Policy Implications of Digital Cash

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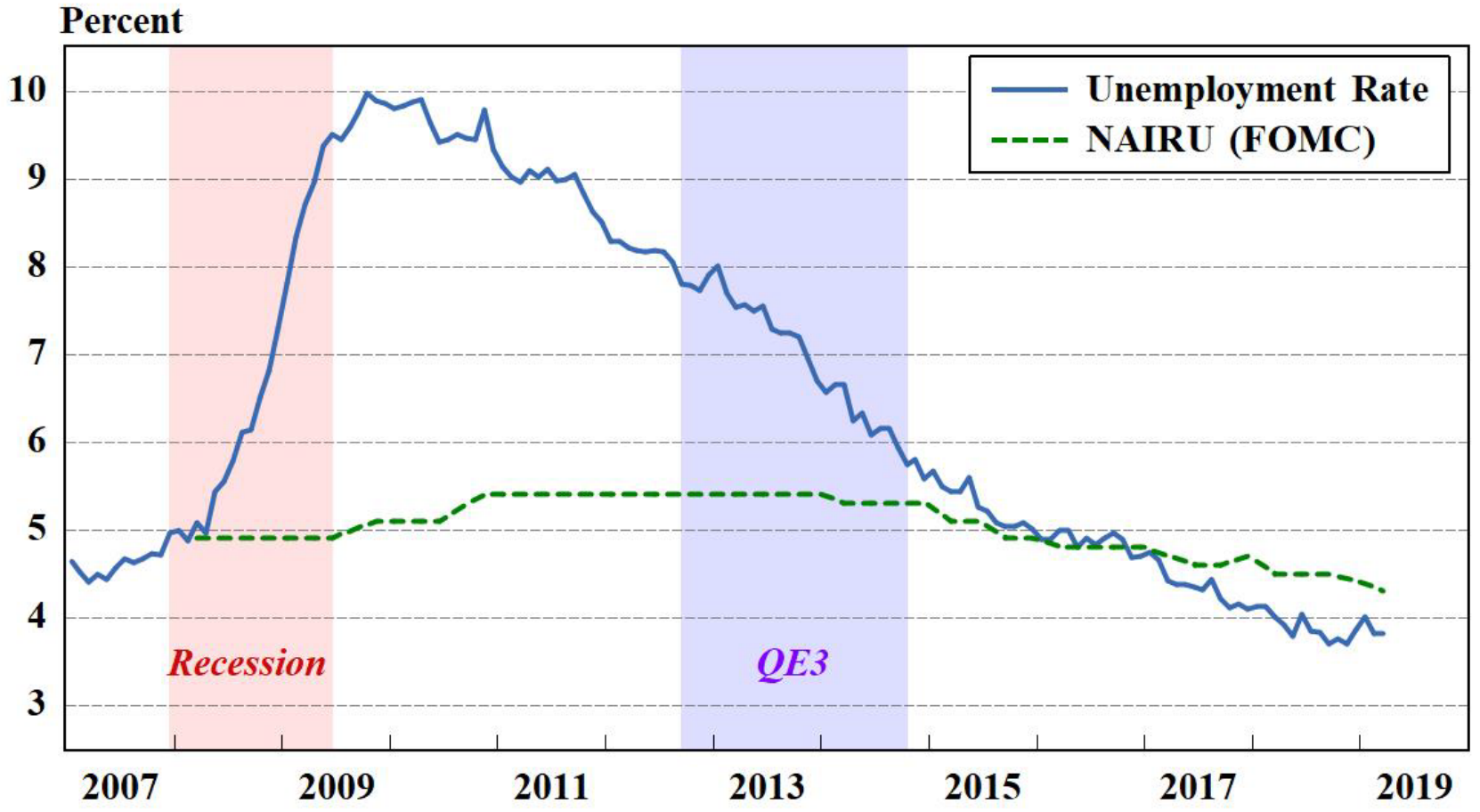
These remarks solely reflect my own views and should not be interpreted as reflecting the views of any other person or institution.

