Roll Call

Fintech experts divided on form for U.S. central digital currency

Rapid progress elsewhere could threaten U.S. hegemony over global finance, and the current payment system is leaving some Americans behind, advocates argue

Peter Feltman

October 27, 2020

Financial technology experts agree that some form of digital payment system by the U.S. central bank is inevitable, although opinions diverge on the form it should take.

Rapid progress on a central digital currency elsewhere could threaten U.S. hegemony over global finance, and the current payment system is leaving some Americans behind financially, fintech advocates argue. China and Singapore are experimenting with digital currencies and may soon be joined by Russia, Japan and Sweden. In addition, private companies, including Facebook Inc., have proposed their own digital currencies that may challenge traditional payment networks.

In the U.S., a central bank digital currency, or CBDC, issued by the Federal Reserve, would be in the form of instantaneously transferable electronic dollars, unlike the digital dollars in bank accounts today, which require trusted parties to agree that the funds are available before a transfer can take place.

Congress has explored whether a CBDC would help get government funds such as COVID-19 relief payments into the hands of underbanked recipients sooner.

Groups studying the idea include The Digital Dollar Project, headed by Christopher Giancarlo, the former chairman of the Commodity Futures Trading Commission. The project supports maintaining the banking system, which would supply consumers with the central currency, although it wouldn't be like retrieving cash from ATMs.

“There appear to be a number of forward-leaning banks and bankers who see some of the opportunities with respect to CBDC, or at least are actively exploring the potential,” said Daniel Gorfine, a Georgetown Law professor who is working on the project. He said in an interview that central bank digital assets could help the underbanked by reducing costs.

“This is why we need to conduct real-world testing,” he said.

Giancarlo previously worked with Gorfine, appointing him in 2017 to run LabCFTC, an in-house think tank focusing on cryptocurrency and other tech issues.

Morgan Ricks, a professor of law at the Vanderbilt Law School, said there is a widespread view that a CBDC will improve inclusion, but he doesn’t support the use of a distributed ledger to track a Fed digital currency. Digital ledgers, such as blockchain, are non-centralized networks that rose to prominence as the backbone of cryptocurrencies such as Bitcoin.

“I think it would be a mistake to go for a blockchain solution,” Ricks told CQ Roll Call. “It’s slow and inefficient, and it doesn’t solve any problems.”

Instead, Ricks said he supports having the Fed keep records of the CBDC through its own central ledger. “Central ledgers work fine,” he said. “There’s nothing magical about distributed ledgers.”

What policymakers should think about, he said, is a system that can maintain balances and clear payments in real time and on a huge scale. The distributed ledgers in place today cannot match the Fed’s ability, he said.

Another question for policymakers is whether customers could keep their currency in an account with the Fed itself. Doing so could change the shape of banking, according to Diego Zuluaga, associate director of financial regulation studies at the Cato Institute’s Center for Monetary and Financial Alternatives.

Threat to commercial banks?

Keeping funds with the Fed would be the ultimate in safety, even more so than in an account insured by the Federal Deposit Insurance Corporation, he said. However, shifting funds to the safer Fed could reduce lending because banks make loans based on the deposits they get.

Zuluaga raised the issue of whether the Fed would pay interest to consumers, which would further incentivize them to pull money from banks.

“The danger I see there is that there is a massive shift of funds,” he said in an interview, “either permanently when this is launched or cyclically every time there is a lack of confidence in the economy or a fear that some banks might fail.”

One solution would be to cap the amount in a Fed account to match that covered by the FDIC, setting a “ceiling on how much money any individual person could hold at a central bank account; otherwise, the central bank would have a competitive edge,” he said.

The Fed currently pays banks that keep deposits with it, and at a higher rate now than most checking accounts. Thus, a bank can take checking account funds and make a profit by depositing them with the Fed instead of lending them out.

“It’s one of the reasons banks have not lent as much in proportion to their deposits as they used to,” Zuluaga said.

Some argue that a central digital currency itself isn’t the solution.

“The goal is not to have a CBDC. That’s a means to an end,” Lee Reiners, executive director of the Global Financial Markets Center at the Duke University School of Law, told CQ Roll Call. The goal instead should be to improve the “antiquated” U.S. payment system, which lags behind much of the rest of the world and still takes multiple days for payments to clear, he said.

Reiners expects the Fed to work to improve the system and only resort to a CBDC if it fits the effort.

If a central digital currency is adopted, a key question is whether it should have a token model of verification or an account-based model. With tokens, a digital currency technology verifies the token itself and establishes that it’s real, similar to a storekeeper verifying a $20 bill. An account system verifies the party sending cryptocurrency and uses this information to update balance information.

One disadvantage to tokens is that if they are lost, the consumer may never get them back, a major problem with Bitcoin. Vanderbilt’s Ricks said he prefers an account system. The customers of banks have protection in the event of fraud, and he supports establishing similar protection for digital accounts.

The Digital Dollar Project promotes tokens held in digital wallets run by regulated financial institutions. Digital wallets allow storage of currencies on computers or mobile apps. It declines to take a position on digital wallets offered by nonregulated groups.

How digital wallets would work with central currency needs to be explored, Reiners said.

“This is something the Fed and Congress could have a say in, in terms of who is allowed to provide wallets,” he said.