

**United States House of Representatives**  
**Committee on Financial Services**  
**Subcommittee on National Security, International Development, and Monetary Policy**

**June 27, 2021**

***“The Promises and Perils of Central Bank Digital Currencies”***

Written Testimony of Julia Coronado

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Thank you for the opportunity to testify. My name is Julia Coronado, and I am the Founder of the macroeconomic research firm MacroPolicy Perspectives. I have spent my entire adult life in the financial services industry, from being a bank teller to a staff economist at the Federal Reserve Board to Chief US Economist at one of the largest global investment banks. I have sat on risk and investment committees, and I now run my own research firm that provides forecasts and research on the US economy to a variety of money managers and nonfinancial companies. I also teach macroeconomics to business school students at UT Austin. I stress to my students that the US dollar did not become the global reserve currency overnight, it took centuries of learning from sometimes profoundly painful episodes and crises and building institutions to balance safety and dynamism and establish the trust essential to a stable, well-functioning currency and financial system. It is a story of evolution, and the job is never done. As strong a position as the US dollar enjoys in today’s global economy, we must keep meeting the ever-evolving challenges and opportunities to secure the efficiencies that come with a stable and well-functioning financial system.

I believe digital currencies present a challenge that the US and other countries must rise to, and if we do it well, we can improve the safety and soundness of our financial system and enhance the equity and efficiency of monetary policy. My remarks will draw on a proposal I put forth jointly with Simon Potter, former head of the Markets Group and System Open Market Account (SOMA) at the Federal Reserve Bank of New York. We published our proposal before the pandemic, but the experience of the last year only underscores its urgency and promise.<sup>1</sup>

**Outline of a Two-Tiered System for a Fed-Backed Digital Dollar**

Let me start by outlining our proposal. We propose the creation of a new system of regulated financial institutions called digital payment providers (DPPs) to facilitate fast, inexpensive retail payments for consumers through the use of a digital currency 100 percent backed by reserves at the Fed. Much like the current banking system, a two-tier system of private providers would promote competition and continued innovation, while Fed oversight would promote safety and soundness. Our proposal would limit account size and preserve the role of fractional reserve commercial banks, adding a

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<sup>1</sup> Coronado, Julia and Simon Potter, [“Securing macroeconomic and monetary stability with a Federal Reserve-backed digital currency”](#) and [“Reviving the potency of monetary policy with recession insurance bonds”](#) Peterson Institute for International Economics Policy Brief 20-4 and 20-5, March and April, 2020 and [“Digital technology and economic science can help during crises like COVID-19”](#) PIIE Realtime Economics Issues Watch, April, 2020.

narrow mandate for DPPs to facilitate retail payments. The proposed system of DPPs would help the Fed ensure that the valuable public good of a stable currency survives the transition to a digital age while using the benefits of lower costs to reach more of the sizable segment of the population—the underbanked—that has not benefited from the payment convenience and security offered by the current banking system. Relying on the private sector alone to offer the benefits of new technology like digital payments, as the United States currently does, introduces significant and growing sources of systemic risk.

The Fed would need to invest in a new infrastructure of standards, oversight and resiliency. Importantly the Fed would establish and monitor a rigorous standard for cybersecurity, consumer privacy, and system resiliency. The Fed would not have access to individual data but could establish and monitor standards for consumer privacy. In recent Congressional testimony Chair Powell cited cybersecurity as the risk that keeps him up at night and our current lack of digital infrastructure has left our economy vulnerable to increasing attacks. An important byproduct of a central bank digital currency will be a public private partnership that confronts one of the most significant risks to the functioning of our market economy.