Three Key Questions

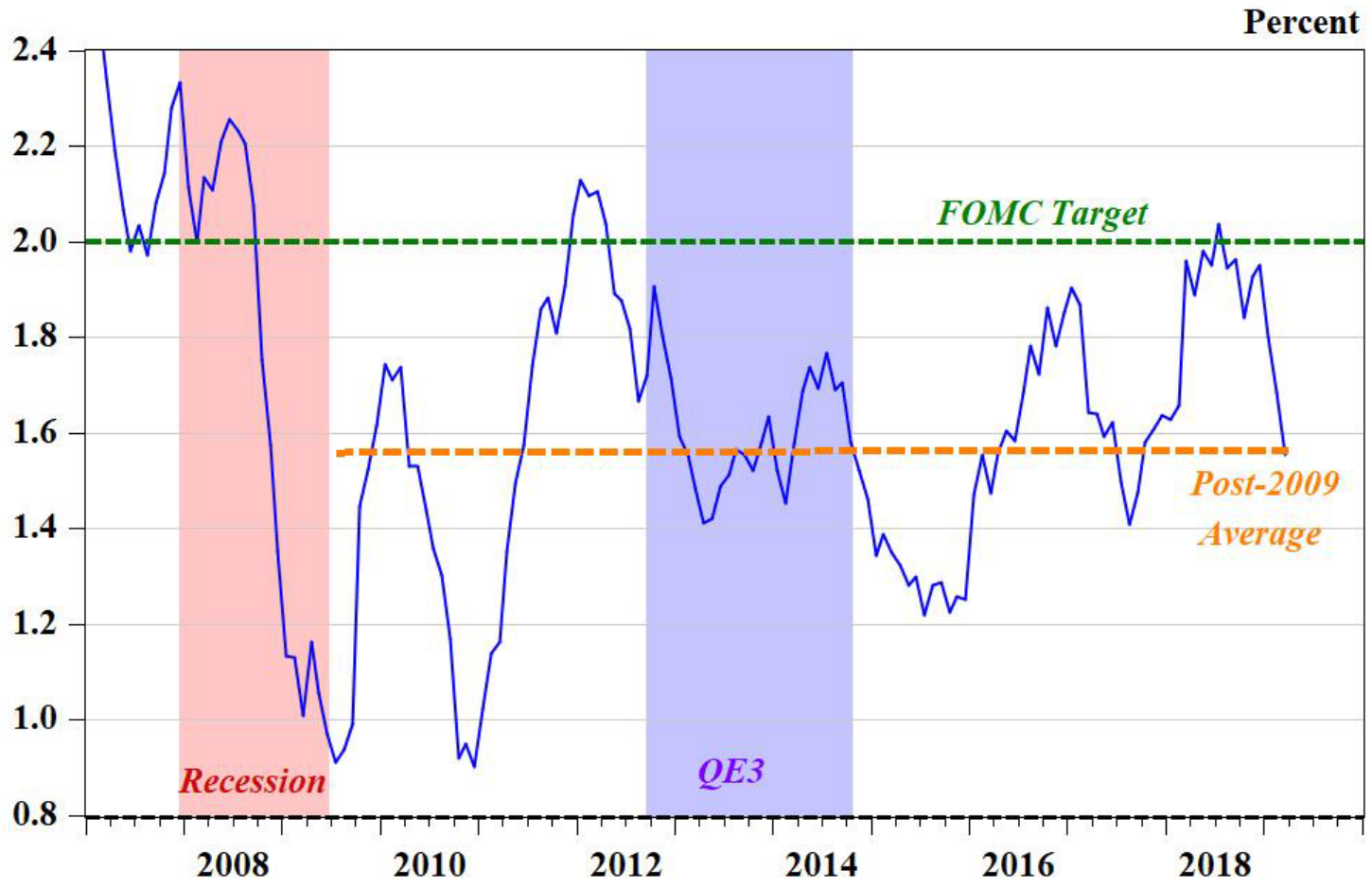
- **Is the central banking toolbox adequate for fostering economic recovery & price stability?**
  - **NO**
- **Can central banks improve the monetary system by establishing digital cash?**
  - **YES**
- **Can the design of digital cash strengthen the stability of the financial system?**
  - **YES**

Did QE3 Affect the U.S. Recovery?



