

The Fed keeps us guessing on the future of a digital dollar

In its long-awaited Central Bank Digital Currency discussion paper, the US Federal Reserve gives a very neutral overview and doesn't shed much light on its own appetite for a "digital dollar". The paper does raise great questions and should be the start of an overdue fundamental debate



Fed chair Jerome Powell had originally announced a central bank digital currency (CBDC) discussion paper for Summer 2021, but agreeing on the text took the Fed Board just a little longer. Instead of positioning itself in favour of or against CBDC [in this paper](#), the Fed provides a neutral overview of money, digital assets and the potential pros and cons of a CBDC. The Fed does provide a clear list of conditions that a "digital dollar" should satisfy:

- Its benefits should outweigh costs and risks;
- Said benefits should be realised more effectively than via alternative methods, such as private stablecoins;
- The digital dollar should complement, not replace, current money forms and payment methods;
- It should protect privacy while also protecting against criminal activity;

- It should be supported broadly by "key stakeholders".

The Fed's open mind contrasts with Frankfurt firmness

Some of these conditions may sound like a no-brainer but in practice, they are not. The conversations about CBDC across the globe are complicated. Economic arguments are mingled and sometimes confused with public policy and strategic considerations. Officials at the Bank for International Settlements call for CBDC as a matter of principle, saying it is "[an idea whose time has come](#)". The ECB states it needs "to ensure that [people] can readily access and use central bank money in digital form too", and has embarked on a two-year investigation, [focusing strongly](#) on technical and operational issues.

Although a multitude of, sometimes conflicting, CBDC goals is being mentioned by central bankers and policymakers in Europe, a thorough discussion about why a CBDC would be the best answer to the (very real) questions about e.g. monetary sovereignty, financial inclusion, strategic autonomy, is hard to come by.

Sweden is conducting a fundamental inquiry in the State's role in payments

Meanwhile, the Swedish Riksbank, widely considered as an early pioneer in CBDC research outside China, did ask existential questions, alongside its research into the technical architecture for an "e-krona". Already back in 2019, the Riksbank [concluded](#) that considering a CBDC "is not a question of a narrow inquiry into an e-krona, but of a broad inquiry in which the question of whether the state shall issue a future e-krona [is] only one component". This broader government-commissioned research is [currently underway](#), with results expected by the end of this year.

The UK House of Lords recently looked at CBDC as well and concluded that it is "a solution in search of a problem", at least for now. Importantly, the Lords [did note](#) that "the case for a digital pound may change in the future". That sounds like a great conversation starter.

The Fed does see potential digital dollar use cases

And now the Fed is finally joining the fundamental debate too. Of course, it prepared well. It already concluded that if a digital dollar ever sees the light of day, it would be "privacy-protected", it would be offered to the general public by private intermediaries, it would be "widely transferable" between intermediaries (or in tech parlance: it would be interoperable), and it would be "identity-verified" (meaning no anonymous usage).

The Fed also identifies a number of potential use cases for a digital dollar, by pointing to shortcomings in the current system. It notes that 7% of US households are unbanked, while another 20% do have bank accounts, but rely on more costly (non-bank) financial services. A CBDC might help here.

The digital dollar may be a necessary defensive move

The average 5.4% fee for remittances sent from the US is also identified as an obstacle to

economic growth and equality. A CBDC may reduce costs of international transfers too, though the Fed notes this requires difficult cross-border coordination.

The Fed does not see the digital dollar as an offensive tool promoting the (already dominant) international role of the dollar. The digital dollar may be a necessary defensive move though if other countries (most notably China) successfully deployed CBDC to bolster the international role of their domestic currency.

Stablecoins are the hot potato

The paper is brief on private stablecoins (such as Tether, USDC or Diem), referring to a [recent joint report](#) by the President's Working Group on Financial Markets, and saying little more than that stablecoins could make payments more efficient, but also pose new risks that need to be addressed. The brevity reflects deep divisions in the Fed Board about whether to embrace private stablecoins (advocated by Governor Waller, a self-declared CBDC sceptic) or to favour CBDC instead (like Governor Brainard).

The Fed concludes its paper by asking whether potential CBDC benefits could be better achieved in different ways and whether CBDC would be a net positive or negative for financial stability. It also asks whether CBDC should be legal tender. With these kinds of questions raised by the world's leading central bank, the global debate about CBDC has entered the next phase.

The first phase was triggered by Facebook's announcement of Libra (now Diem) back in 2019. This invited a near-global backlash among policymakers, and a "we need CBDC and we need it now"-response among central bankers. By now putting these fundamental questions on the table, and by stating that the Government, Congress and other key stakeholders all need to support a digital dollar, the Fed is pushing for a holistic and fundamental debate about CBDC. This is shaping up to be a highly interesting year for CBDC, and for the longer-term setup of the financial-monetary system in general.

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