Some Fed officials have urged the need for caution in developing a digital currency given the dollar’s role as the global reserve currency, I cite that as a need to move forward with a sense of urgency. Not only are private crypto currencies proliferating that pose risks to financial stability, but other countries are advancing the ball on CBDCs. Greater efficiency and transparency in cross border transactions is an area where a digital currency holds great promise. The US should not only be engaged but play a leadership role.<sup>2</sup>

### **Digital Currencies Present an Opportunity to Make Monetary Policy More Equitable and Efficient**

Why does the Fed need a new tool for monetary policy? Interest rates have fallen around the world in recent decades reflecting the global forces of slowing population and top line GDP growth, as well as widening economic prosperity across emerging economies that has produced savings and a strong demand for the safe haven of government bonds as a store of value. With interest rates close to their lower bound the Fed and other central banks have turned to balance sheet policy to achieve their goals. Bond purchases work by lowering longer term interest rates and boosting a wide range of asset prices. In supporting asset prices the Fed has faced the critique that its policies exacerbate inequality. Boosting asset prices does make the rich richer, however the alternative is to allow unemployment to increase which disproportionately harms lower wage and black and brown workers. Doing nothing is not an option, but the Fed currently lacks the tools to boost the economy in a more equitable fashion.

Digital accounts can add a new tool for monetary policy. Under a structure authorized by Congress the Federal Reserve could make direct payments to consumers’ digital accounts in the event of a recession. We propose the creation of recession insurance bonds (RIBs)—zero-coupon bonds authorized by Congress and calibrated as a percentage of GDP sufficient to provide meaningful support in a downturn. The Treasury would hold these securities on behalf of the public and the Fed would purchase them and credit households’ digital accounts in a downturn when its policy interest rate was constrained by the lower bound.

Cash transfers to people may sound like the domain of fiscal policy, yet it precisely mirrors the permanent expansion of the money supply Milton Friedman described as helicopter drops. While the COVID recession confirmed that interest rates and balance sheet expansion remain powerful and valuable tools in the Fed’s arsenal, we have also seen that

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<sup>2</sup> The Fed has stepped up its efforts to evaluate the costs and benefits of a central bank digital currency as outlined in a recent speech by Federal Reserve Board Governor Lael Brainard, “[Private Money and Central Bank Money as Payments Go Digital: an Update on CBDCs](#),” May 24, 2021.

providing cash to households in a crisis is equally if not more powerful in sustaining demand when the economy is hit with a shock that leads to rising unemployment. Equal cash payments to households also provide a proportionately larger boost to lower income households. When the Fed's policy rate has been cut to zero and the FOMC judges that the economy needs additional stimulus, Congress could authorize the Fed to deposit money into consumers' digital accounts.

The Fed's toolkit has evolved over time and Congress has revisited the Federal Reserve Act to ensure the Fed is equipped to support the public interest. Congress should authorize both a framework for the Fed to create a digital currency to ensure the dollar continues to serve the broadest number of people in a modern, technology driven economy and should simultaneously consider creating a framework that allows the Fed to make direct money injections to households' new digital accounts in a downturn. In the aftermath of the Great Recession the Fed expanded its balance sheet by \$3.5 trillion, during the pandemic the Fed has expanded its balance sheet by nearly \$4 trillion. If half of the recent balance sheet expansion had instead been channeled into cash transfers to households it would have financed deposits for every person over 18 of more than \$7,500. This is considerably more than households received in stimulus payments from the various fiscal packages.

Digital payments to consumers could also reduce risks to financial stability. The Federal Reserve has a division that monitors the maturity transformation in the financial system, debt growth across sectors and asset prices. Regulations put in place since the global financial crisis of 2008-09 have ensured that the degree of maturity transformation that facilitated the housing bubble has not returned and enhanced capital and liquidity requirements meant failures in the banking system did not amplify the COVID crisis. Lending standards for households did not deteriorate over the past cycle and debt to income ratios remain well below the peaks of the financial crisis. However, the Fed's increasing reliance on bond purchases may be contributing to asset price inflation becoming higher and more cyclical than in the past. The Fed's most recent financial stability report concluded that "valuations for some assets are elevated relative to historical norms even when using measures that account for Treasury yields."