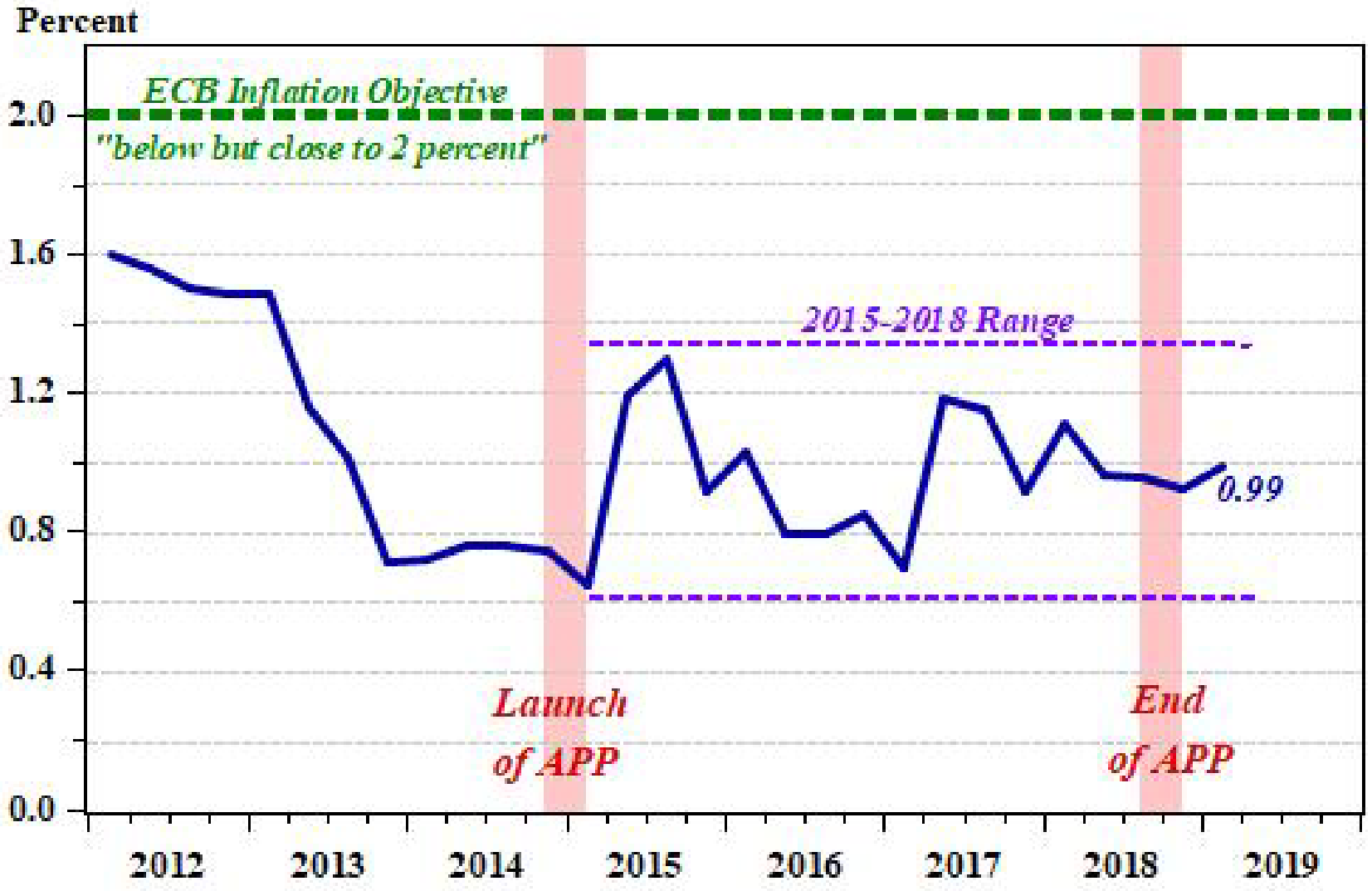
Sources: U.S. Bureau of Labor Statistics, Federal Reserve

Did QE3 Affect U.S. Core Inflation?

