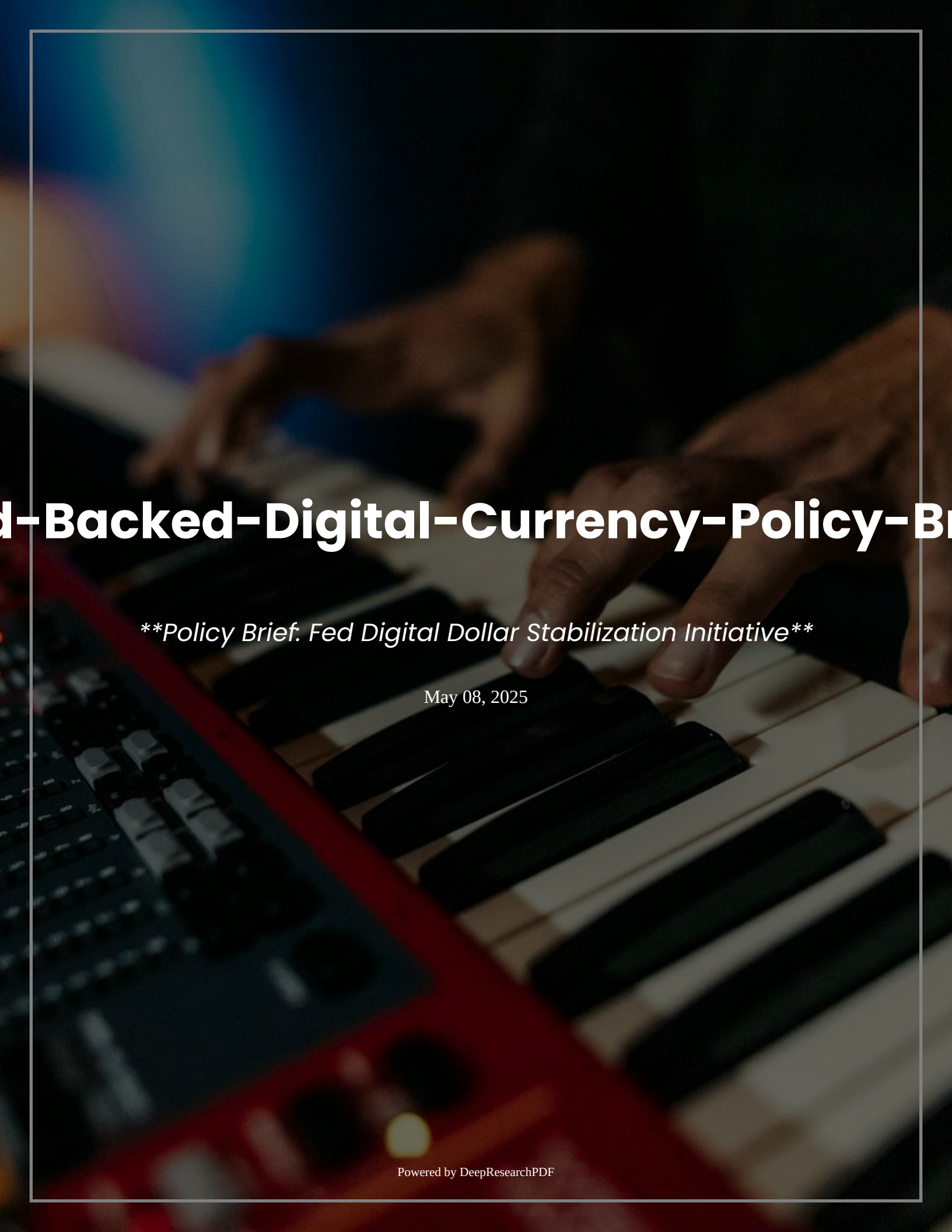

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Policy Brief: Fed Digital Dollar Stabilization Initiative

May 08, 2025

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Policy Name: Federal Reserve Digital Currency and DPP System

- *Proposal: **Establish a** Fed-backed digital dollar **system, implemented via regulated** Digital Payment Providers (DPPs) **as proposed by Coronado and Potter (2020). Each U.S. resident would have access to a** digital currency account **fully backed by the Federal Reserve. Strict** account caps **(e.g. \$10,000 per person) and other safeguards would limit the system's size and protect traditional banks. The Fed would** seed each account **with an initial \$500 grant to encourage adoption, and DPPs could optionally issue a** stablecoin **(a digital dollar token) backed 1:1 by Fed reserves (with growth limits). This system expands the Fed's** countercyclical toolkit **by enabling** direct-to-consumer stimulus** ("helicopter money") during recessions, while promoting financial inclusion and payment innovation.

Background: Modern Recessions Expose Policy Limitations

Storefront with "Everything Must Go" sale signs during the Great Recession (2009). The 2007–09 downturn saw GDP fall 4.3% and unemployment reach 10%, the worst postwar slump.

