem with this statement is that it says nothing about the degree of substitution between a *non*-interest bearing CBDC and commercial bank money. Commercial bank money that serves as a medium of exchange generally earns little to no interest, so even a non-interest-bearing CBDC is a near-perfect substitute for commercial bank money.

Still, the interest-bearing version is particularly relevant to the policy discussion.

The Fed's current operating framework depends on paying interest to banks for their reserves. No version of reality exists without political pressure for the Fed to pay individual CBDC holders *at least* the same rate of interest as it pays banks on reserves, and even that level of payment increases the risk of disintermediation.

Similarly, the political pressure will always be to expand the pool of people using the CBDC. While CBDC proponents currently speak of helping only the "unbanked" and the "underserved," there is absolutely no chance that those groups won't soon be more broadly defined. (Apparently, there's also no chance that CBDC proponents will acknowledge that broader economic

problems, not a lack of digital money, keep these folks out of the banking system. But that's another column.)

And the political reality is that CBDC advocates want to use public funds to provide something (money) at a lower cost than the private sector. Setting aside the incredibly rich irony that government rules and regulations are a primary driver of that cost in the first place, as well as the fiction that the government providing something means the cost is actually lower, this policy equates money with a public good. That is, CBDC advocates do not care if the private banking system is completely disintermediated–they want the government to provide money.

But money itself is not a public good. The fact that its production has been increasingly encroached upon by the government is irrelevant. And the fact that something called a CBDC even exists is only due to payment innovations that occurred in the private market. The CBDC itself is mainly the government's attempt to protect its privileged position and exert more control over money.

The problem is that there is no limit to the level of control that the government could exert over people if money is purely electronic *and* provided directly by the government. A CBDC would give federal officials full control over the money going into–and coming out of–every person's account.

This level of government control is not compatible with economic or political freedom.

If Congress really wants to provide more access to financial markets and ensure more innovation in financial services, members should support more private innovation and competition. They should work to lessen government monopoly and regulation while ensuring that the Fed cannot issue a CBDC.

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