

Federal Reserve Shares Update on Central Bank Digital Currencies

August 28, 2020

While participating in the Federal Reserve Bank of San Francisco's innovation office hours on August 13, Federal Reserve Governor Lael Brainard reported on the [Federal Reserve's ongoing research](#) and experimentation related to distributed ledger technologies (DLT) and the potential use for digital currencies, including central bank digital currencies (CBDCs).¹ The report comes at a time when CBDCs have received increased attention from central banks across the world,² which see the potential of CBDCs to modernize and develop more resilient payments infrastructure,³ as well as provide new tools for monetary policy transmission. As Governor Brainard explained, the COVID-19 pandemic has underscored the importance of immediate and trusted access to funds for the many households and businesses that face cash-flow constraints.

The Fed's CBDC efforts

Governor Brainard detailed the Federal Reserve's multi-pronged approach to understanding the significant policy implications of CBDCs and getting hands-on experience of the technology's opportunities and limitations, which includes in-house experimentation conducted through the Federal Reserve Board's Technology Lab, a multi-year collaboration with Massachusetts Institute of Technology's Digital Currency Initiative to build and test a hypothetical digital currency and participating in the CBDC coalition of central banks focused on challenges such as cybersecurity and anti-money laundering. She noted that given the US dollar's important role, the Federal Reserve must remain on the frontier of research and policy development regarding CBDCs. However, since the US dollar continues to be in strong demand, Governor Brainard noted that the Federal Reserve remains committed to ensuring the public has access to a range of payment options.

International competition

To maintain the US dollar as the world's reserve currency and the "anchor of the nation's payment systems," the Federal Reserve must remain on the frontier of research and policy development regarding CBDCs.⁴ While DLT's first challenge to the US dollar came in the form of private money, such as Bitcoin, and subsequently stablecoin projects like Facebook's Libra,⁵ today the US dollar faces increasing challenges from other countries that are forging ahead with the development of their own CBDCs, such as China. This increased international competition has led to US regulators and nonprofit organizations such as the [Digital Dollar Project](#), led by former US Commodity Futures Trading Commission Chairman Chris Giancarlo, to advocate for the US to "take a leadership role in this new innovation."⁶

Privacy

Another often-discussed policy implication of the adoption of CBDCs is the impact it would have on the consumer privacy.⁷ While CBDCs and other DLT-backed digital currencies offer the potential to improve tracing and automate anti-money laundering and terrorism financing compliance, they also run the risk of being exploited by state actors to track all financial transactions.

International competition to develop CBDCs is in turn heightened, given that society's preferences significantly differ regarding how to balance the tension between privacy and transparency.

New monetary tools for central banks

CBDCs offer an array of new monetary tools that are not possible using the current payments infrastructure and also increase the potential for monetary policy transmission. The ability for a central bank to dynamically adjust the interest rate on cash-like instruments, potentially even crossing the zero interest lower bound to negative interest rates, would give central banks a powerful counter-cyclical tool. CBDCs potentially also offer a better way to deliver stimulus payments to populations than the current system, which has shown to be inefficient and slow. Finally, the programmability of CBDCs could enable regulators to treat individual units selectively (i.e., non-fungible cash), for example, to restrict stimulus payments to being spent on certain types of items.

Notes

1. Gov. Lael Brainard, [An Update on Digital Currencies](#), Remarks at the Federal Reserve Board and Federal Reserve Bank of San Francisco's Innovation Office Hours.
2. More than 80% of central bank respondents to a Bank for International Settlements survey in 2019 reported engagement in CBDC projects. One in 10 of these banks, representing approximately one-fifth of the world's population, deemed it likely that they would offer CBDCs within the next three years. See C. Boar, H. Holden, and A. Wadsworth, [Impending Arrival – a Sequel to the Survey on Central Bank Digital Currency](#), BIS Publication 107, 2020.
3. In a related development, the Federal Reserve has [recently announced the launch of FedNow](#), a 24x7x365 service that “will enable individuals and businesses to send instant payments through their depository institution accounts.”
4. A whitepaper published in August 2020 noted that while several central banks have already completed or are in the process of initiating advanced stage pilots, only a handful of central banks are likely to progress toward full project implementation and issue a digital currency within the next five years. See *A Global Look at Central Bank Digital Currencies – From Iteration to Implementation* commissioned by Blockset and KPMG LLP.
5. Libra Association, [Libra White Paper](#) (April 2020).
6. Digital Dollar Project, [Exploring a US CBDC](#) (May 2020).
7. To a large extent, the impacts of CBDCs on privacy and other policy issues would turn on (i) the relative adoption of CBDCs as compared to other methods of payments, and (ii) their specific architecture, most notably whether a particular CBDC was developed as (a) a “wholesale” or synthetic” CBDC (only available for transactions amongst banks and other financial intermediaries) or (b) a “retail” or “account-based” CBDC (where the ultimate consumers would be able to transact in CBDCs, directly held in accounts at the Federal Reserve or other banking institutions).

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