- *The Great Recession (2008–09) **underscored the limits of traditional monetary policy. The Federal Reserve cut interest rates to near zero by December 2008 – the first time hitting the**

• zero lower bound **in the postwar era. Despite massive interventions (e.g.** quantitative easing**, or QE), the economy suffered a 4.3% drop in GDP and 10% unemployment. Recovery was painfully slow, in part because once rates hit zero, the Fed's primary tool was exhausted. The Fed resorted to unconventional measures (QE, forward guidance), whose effectiveness remained debated. Fiscal stimulus (e.g. the 2009 ARRA) helped, but its deployment was constrained by political delays and was arguably insufficient early on. This experience revealed a** policy gap** – the need for new tools when interest rates can't be cut further.

• *The COVID-19 recession (2020) **was sharp and fast. In Q2 2020, U.S. GDP contracted at a record** –31.4% annual rate**, and unemployment spiked to** 14.7% in April 2020 **– the highest since the Great Depression. The policy response was unprecedented: the Fed slashed rates to zero and doubled its balance sheet via QE, and Congress authorized over \$5 trillion in fiscal aid. Direct payments to individuals (stimulus checks) proved vital to cushion incomes. However,** distribution lags **blunted the impact. It took** 3 weeks to 3 months **for many Americans to receive relief funds in 2020, a delay that imposed hardship and reduced the stimulus's timely effect. These delays especially hurt lower-income and unbanked households, many of whom waited for mailed checks or prepaid cards. This highlighted a major** challenge**: the federal government lacked infrastructure to** rapidly deliver stimulus to everyone**. The COVID crisis also illustrated how reliance on ad-hoc fiscal packages can be uncertain and slow – a problem that automatic, monetary-based stabilizers could alleviate.

• *Current macroeconomic risks (2023–2025) **further expose monetary policy limits. A rapid post-COVID rebound, combined with supply shocks, drove U.S. inflation to** 9.1% in June 2022 – a 40-year high**. The Fed responded with aggressive interest rate hikes, which slowed inflation but created stress in the financial system. In** March 2023**, Silicon Valley Bank (SVB) collapsed after**

- **depositors attempted to withdraw \$42 billion in 24 hours – a technology-fueled bank run that regulators struggled to contain. SVB's failure (along with Signature Bank and others) exposed** systemic fragilities**: in a digital banking era, panic can spread instantaneously via social media and mobile apps, outpacing traditional crisis responses. The Fed and FDIC had to intervene with emergency measures to backstop deposits and prevent broader contagion. Meanwhile, raising interest rates to fight inflation has been constrained by fears of triggering recession or more financial instability. In sum, the Fed faces a** dual challenge**: containing inflation without ample "buffer" (rates are now near their effective ceiling) and safeguarding financial stability in a rapidly evolving, tech-driven environment. These circumstances underscore the need for innovative tools to** stabilize the business cycle** more effectively.

- *Gaps and Challenges:** Three key weaknesses in the status quo hamper effective stabilization:

- **Lagging and uneven stimulus deployment:** As noted, delivering aid through the current system can be slow and regressive. Millions of Americans lack fast access to funds because they aren't integrated into the banking system. In 2020, the unbanked waited weeks longer for relief. Such lags reduce the countercyclical punch of stimulus, essentially "missing the moment" when support is most needed. Automatic stabilizers (like unemployment insurance) exist, but discretionary aid (rebates, transfers) often suffers from legislative and logistical delays. A more direct mechanism is needed to **inject stimulus in real time** when a downturn hits.

- **Limited reach to the unbanked/underbanked:** Roughly **25% of U.S. households are unbanked or underbanked**, meaning they lack full access to traditional financial services. These populations are often those most vulnerable in recessions. Conventional monetary tools (rate cuts, bank lending programs) may not reach them at all. Even fiscal programs face hurdles: without bank accounts, people rely on check cashers or prepaid cards, incurring fees and delays. This gap not only

- raises equity concerns but also **reduces the efficacy** of stimulus – if a quarter of Americans cannot quickly receive or utilize aid, consumer spending support is suboptimal. Ensuring broad financial access is thus a precondition for maximum stabilization impact.

- **Fintech and digital currency risks to stability:** The financial landscape is being transformed by fintech firms, cryptocurrencies, and private "stablecoins." On one hand, digital payment innovation promises faster, cheaper transactions; on the other, much of this activity occurs **outside the regulatory perimeter**. The **stablecoin market cap surged to around \$180–200 billion by 2022** (a nearly tenfold increase in two years), as corporations and consumers adopted crypto-dollar alternatives. But this boom has come with **episodes of instability** – for example, the \$18 billion TerraUSD stablecoin collapsed in 2022, erasing billions in value and rattling crypto markets. The rise of unregulated digital money poses potential threats: **monetary control** could wane if significant payment activity shifts to private networks, and **financial contagion** could spread through new channels. Moreover, big tech payment platforms and cryptocurrencies could exacerbate bank runs (imagine a panic-induced shift from bank deposits to a supposedly safer digital token). In the absence of a **public digital currency option**, the U.S. risks **lagging behind** innovations by other nations (China's e-CNY, the EU's proposed digital euro) and ceding ground to less regulated alternatives.

