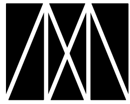

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POLICY BRIEF

A New Coin of the Realm? Central Bank Digital Currency as New Public Money

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The purpose and role of the Federal Reserve (the Fed), like those of many central banks, have been under intense reexamination since 2020. The Fed's crisis-fighting powers have expanded organically alongside mounting pressure to address a wider array of social and economic justice issues ranging from climate change to inequality.[1] Central banks are also reexamining their role of supplying public money and considering whether to create a digital form of public money, referred to as central bank digital currency, or CBDC.

For the most part, central banks around the world seem eager to create CBDCs. Nearly every central bank is actively studying and consulting the public on the issue, and at least three central banks, including the People's Bank of China, have fully launched a CBDC.[2] Given the United States' unique constitutional structure, which places certain limits on the Fed's authority, combined with the global dominance and importance of the dollar, whether the Fed should create a CBDC is a question of tremendous domestic and international significance.

To date, policy papers have examined the feasibility of a CBDC from a technological standpoint, and economic analyses have reflected on the impact of a CBDC on financial system structure and monetary policy transmission. Little attention has been paid, however, to the legal elephant in the room: How will CBDC transform individuals' rights in public money? And how will CBDC transform the relationship that money creates between people and the state (and, in this case, the central bank)? Here, I present some highlights from my forthcoming article in the *University of Pennsylvania Law Review*.[3]

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CENTRAL BANK DIGITAL CURRENCY: TOO GOOD TO BE TRUE?

To start, it's helpful to briefly explain what a CBDC is. In the United States, as in most Western capitalist economies, there are two basic categories of legal-tender money: public and private. The Fed issues public money. It consists of currency (cash and coins) and is available to households and businesses, that is, the participants in the real economy. Public money also includes central bank reserves, which are supplied directly and only to the financial system. Banks, meanwhile, issue private money in the form of demand deposits. When a bank makes a loan, it deposits money into a borrower's account, thus creating money. This system was established in the National Bank Acts of 1863 and 1864, which created the national banking system. From an economic point of view, currency and demand deposits are equal: both are completely fungible, interchangeable media of exchange and stores of the dollar's value.

Creating a CBDC would represent a new, third kind of public money, one that is digitally issued by the Fed, like bank reserves, and *also* available to everyday citizens, like bank deposits. A digital dollar would be issued by the Fed directly to citizens but held in an account maintained by a bank or nonbank institution (a wallet). But rather than owning a contractual liability of a bank (a bank "IOU"), the holder of a CBDC would hold something that appears on the balance sheet of the Fed.

For the past three years, most central bankers who have spoken publicly about CBDC have focused on the benefits of CBDC (though the Fed has been more neutral). These central bankers claim that a CBDC is safer than privately issued demand deposits because it carries less credit risk. Central bankers also expect a CBDC will give rise to payment efficiencies—namely, lower cost, faster speed, wider access—both domestically and internationally.

There are also several policy reasons central bankers would like to create a CBDC. Principally, these include crowding out "stablecoins" (cryptocurrencies that peg their market value to something stable, often a sovereign currency, like the US dollar), which they perceive as a risk to their monetary policy transmission; dampening the financial stability implications of the continued proliferation of unregulated stablecoins; and improving the inclusiveness of the financial system. Setting to one side the question of whether any of these benefits is in fact likely to accompany a CBDC (or whether these are just "red herring"), the cost side of the ledger is still underexamined.

MONEY AS A "BUNDLE OF RIGHTS"

The best way to compare CBDC to existing state-issued money is to reflect on money as a "bundle of rights." This differs from the economic view of money, which focuses on its functionality as a medium of exchange. The bundle-of-rights construction puts the emphasis not on how money is used but rather on how money can empower the state relative to people and vice versa. This analysis is key because, although CBDC might seem innocuous or like nothing new (from an economic usage standpoint), the bundle-of-rights perspective casts CBDC in a very different light.

The first stick in the bundle to consider pertains to monetary sovereignty. The term *monetary sovereignty* has been asserted in the CBDC conversations as an unquestionable and infallible reason to maximize the state's ability to issue (really, control) a country's currency. This translates into an urgent need to create a CBDC to rival private digital currencies, mostly the specter of a widely used stablecoin. (Unbacked cryptocurrency, though it purports to replace sovereign currencies, is not really taken seriously by most central bankers.)