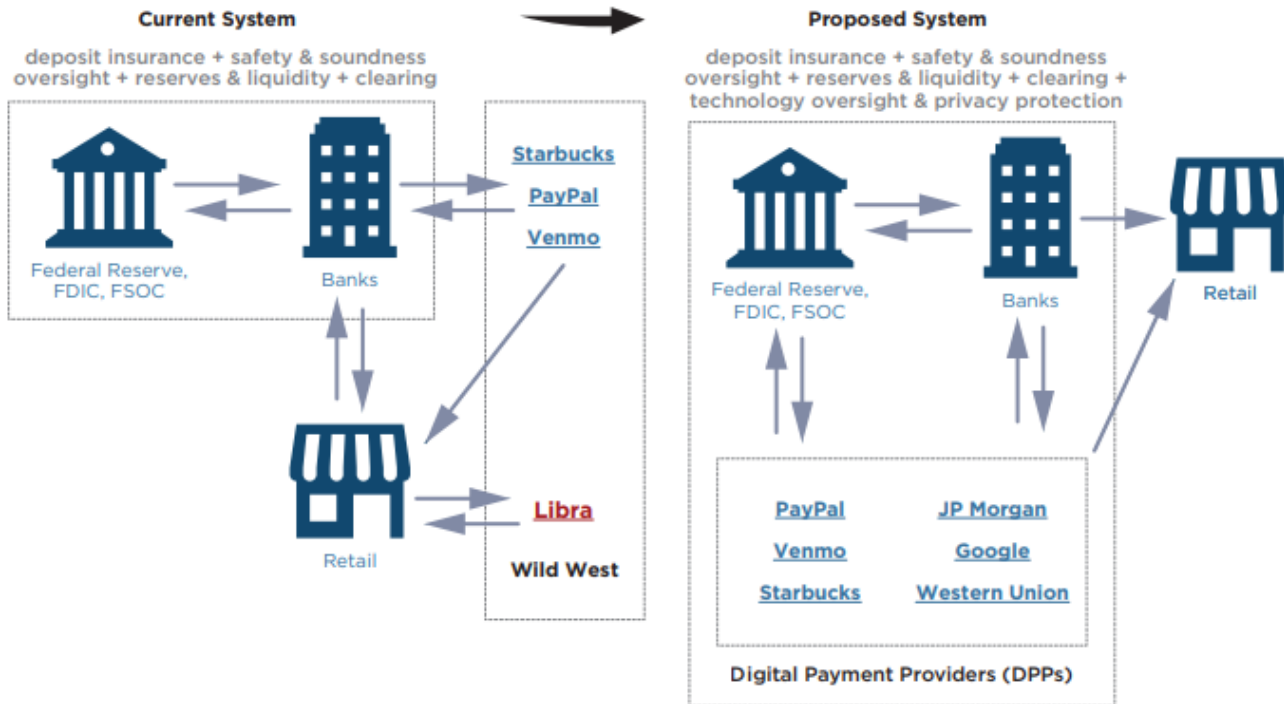
The Fed stabilizes the economy during a recession by supporting aggregate demand. Lower interest rates and higher asset prices spur investment and spending on durable goods like housing and cars. Stronger demand leads to job creation. Asset prices usually decline in a recession because the outlook for the economy has deteriorated and uncertainty has risen. Declining asset values can amplify and deepen a recession. However, asset purchases are a relatively new tool of monetary policy and limited experience makes it difficult to know all their benefits and consequences. Direct payments to consumers can also stabilize demand in a recession, and knowing the Fed possesses such a tool may lead investors to be less inclined to reprice assets downward which could in turn reduce the need for, or scale of future large scale asset purchases that might increase risks to financial stability. The Fed may still need to play lender of last resort in a downturn, but direct support for demand could reduce the need for ongoing market interventions.

Disruption from technology has become an inevitable part of every industry. We must address the new frontiers of currency and payment processing and the challenges of persistently low interest rates to ensure the stability of the US and global monetary systems. Disruption also creates opportunity. Developed together, a Fed backed digital dollar, low-cost accounts and payment processing, and a framework in which the Fed can make digital deposits to consumers in a recession would provide US institutions with the tools necessary meet the challenges of the current global environment. As Congress explores the appropriate authorizations and agency organization for a US digital currency, I would urge you to think expansively and consider not only issues related to payments and the functioning of the currency but also structures for providing the Fed better tools for conducting more equitable and efficient monetary policy.

