PBS NEWS HOUR

Why the U.S. is eyeing a digital dollar

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With **fewer consumers** using cash on a regular basis and more countries adopting virtual currency, the New York Federal Reserve Bank and several other major banks last month **launched a 12-week pilot program** to test the use of a digital dollar. But some experts and activists question whether a digital currency will live up to its potential, like making banking more affordable.

The program is the latest step by the central bank to begin its rollout. These efforts also follow the **introduction of the eCash Act in March** by Rep. Stephen Lynch, D-Mass. The bill, which was cosponsored by three other Democratic lawmakers but not passed by either chamber, would call on the Treasury Department to take steps toward implementing a digital currency minted by the government.

"The reality is that cash — that is, physical currency — is on its way out in practically every economy in some countries....The use of cash is already plunging and I suspect the day will come even in the U.S. when currency is not used anymore," said Eswar Prasad, a professor of trade policy at Cornell University.

WATCH: U.S. backed digital currency could live alongside certain cryptocurrencies

Using digital tokens representing deposits from customers, the pilot will be testing how those tokens are "settled" through the central bank using a ledger shared by the institutions.

When implemented correctly, a central bank digital currency can make transferring money easier and lower costs for individuals and businesses — particularly for people who cannot afford to use traditional commercial banks. But it could also become a privacy threat, experts say.

Once an obscure part of financial technology, digital currencies have become more mainstream in the last five years — particularly, as interest in the cryptocurrency bitcoin has grown. Cryptocurrencies have offered a method of payments outside of formal banking systems but interest surged as they also became the object of financial speculation, with fortunes quickly won and **many more easily lost.** When cryptocurrency exchange **FTX collapsed** last month, ordinary customers were left unable to withdraw their funds, triggering investigations by **the SEC**, **the U.S. Attorney's Office in New York** and **Congress**, and **charges against former CEO Sam Bankman-Fried**.

WATCH: The effects of FTX's collapse on the cryptocurrency industry

Central bank digital currencies like the one the Federal Reserve differ from cryptocurrencies in important ways. Many cryptocurrencies can be generated by anyone with the ability to "mine" the currency, using computers to solve complex equations. But a central bank digital currency is one issued and backed up by – you guessed it – a central bank, just as a hard currency is.

With cash being replaced by digital transactions in many settings, Prasad said the question for the central bank "then becomes whether it will maintain the viability of its money at the retail level by issuing a digital form of its currency."

Digital currencies have been launched or are being tested by at least 15 central banks, including those of China, Canada and Jamaica, for a variety of reasons. China, which began piloting **its digital currency** in 2020, expanded the digital yuan ahead of the 2022 Olympic Winter Games. According to some experts, the digital yuan could create an international currency to compete against the dollar, as well as create a system of payments similar to those developed by Chinese companies like WeChat or AliPay. The Eastern Caribbean Reserve Bank, which is unique in that it issues currency for eight countries, created a digital currency intended to ease the costs of transactions across borders and provide financial services to people who do not use banks.

Prasad said central bank digital currency (CBDC) could help people without bank accounts gain access to financial services, including cashless payments.

"A CBDC might fill that gap and it might also create more competition, which could bring down the costs of digital payments in the U.S. and provide alternative options," Prasad said.

More accessible banking?

In the United States, 4.5 percent of households are "unbanked" (meaning that no one in the home has a bank account), **according to a 2021 survey by the FDIC**. Black Americans, Latinos and poorer people are more likely to be without access to banking. The most common reason given was that no one in the household had enough funds to meet the minimum deposit requirements. Because digital payment systems like Venmo or Apple Pay require the use of bank accounts or credit cards, people without those financial services can't use such payment systems, either.

Mario Small, Quetelet Professor of Social Science at Columbia University, said that services often used by unbanked people, such as payday lending, have largely moved online as well.

