

Does the U.S. need to have a digital dollar?

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A cryptocurrency is a digital asset used as a medium of exchange where ownership is recorded in a digital ledger, i.e., a decentralized database using cryptography to secure and verify the transfer of ownership. Bitcoin, first released as open-source software in 2009, is the first decentralized cryptocurrency. Since the release of Bitcoin, over 6,000 altcoins, i.e., alternative variants of bitcoin, or other cryptocurrencies) have been created. This evolution of cryptocurrency has led to two new and unique varieties of digital currencies. There are stablecoins and central bank digital currencies (CBDCs). Both are getting a lot of attention these days thanks to the combined efforts of Facebook and the People's Bank of China to shake up the financial sector. We have even seen a proposal(s) for a US central bank digital currency (CBDC). Let's examine how that fits into the broader geopolitical environment.

A stablecoin is a cryptocurrency backed by a quantifiable asset such that it has monetary value. Facebook's Libra proposal will be a stablecoin backed by a basket of fiat currencies, including the US dollar, the British sterling pound, and the Japanese yen. A CBDC is a digital representation of fiat currency. Two current examples include China's CBDC, known as digital yuan and Venezuela's Petro, which will be replacements of their respective country's coins and printed bills. Both rely on blockchain technology to work. Transaction and user information is protected through encryption. CBDCs are not privately owned. They are created, maintained, and owned by central banks. Currency control is another aspect to consider. Stablecoin control rests solely in the hands of developers, miners, and coin owners. Currency control in a CBDC scenario always belongs to a central bank. Control of China's CBDC rests solely with the People's Bank of China.

The Federal Reserve has been [examining the potential of a CBDC](#). The [digitaldollarproject.org](#) led by former US Commodity Futures Trading Commission (CFTC) Chairman Chris Giancarlo is proposing a framework for the creation of a US CBDC. It advocates for a two-tiered banking system that preserves the current distribution architecture and its related economic and legal advantages while inviting innovation and accessibility. Under this model, the Fed would issue digital dollars to banks, while users could either store funds in their accounts or hold onto these tokenized dollars in their digital wallets. The bank would be able to lend against the funds held in accounts. The coronavirus crisis has also put focus on the digital dollar debate. [US House and Senate bills](#) proposed in March would allow individuals to maintain a direct account with the Fed consisting of digital money and no intermediary bank providing immediate relief to US residents.

Not everyone thinks a US CBDC is a good idea. In a recent report titled, *You say you want a revolution: Considering central bank digital currency*, JP Morgan Chase warned that a US CBDC would have a negative impact on the dominance of the US dollar in the global economy. The report suggested that such CBDCs can hurt the US dollar both in the area of trade settlement and the prevalence of the US dollar within the SWIFT (Society for Worldwide Interbank Financial Telecommunications) messaging system. Every day, nearly 11,000 SWIFT member institutions send approximately 33.6 million transactions through the network predominantly involving US Dollars. The report also highlighted that even the European regulators want to reduce the dominance of US dollars from the global payment system. In 2018, SWIFT suspended the access of multiple Iranian banks following US sanctions, and the move might have violated EU laws. If countries can circumvent the SWIFT system, it would be difficult for the US to put international sanctions and terrorist-financing enforcement.

There are other issues to address. How would a US CBDC handle privacy? Crypto industry leaders and law experts have debated the privacy implications of central bank digital currencies. The question is will utilizing an improved US CBDC over our antiquated ACH payment system be worth the cost of privacy, control, and surveillance. Former Fed chairman Larry Summers has argued that supporting the anonymous movement of multimillion-dollar sums of money should not be an objective of fiscal policy. Christopher Giancarlo has asserted that a state-issued virtual currency affords opportunities to code nuanced privacy-balanced individual rights with the oversight needs of government. Dante Disparte, the vice chairman of the [Libra Association](#), has argued that a plurality of private and digital currencies will best serve the public, allowing individuals to choose to use whichever protocols best serve their needs. How does a US CBDC foster economic inclusion if it requires owning a smartphone? Marginalized individuals who do not have access to mobile phones may be excluded from the benefits of the digital society in the absence of a prerequisite tool with which to interact with digital financial services. In this way, CBDC-linked mobile money may risk worsening both digital inequality and financial inclusion among the most vulnerable and socioeconomically excluded from society.

Before we take a giant leap forward, we might consider developing pilot programs and validation tests for use cases such as domestic payments, international payments, or government benefits, and range from direct peer-to-peer payments to issuing government aid in response to disasters. Chris Giancarlo has suggested that these pilot programs be evaluated based on a number of factors, including the impact on the money supply, technological choices, privacy from both government intrusion and commercial exploitation, impact or use in sanctions and compliance with AML/KYC laws. This will also require lawmakers and policymakers to execute any potential CBDC solution. This process of building a digital dollar will take years, and it is way too important to be done hastily. CBDC's are poised to alter our financial infrastructure in unprecedented ways over the next five or so years. Participants in the financial system should use this time to analyze potential implications, prepare for possible disruptions, and begin actively exploring what role they want to play and what partnerships they need to strike to maximize their value and use of digital assets and currencies.

The Withers team can help their financial partners with the legal and technology expertise to stay ahead of developments.

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