## Exhibits

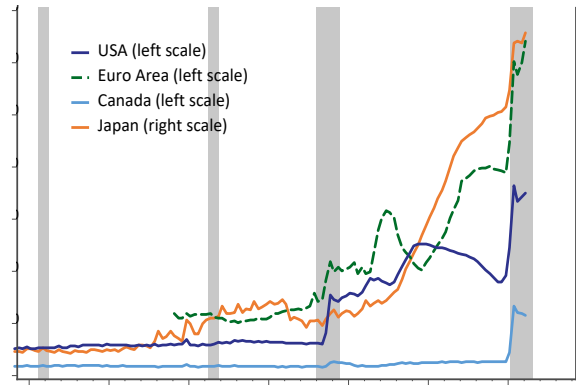
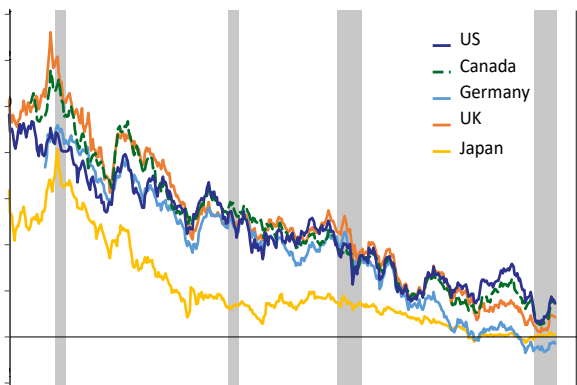
*We propose the creation of a regulated system of digital currency providers (DPPs) to provide low cost retail payment processing to more people and Recession Insurance Bonds (RIBs), a structure that would allow the Fed to make direct cash payments to consumers' digital accounts in a downturn after interest rates have been cut to zero*

### Ensuring safety and soundness in a digital world

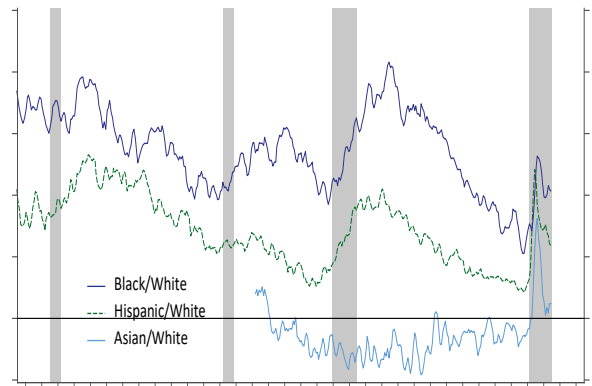
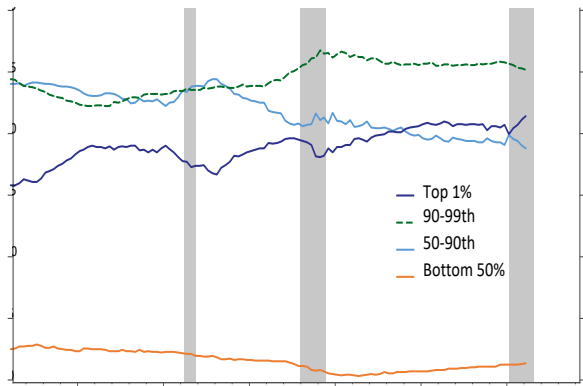


FDIC = Federal Deposit Insurance Corporation  
 FSOC = Financial Stability Oversight Council

*Why does the Fed need a new tool for monetary policy? Interest rates have fallen globally over time reflecting slower growth and rising demand for safe assets leaving central banks increasingly reliant on balance sheet policy in downturns.*



**The bottom half of American households don't directly benefit from higher asset prices, but recessions hit nonwhite and lower income workers hardest. The Fed doesn't have the option of ignoring its Congressional mandates of maximum employment and price stability.**



**Steps taken by Congress and the Fed after the Global Financial Crisis has led to reduced debt in the household and financial sectors. But the era of low interest rates and balance sheet policy mean that lower and more stable consumer inflation has been accompanied by higher and more cyclical asset price inflation.**