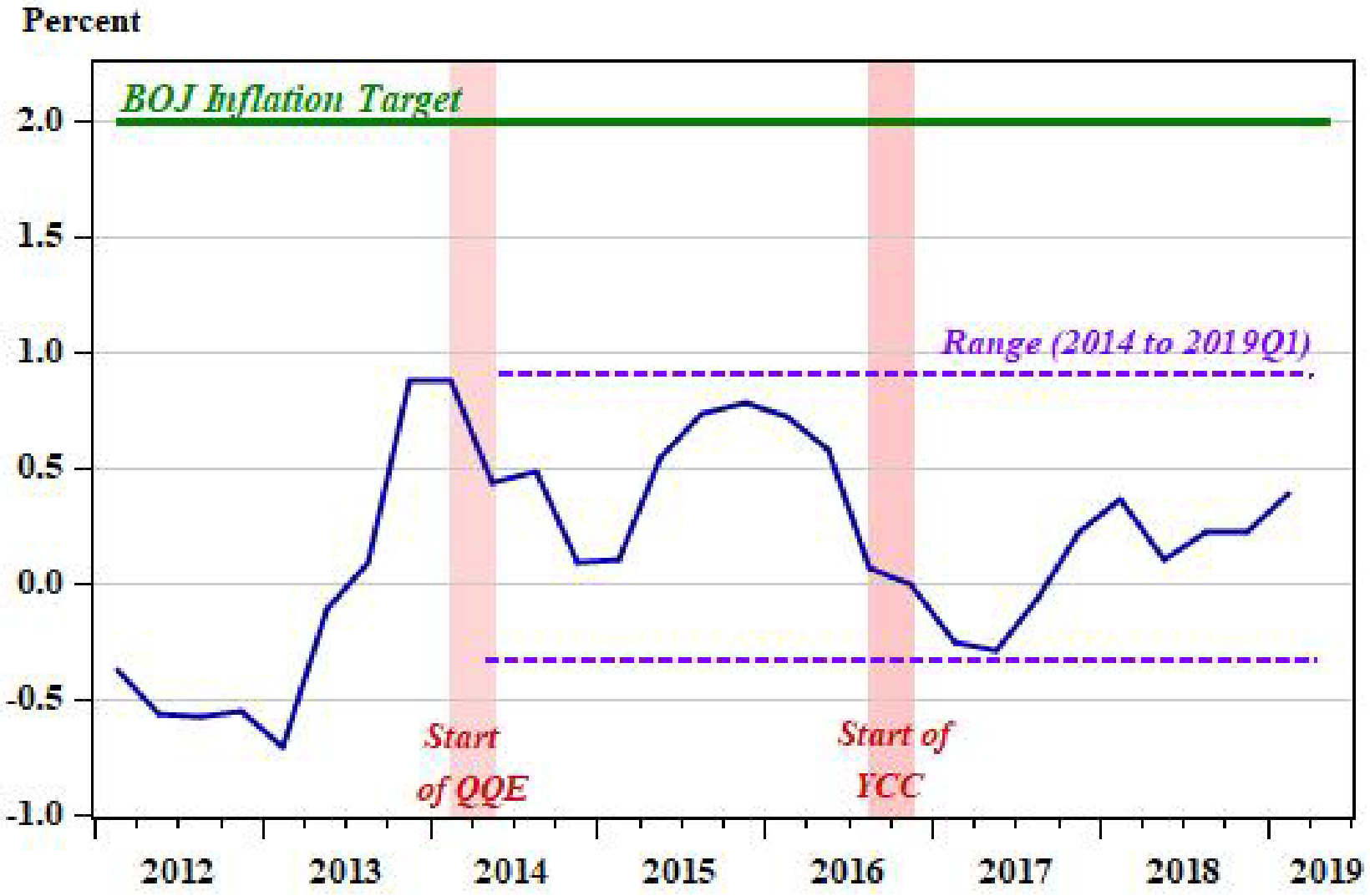


Source: U.S. Bureau of Economic Analysis (4-quarter chg, %)

Euro Area Core Inflation



Japan Core-Core Inflation



Fundamental Goals of the Monetary System

- An efficient medium of exchange for economic & financial transactions.
- A secure store of value with essentially the same rate of return as other risk-free assets.
- A stable unit of account that facilitates the decisions & plans of households and firms.

➢ The monetary system should be particularly convenient and efficient for less-sophisticated families and small businesses.

The Bordo-Levin Proposal
(see 2018 Hoover e-book & 2019 NBER WP)

- **An account-based system of digital cash can provide an efficient medium of exchange.**
- **Public-private partnerships between the central bank and commercial banks will foster innovation, preserve privacy, and promote financial stability.**
- **The interest rate on digital cash can serve as the primary tool of monetary policy.**
- **The central bank can foster true price stability & more rapid economic recovery from shocks.**

Key Elements of Our Proposal

- Individuals & businesses should remain free to use paper cash or private payments.
- Fees should be imposed on large transfers between digital cash and paper cash, thereby curtailing arbitrage and eliminating the ELB.
- Moderate amounts of digital cash balances should be exempt from negative interest rates.
- Thus, the central bank could respond to severe adverse shocks while ensuring that no implicit taxes or fees would be imposed on ordinary households and small businesses.

Digital Cash and Financial Stability

- **In a financial crisis, cutting the digital cash interest rate below zero would prevent runs from other assets into digital cash.**
- **A temporary surge in risk spreads would be reflected in a lower risk-free rate, insulating the nonfinancial economy from the crisis.**
- **A relatively steep yield curve would foster bank lending and rapid recovery, in contrast to unconventional tools that flatten the yield curve and hence induce imprudent behavior in conjunction with a sluggish recovery.**

Near-Term Practical Steps

Central banks can take two near-term steps towards implementing digital cash:

- **Establish a real-time payment system (RTPS), enabling consumers and businesses to make instantaneous and secure payments at practically zero cost**
- **Encourage narrow banks, which can offer safe and liquid accounts that accrue roughly the same interest rate as Treasury bills**