As a matter of international monetary law, this strong notion of monetary sovereignty is accurate and justifiable so far as it goes: clearly, no nation should be able to curtail another's use of its sovereign currency or monetary policy. But as a matter of domestic law—that is, whether the state is the supreme authority over money—the notion of monetary sovereignty poses a different question. To answer it, one must consult the intellectual legal history of the power of the sovereign (i.e., a prince or emperor) over money—a history that dates back at least to Roman times.

The upshot of this history is that for most of it, the sovereign had the exclusive prerogative to create the money that was used within the realm. This legal setpoint makes sense, of course, if one also believes that the prince has a natural-law right to reign supreme in the land. As one 16th-century writer summed it up, "Indeed, after law itself, there is nothing of greater consequence than the title, value, and measure of coins, as we have shown in a separate treatise, and in every well-ordered state, it is the sovereign prince alone who has this power."[4]

When the US Constitution was drafted, its Framers took an intentionally different approach, known as *popular monetary sovereignty*, to mirror America's general approach to popular sovereignty and self-government. They saw the old-world approach to monetary sovereignty as nothing short of an enabler of tyranny.[5] The Founding generation believed that the people, who are after all the sovereign in America, should have a right to create money coequal to if not greater than the state's right to do so. Accordingly, the Constitution contains language prohibiting states from creating their own currencies and limiting the federal government's role to that of coining (minting hard currency). This implied a role for private actors to issue paper or other forms of money as society needed.

The Framers knew that, with full power over money, sovereigns like kings would frequently resort to overissuing currency—to fund wars or other diversions—resulting in inflation. So, they intentionally limited the state's role in issuance to the power to coin and left ample space for a private sector issuance system to serve as a check on the state's tendency to abuse the currency.

CBDC would shift this balance, which has more or less held firm since 1776. The uptake of a CBDC will, at least to some degree, disintermediate banks. Today, the majority of the money supply is issued by the private sector;[6] CBDC puts a thumb on the scale to tilt the demand for (and the supply of) money from the banking sector to the Fed. As will be discussed, this will empower the state in some knowable but also likely unknowable ways.

Related to the question of who creates most of the money in America—the Fed or the private sector banks—the second stick in the bundle concerns what rights people have to the underlying value of money. Most people take for granted that the money they possess in their bank accounts is their property in the sense that the value that their balances represent cannot be adjusted arbitrarily by the state. But again, this was not always the case. Sovereigns would frequently resort to debasement to avoid the unpleasantness associated with taxation or borrowing, foisting the pain of inflation onto the population at large. This, too, the Framers understood and thus limited the president's ability to control money by lodging the power to create money in Article I, which lists powers that are exclusively reserved to Congress.

The federal courts interpreted the Constitution as such. Until the 1930s, courts routinely protected economic rights as property rights with heightened constitutional scrutiny. Their rationale was that individuals had fundamental rights to the value of things over which they could exercise self-ownership—such as physical property, intellectual property, and the derivative fruits of their labor and skill.[7]

And our monetary regime more or less tracked with "property-in-value" view. For one, maintaining fidelity to some version of the gold standard until 1971 reflected respect for the notion that money had a reference value that was external to political forces. Even when the United States did adopt a fully fiat currency, Congress would shortly thereafter encourage private sector money creation in the form of Money Market Funds and restrain the Fed from undercutting banking services through the Monetary Control Act, upholding again the view that there would be some restraint on the state's ability to undermine the value of currency for nefarious reasons, such as to pursue public policy that did not have widespread democratic assent.

CBDC is a policy tool, not a property right. As conceptualized, CBDC offers policymakers a new vehicle for making fiscal transfers more efficiently, imposing negative interest rates, and reducing demand for various forms of private money. This policy tool carries many variables: how much CBDC any one individual can hold, what the interest rate on the instrument will be, and even possibly whether some groups of people may have access to CBDC on one set of terms versus another. These variables are possible thanks to the programmable nature of a CBDC.

Yet programmable money is not an unalienable property right of the kind we typically associate with the natural-law tradition adopted by the Framers and intended in the Constitution, and so it leaves open the questions of if and how one's value in a CBDC could be adjusted by the state to meet its objectives or address perceived emergencies at any point in time. Emergencies often result in erosions of civil liberties, temporary or permanent; the question is whether CBDC would usher America into an age in which economic liberties are increasingly suspended as well.

Together, the rights associated with popular monetary sovereignty and property-in-value impose limits on the sovereign's (in our case, the president's) ability to use money as a way of accreting power to the detriment of the people.