"In this space, you could imagine the creation of a central bank digital currency – as opposed to something like bitcoin – might have a positive impact," Small said.

But Small warns that new payment services like a digital dollar could also simply recreate the inequalities of existing financial services.

"I think the devil is going to be in the details," Small said. "My expectation would be that the people most likely to adopt digital currencies are going to be those people who are already well plugged in to both online financial services and also to the banking system. And so it is possible that if we're not careful about how to implement it, that would just exacerbate inequalities that already exist."

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Some central banks, including China's, have created digital wallets that allow customers to hold digital currency issued directly by the banks. But the U.S. Federal Reserve is unlikely to work directly with customers. According to the Treasury Department's **"Future of Money" report** published in September, allowing customers to hold digital currency with the reserve bank is one possibility, though the "more feasible model" is a two-tiered system that used intermediaries such as private banks to issue digital currency to customers.

"I think the Fed doesn't want to be in the position — and no central bank really wants to be in the position — of beginning to take deposits," Prasad said.

Prasad said taking deposits would push the Federal Reserve into also allocating credit, setting itself up as a possible competitive threat to commercial banks.

"No central bank really wants to create a threat to the commercial banking system because commercial banks are very important to creating credit in an economy. So I think from a central bank's point of view, I think the 'do no harm' objective would come into play here," he said.

But he suggested the government could require commercial banks to offer low- or no-fee services for customers making small transactions in digital currency, something other countries launching digital currencies have already started to explore.

J.W. Mason, associate professor of economics at John Jay College of Criminal Justice, is skeptical that a digital dollar is the way to address the issue of people lacking access to financial services.

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That notion has "been used to justify the Fed getting into the world of this exciting, cool new technology, which has a lot of people very excited, but really doesn't have anything particularly to do with the problems that have been identified," Mason said.

"There's a real problem to be solved there. But you don't really need a new currency."

Mason said regulatory changes, such as allowing the post office to **again offer banking services** or restricting the fees commercial banks charge, would be a better way to help those who are unbanked.

"You know, we can regulate banks. That is a thing we can do," Mason said.

Privacy concern or protection?

There are also possible privacy issues with a digital currency. U.S. dollars in the form of cash can be used without monitoring. Digital payment systems like apps and credit card leave records, and a digital dollar would likely leave a similar trail.

"This could go drastically in either direction in terms of our privacy rights," said Lia Holland of the digital rights organization Fight for the Future.

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Currently, payment apps such as Venmo or Cashapp can harvest data about what sort of purchases you make, which can be shared with third parties, often **for marketing purposes**. Retailers also commonly track specific consumers through online shopping, social media and loyalty programs. When it comes to the U.S. government, the Treasury Department monitors transactions that it suspects are **related to terrorist activity**, while the IRS requires that **taxpayers fill out a special form** if they receive more than $10,000 in one or related transactions to guard against financial crimes.

Prasad agrees that privacy would be a concern for a digital dollar and said that collecting user data is one of the reasons the Chinese government wanted to issue its own digital currency rather than allow the field to be controlled by private companies.

There, private companies that provided digital transactions "were gathering huge troves of data, which until recently they were not willing to share with the government," Prasad said.

On the other hand, Holland said a privacy-protecting digital dollar, one that did not try to profit using information about your financial behavior, would be an improvement over other payment services.

"The digital dollar could serve as a return to privacy," Holland said.

Some lawmakers have taken note of these debates. The proposed eCash bill called on the Treasury Department to pursue a digital currency in a way "**that replicates and serves the privacy, anonymity-respecting, and minimal transactional data-generating properties of physical currency**" and serves people who have been unable to afford traditional financial services like banks.

Despite that (unfulfilled) congressional effort to uphold consumer privacy, Holland said that the ability to surveil "digital transactions is incredibly tempting for legislators and lawmakers. And so for them to actually create a rights-preserving digital dollar, it would be an uphill battle.".

By – **Kenichi Serino**