Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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As we noted earlier today, the Federal Reserve Bank of Atlanta's digital-payments paper is startling in its conclusion that under-served consumers would do better without banks. Perhaps banks deserve rebuke, but it's unusual for a Federal Reserve Bank to pooh-pooh the benefits of regulated banks instead of deciding how best to add yet more regulation. Another unwritten law of central banking is agnosticism about the relative merits of market competitors other than when it comes to safety and soundness. In part because they are so ground-breaking, the Atlanta Fed's recommendations will make a difference given that the Biden campaign espoused postal banking, Democrats favor "Fed accounts", and the OCC plans new payment charters. Now, advocates for these ideas and more than a few others have a Federal Reserve Bank at their back.

Timing can indeed be everything. Although the paper carefully asserts its unofficial status, its lead author is the Atlanta Fed's president, Raphael Bostic. It also comes at a time when Atlanta has joined other Reserve Banks to look for ways to enhance racial equity. Proposals promoting financial inclusion are critical to this effort, placing this paper squarely also in the midst of the "third-mandate" debate that will drive much of what Democrats demand of the Fed in a Biden Administration.

The Atlanta paper does note some obstacles to its brave new digital world, most notably the digital divide we highlighted in a recent ***EconomicEquality*** blog post. It also states that several of the most critical digital-payment unanswered questions – i.e., ensuring consumer privacy – are beyond its scope. It also acknowledges that, even though going cashless is in its view more than good for LMI consumers, some ornery ones might take some convincing.

However, there's an app for that: a "public banking utility." It is here that I think the Atlanta Fed paper could have an impact not only on the looming debate over postal banking, public banks, and Fed accounts, but even over the future of the Fed. After all, isn't the Federal Reserve System already the equivalent of a public-banking utility for traditional payments? Why not just expand its scope to ensure that digital payments have a home even as the central bank's own digital currency remains under review?

There are lots of ways to do this – BigTech companies for example think the Fed should simply open the payment system to nonbanks, an idea the IMF favors if nonbanks post sterile reserves to back their contingent risk. The OCC has adopted a similar approach for its new stablecoin charter and could do so as well for its payment banks. Another approach recently proposed by progressive House Democrats would have the Fed fund public banks that then access the

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payment system – i.e., pretty much what the Atlanta Fed proposes but with a central-bank price tag.

If Republicans control the Senate next year, they will likely block any payment public utility that needs a statutory key to open its doors. However, the Fed may well have the discretion to serve whomever it chooses on terms and conditions largely of its liking. Neither the Federal Reserve Act of 1913 nor the Monetary Control Act of 1980 foresaw digital payments or the universe of nonbanks ready and able to provide the services needed to expand them. Thus, it's not so much what the Fed can do to redefine the fundamental structure of U.S. retail finance – it's what it wants to do that determines the future. In this context, the Atlanta Fed paper warrants a careful read.