Finally, the third stick in the bundle relates to privacy in one's monetary transactions. There are two elements to consider here. Currently, retail public money—again, this is cash and coin—offers complete privacy; it is what is called a bearer instrument, meaning its value is recognized immediately upon presentation regardless of its provenance. In contrast, demand deposits are subject to intense levels of government scrutiny pursuant to the Bank Secrecy Act, which requires that banks conduct due diligence on their depositor customers and monitor all transactions over a certain dollar threshold for suspicious activity (i.e., the financing of illicit activity or tax and sanctions evasion). The Supreme Court determined long ago that there is no Fourth Amendment privacy right to the contents and movements into and out of one's bank account.[8]

Given that CBDC will, if it comes to pass, be held by financial intermediaries acting as the Fed's wallet, CBDC will certainly be subject to the same surveillance requirements that demand deposits are. Under this intermediated model, the private sector would offer accounts or digital wallets to facilitate the management of CBDC holdings and payments.[9] Central banks have essentially admitted that, largely for national security-related reasons, they have no desire to create a CBDC that functions like a bearer instrument (in my opinion, rightly so), and they otherwise lack the technological capacity to offer cash-like privacy on an account-based CBDC (at least right now).

Aside from privacy, there is the question of who captures the value in one's payments data. An individual's payments transaction history is valuable data to a range of private corporations; it can also be valuable to the state in tailoring public policy or (less charitably) circumventing legal limits or loopholes that would otherwise impede such policy.

THE FED AS A PEOPLE'S BANK?

A CBDC is likely to increase the Fed's power yet simultaneously reduce its independence from the politics of the executive branch (and possibly, from those in Congress).

How will CBDC increase the Fed's power? In the most straightforward sense, because the Fed (like other central banks) has reassured the public that cash would not be retired immediately alongside the issuance of CBDC, creating CBDC could increase the liability side of the Fed's balance sheet.[10] From there, there are two relevant aspects to consider: first, what assets would the Fed then proceed to buy to match these newly created liabilities; and second, how much CBDC (and, correspondingly, how many new assets) would the Fed create (and then buy)?

As for what the Fed would buy, there are three main options, each with its own can of worms. The first option would be for the Fed to buy more Treasury securities, as it does in the ordinary course of open market operations. Would large quantities of these new purchases alter the incentives in Congress and the executive branch to exercise fiscal discipline if the Fed is standing ready to absorb more government debt?

Relatedly, would the Treasury resume its pre-1950s practice of pressuring the Fed to buy government debt, or set rates that would be favorable to its issuance once it knew that the issuance of a CBDC was available to create additional headroom for more bond purchases? The reintroduction of such a dynamic would dramatically undermine the Fed's independence from the president.

One also wonders whether there would be enough Treasury debt for the Fed to buy. While that seems a far-off problem in today's era of rising deficits, the Fed did in fact for a time worry that it would run out of Treasury debt to buy in the 1990s.[11] It considered what else it could legally and sensibly add to the asset-purchase menu.

This brings us to option two: corporate bonds. But buying corporate bonds is problematic for the Fed's independence as well, as it requires the central bank to choose winners and losers in the economy—insofar as it is allocating credit to some sectors and not others—which is, at base, a fiscal function that should be reserved for elected leaders. For the Fed to assume this job opens the door to the executive branch or Congress to pressure the Fed to buy the bonds of politically favored sectors and forgo those that are not in the majority's good graces.

The third option is a bit more esoteric, but it bears mention in light of the growth of what I have elsewhere referred to as the "Monetary Executive"; the subconstitutional tradition of the president exercising unilateral monetary or fiscal powers that belong to Congress.[12] Section 14 of the Federal Reserve Act also permits the Fed to buy agency debt. In a world with CBDC, would the Fed likewise be pressured by an administration to buy a wider range of agency debt to increase a particular agency's funding without going through appropriations? Funding new climate initiatives at the EPA might be a good hypothetical and contemporary example.

Finally, CBDC would establish for the first time a direct relationship between households and the Fed. This immediately puts on the table policy interventions that today would seem anathema to an independent central bank. These include, for example, so-called "people's quantitative easing"—the idea that, during a crisis, the Fed could initiate helicopter drops for everyday people (i.e., issue CBDC and distribute it to all accounts, just like a fiscal stimulus but without the corresponding debt).[13] Alternatively, CBDC might smooth the path for future legislative initiatives to use the Fed to lend to the real economy much like the CARES Act did.[14] This, however, would position the central bank in an industrial lending role—a role Congress long ago abandoned in recognition that it was not the proper role of an independent central bank.[15] One might even imagine the central bank facing pressure to create something like an overnight reverse repurchase agreement facility for households, in which loans were made to struggling families accepting liens against one's house, car, or appliances. The point is, once the central bank bills itself as the "People's Bank," how will it proceed to draw the line when asked for help by people in distress?

