Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

DATE: April 18, 2022

One of the really sort-of sweet things about many who espouse the inevitability of digital assets is boundless hope for crypto domination derived from little knowledge of how the financial system actually works. Last week, a prime example surfaced on Reuters, which touted a plan by which $10 billion of bitcoins would supplant the dollar as the global reserve currency. Here's to hoping, but the total USD money supply clocks in at close to $22 trillion, suggesting one might need more than a few billion to make even a bit of a dent. Digital currency may well reign supreme, but it won't be much more than a speculative bet until someone figures out how to integrate it into legacy systems and market, policy, and regulatory realities.

One might say that using M3 as the measure of the dollar's power is unfair. So, let's use just currency in circulation. That's a lot less, but still a formidable $2.3 trillion, a number not only humbling to entrepreneurs, but also progressive Democrats crafting a new form of digital currency via the U.S. Treasury.

Our in-depth analysis assesses this "e-cash" legislation. The idea here is to create a digital asset that is identical to physical dollars in all but physicality. This may be a worthy effort, but it won't be easy.

Take just one issue: the bill mandates that e-cash be fully private and anonymous but also ensures effective AML enforcement. Quite simply, that can't happen.

Still, as physical-cash transactions shrink, the absence of an electronic substitute with instantaneous convertibility becomes increasingly vital for those unable or unwilling to open bank accounts, especially for the 5.9 million Americans who get paid via cash or similar non-deposit instruments. And, if e-cash advocates can work out another contradiction in their design – using e-cash as the payment vehicle for government benefits, while keeping anonymity – then many millions more would benefit from faster and more certain receipt of essential funds. As a BIS study last week laid out, digital forms of fiat currency might – just might – have meaningful inclusion benefits. Given how increasingly unequal the U.S. has become, anything that's inclusive is something to be carefully considered.

Much must be settled before the inclusion benefits of digital fiat currency are assured. For example, the e-cash bill mandates that its new form of fiat currency must ensure payment finality along with instantaneous clearing without restricting paying agents to regulated entities with proven operational capabilities and the capital and liquidity to back this up. While it's theoretically wonderful to give lower-income families instant access to fiat currency, these families would be devastated if even a little goes missing – 37 percent of Americans said earlier this year that even a "surprise" $100 loss would seriously set them back.

2101 L Street, N.W. – Suite 300
Washington, DC 20037
Phone: 202.589.0880

E-mail: info@fedfin.com
Website: www.fedfin.com

It could be that digital currency is the only way forward for money just as electronic transmission has long supplanted hand-to-hand payments. However, neither e-cash nor CBDC can be a sound alternative to physical fiat currency and private digital assets until its advocates better understand what money is, how the payments system works, and – perhaps even more important than this technical foundation – that they can't have all their digital cake and still eat the physical system too.