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## **Stablecoins Are the Bridge From Central Banks to Consumer Payments**

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OPINION

*Credit: Shutterstock*

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As many still wait to receive the check from the Paycheck Protection Program and Health Care Enhancement Act, which is set to

distribute \$484 billion in an effort to boost the U.S. economy, it brings to the forefront the question of why central banks have still not created a true digital alternative to cash.

When completed, the Economic Impact Payment program will distribute 150 million payments. Eighty million people who received their 2018 or 2019 tax refund by direct deposit will receive direct deposits. The rest will primarily be paid using paper bank checks. As of May 6, 2020, there was \$1.87 trillion worth of Federal Reserve notes in circulation, which accounts for 5%-10% of all U.S. currency in circulation, with the remaining 90% sitting in financial institutions or electronic accounts. Just under half of the stimulus payments are sent via paper check, which incurs additional cost to the government and recipients (especially the unbanked, who will face exorbitant fees). This alone shows how misaligned the current banking infrastructure is in the U.S. with the reality of how money circulates today.

Financial systems as we know them are on their last legs due to persistent negative or barely positive interest rates. Open access internet protocols have unleashed a wave of creativity and growth in finance and beyond, but banking is not one of them. The reason stems mostly from the fact that successful open-access protocols for money and identity, while sorely needed, are conspicuously absent at present. A regulatory-compliant, fiat-backed tokenized medium of exchange can help to fill this gap. While [bitcoin](#) has led the charge for a new vision of cryptocurrencies, the emergence of stablecoins is possibly more critical by way of filling this gap. My co-founder at [Sila](#), [Shamir Karkal](#), [gave his opinion](#) on the role [FedNow](#) will have in modernizing U.S. payment systems, but FedNow is still five years away and focuses on updating an ACH [automated clearinghouse] system that has barely been improved upon since 1972.

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What is more troubling is the prevailing macroeconomic framework, which authorities use to guide macroeconomic activity, is based on outdated paradigms. Standard models that are supposed to govern money creation and interest rates, for example, still treat private banks as pure intermediaries, ignoring the fact that they are big, active, money-creating elements unto themselves. The fact that banks have their self-centered motivations and profit-making strategies injects significant additional complexity into the system.

Although the potential for sweeping change is sparking fervent innovation, many obstacles remain. How these digital networks get built and used are critical factors in ensuring they promote equity and accountability. New financial networks, and CBDCs in particular, could enable extreme levels of centralized control if not handled with care.

***See also: [Ajit Tripathi - 4 Reasons Central Banks Should Launch Retail Digital Currencies](#)***

New technologies for blockchain-based distributed ledgers are making it possible to create digital currencies far more efficient than the analog/digital U.S. dollar and purely digital bitcoin.

As stablecoin projects seeking to disrupt payments such as libra have enjoyed broad media coverage, they are also increasingly scrutinized by regulatory authorities. As the term “stablecoin” gained popularity in finance, its meaning has blurred. From a technology-agnostic perspective, I’ve concluded what a stablecoin is really is:

- should not be a form of currency
- should be usable without any direct interaction with the issuer
- should be tradable on a secondary market and have low price volatility in terms of a target quote currency

Jointly with my MIT colleagues, Prof. Alex (Sandy) Pentland and Dr. Thomas Hardjono, we had proposed the idea of a [Digital Trade Coin \(DTC\)](#) back in 2017. DTCs combine the best features of both cash and digital currencies and are mostly immune to policies of the central banks that control the world’s reserve currencies.

In the process of creating DTCs, the administrator will be in charge of real assets, sponsors will own fiat currency and the general public will own DTCs, which are always convertible into fiat at the current market price. If that sounds familiar to libra – its similarities to our [2018 paper proposing a Digital Trade Coin](#) may not be a coincidence.

## **Digital dollar**

The head of the Bank of International Settlements (BIS) Innovation Hub, Benoît Cœuré, said the ongoing coronavirus crisis had put the global conversation around CBDCs back in the limelight. CBDCs can give policymakers more effective tools to support the economy, particularly during times of crisis, while maintaining financial stability.

As we have seen in recent weeks amid the issuance of the stimulus packages to combat the economic impact of COVID-19, a flurry of “Digital Dollar” proposals have made it to Congress and more keep coming. The conversation around a central bank’s core role as the sole issuer of banknotes in circulation has also come to the forefront.

CBDCs, similarly to cash, would be conducted on a peer-to-peer basis. CBDCs open up possibilities for a more effective monetary policy, but also a chance of pushing interest rates into seriously negative territory and other controversial policies.

On the one hand, it offers the promise of increasing efficiencies in tax collection while reducing money laundering and illicit payments. On the other, it places too much government control over ordinary citizens.



DIGITAL DOLLARS: Former CFTC Chairman Christopher Giancarlo said building a digital dollar could take years, but work needs to start now to achieve this.

Source: CoinDesk archives

In principle, it would be possible to open a checking account at a central bank directly, thus making retail banks obsolete and crushing that industry. Bypassing input from private banks could ultimately give the government absolute control over the economy. It would also mean the government has a record of everything we buy – including

all the purchases we usually make via anonymous cash.

This idea is increasingly looking like a possible scheme, and countries such as China, the U.K., Singapore and Sweden have been studying the possibility of implementing such a strategy for the last few years. China has been leading the charge, with the introduction of libra seemingly accelerating the development of the Digital Currency Electronic Payment (DCEP) initiative.

Big data and the emergence of digital currencies and digital contracts could have a more significant role in influencing monetary policy. Rather than using historical averages to estimate what might happen in any economic system, it is possible now to completely simulate every individual trade and transaction and analyze all potential outcomes. CBDCs would make such analysis even more efficient but could come at a high cost to liberty and privacy. The critical takeaway here is that although the technology itself is decentralized by design it can be used to create centrally controlled systems.

## **Bottom-up better**

The idea of distributed ledgers is not new but modern technology has certainly given it a new lease of life. Digital cash is a promising avenue. If physical cash disappears, it is possible to imagine a future where everyone has direct access to central bank cash, albeit indirectly. Retail banks may bifurcate into narrow banks and investment pools.

The move towards fully digital currencies brings much-needed efficiency to U.S. payment systems, which could unleash a new wave of innovation in finance and beyond. With a whole new level of clarity, we (and the government) could learn to recognize and act on early-warning economic signals that arise from within the trillions of transactions recorded in a ledger, thus increasing system stability and safety.

But the focus on CBDCs raises many political and sociological concerns and provide significant obstacles to its ultimate implementation. The current innovations and testing of multiple forms of stablecoins could bridge the gap between total government control and current efficiencies in U.S. payment systems. The ultimate push will likely come bottom-up from fintech innovation, rather than top-down from the government. I, for one, think that is the best approach to make the best ultimate solution to fix the problems in payments today.

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Sep 10, 2020 at 10:00 UTC

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