CONCLUSION

Ultimately, these shifting dynamics between the Fed, the Treasury, and the president redound to the individual economic rights analysis as discussed. Although a CBDC might appear at first blush to give individuals more economic freedom, in reality it spurs a stronger state, with more levers to pull in an emergency (but with fewer checks), and almost certainly a less independent central bank, one more suspectable to pressure from the president and continuing populist entreaties.

NOTES

1. See Christina Parajon Skinner, "Central Bank Activism," *Duke Law Journal* 71 (2021): 247 (describing the increasing demands on the Fed to expand policy objectives to combat social and political issues).
2. "Central Bank Digital Currency Tracker," Atlantic Council, 2023, accessed May 9, 2023, https://www.atlanticcouncil.org/cbdctracker/.
3. Christina Parajon Skinner, "Central Bank Digital Currency as New Public Money," *University of Pennsylvania Law Review* 172 (2023).
4. Jean Bodin, *Bodin: On Sovereignty*, trans. Julian H. Franklin (New York: Cambridge University Press, 1992), 78. According to one modern-day commentator, Adam Woodhouse, "Buridan's prince not only retains the legal monopoly on controlling all aspects of monetary policy, but he can also escape moral censure for debasing the coinage if he claims to act under necessity." See Adam Woodhouse, "'Who Owns the Money?' Currency, Property, and Popular Sovereignty in Nicole Oresme's *De moneta*," *Speculum* 92, no. 1 (2017): 101.
5. See Christina Parajon Skinner, "The Monetary Executive," *George Washington Law Review* 91 (2023): 164.
6. One broad measure of the money supply, M2, was at $21.4 trillion at the end of 2022. The portion of it provided by the Fed—currency—was only $2.3 trillion. "FRED Economic Data," Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/graph/?g=15jIx (accessed May 25, 2023).
7. See Coppage v. Kansas, 236 U.S. 1, 26 (1915) (court invalidating as violations of liberty and property rights protected by the Due Process Clauses of the Fifth and 14th Amendments laws that prohibited employers from forbidding their employees to join labor unions); Chas. Wolff Packing Co. v. Court of Industrial Relations, 262 U.S. 522 (1923) (unanimously holding that states cannot require industrial disputes to be settled by government-imposed mandatory arbitration); also see Adkins v. Children's Hospital, 261 U.S. 525 (1923) ("freedom of contract is . . . the general rule, and restraint the exception, and the exercise of legislative authority to abridge it can be justified only by the existence of exceptional circumstances").
8. See United States v. Miller, 425 U.S. 435, 96 S. Ct. 1619, 48 L. Ed. 2d 71 (1976) (holding that bank depositors had no protectable Fourth Amendment interest in bank records maintained pursuant to the Bank Secrecy Act).
9. See "Money and Payments: The U.S. Dollar in the Age of Digital Transformation," Board of Governors of the Federal Reserve System, January 20, 2022, https://www.federalreserve.gov/publications/january-2022-cbdc.htm.
10. This is assuming no other changes are made to the Fed's operating system concerning the supply reserves and the overnight reverse repo facility. In other words, it is also possible that the size of the balance sheet would remain the same and only the composition of liabilities would change.
11. Federal Reserve System Study Group on Alternative Instruments for System Operations, Memo: Alternative Instruments for Open Market and Discount Window Operations, December 10, 2000.
12. Skinner, "The Monetary Executive," 164.
13. Frances Coppola, *The Case for People's Quantitative Easing* (n.p.: Polity, 2019); Frances Coppola, "The Case for People's Quantitative Easing," *Coppola Comment* (blog), July 10, 2019.

14. CARES Act, Pub. L. No. 116–136, § 4015, 134 Stat. 281, 481 (2020).

15. David Fettig, "Lender of More Than Last Resort," Federal Reserve Bank of Minneapolis, December 1, 2002, https://perma.cc/N32D-PK7V (accessed May 9, 2023). ("The Federal Reserve banks, 12 in number, which were never designed to do business with any individual or any person, but were banks of issue or rediscount to deal with other banks, ought never, in my opinion, to be put into the lending business. It is a perversion of the original purpose for which those banks were established.")