- *Shortcomings of Current Stabilization Tools:** Traditional monetary and fiscal tools have proven valuable but imperfect in addressing these challenges:

- **Conventional Monetary Policy (interest rate adjustment):** Cutting the Fed's policy rate has been the primary recession-fighting tool. But when severe downturns hit, rates quickly reach zero, as in 2008 and 2020. The **zero lower bound** means the Fed cannot stimulate further via rate cuts, leading to protracted recoveries. While some central banks have experimented with negative rates, the U.S. has been reluctant (and physical cash prevents deeply negative rates in any case). Thus, in major recessions the Fed is left "pushing on a

- string.” Low global interest rates imply this constraint will recur in future recessions. In short, interest rate policy alone is insufficient for modern downturns.

- **Quantitative Easing (asset purchases):** QE became the Fed’s go-to unconventional tool post-2008. By buying trillions in Treasuries and mortgage bonds, the Fed lowers long-term yields and injects liquidity. QE undoubtedly helped stabilize financial markets and prevented worse deflation. However, **QE’s transmission to the real economy is indirect** and sometimes unequal. Critics note that QE **inflates asset prices**, disproportionately benefiting wealthier households (who hold stocks and real estate), with relatively modest direct impact on consumption by average families. While QE supported a recovery in employment, the boost came with a lag, and its distributional side effects have raised concerns of worsening wealth inequality. Additionally, QE as practiced involves intermediaries (banks, investors) and thus may not reach households most in need of liquidity during a crisis. It’s a **blunt instrument** when we may need precision targeting.

- **Fiscal stimulus (government spending and transfers):** Fiscal policy can directly support incomes (e.g. stimulus checks, enhanced unemployment benefits, aid to states). Indeed, the swift 2020 fiscal response is credited with averting a deeper depression and enabling a rapid initial rebound. However, discretionary fiscal measures depend on political willingness and speed. There can be significant **lags** (as seen in 2008 when Congress’ response was slower and smaller until the crisis deepened). Political debate can delay or dilute needed relief. Moreover, fiscal expansions raise deficits, which in some cases leads to hesitancy or premature austerity. In the 2010s, concerns about debt led to fiscal tightening that may have slowed the recovery. In short, while fiscal tools are powerful, they are not **automatically or consistently available**. There is a case for designing **automatic stabilizers** that don’t rely on repeated congressional action.

- **Financial sector interventions:** The Fed and Treasury have emergency powers (e.g. lending facilities, deposit guarantees) to quell

- crises, as used in 2008 and 2023. These are reactive measures to maintain stability, but they do not directly stimulate broad consumption or investment. Additionally, **moral hazard** concerns arise if private finance expects bailouts. The need is to reduce the likelihood of such crises in the first place by strengthening the system's resilience (for example, giving households a truly safe store of value to reduce panic shifts).

In summary, current tools have **critical limitations**: conventional monetary policy is constrained by the zero bound; QE has side effects and may not reach Main Street; fiscal stimulus, while effective, can be slow and uneven; and the evolving fintech environment introduces new risks that our toolkit isn't yet equipped to manage. These gaps warrant a new approach that leverages technology to deliver monetary support more directly and inclusively.

Policy Recommendation: A Fed-Backed Digital Currency via DPPs

- *Proposal Overview: **The Federal Reserve, with authorization from Congress, should implement a** central bank digital currency (CBDC) **system for retail use, structured around** Digital Payment Providers (DPPs)**. This model, inspired by Coronado and Potter's 2020 proposal, entails** regulated intermediary firms** offering digital Fed accounts to the public. Key design features include:

- **Fed-Backed Digital Accounts:** Every U.S. resident (or at least every adult citizen/permanent resident) could open a **digital dollar account** through a licensed DPP. Funds in these accounts would be **fully backed by reserves at the Federal Reserve**, making them as safe as central bank money (similar to holding physical cash or a Fed deposit). In effect, consumers gain access to a digital form of **sovereign money**. DPPs could be commercial banks, credit unions, or approved fintech/payment companies that meet regulatory standards. Importantly, the funds are not lent out or invested by the DPP – they

- remain on the Fed's balance sheet. This structure is akin to a **"narrow bank"** model, eliminating credit risk for account holders. **Fed backing** also means DPPs face minimal capital requirements, encouraging broad participation and competition. The government would set **standards for accessibility and service** (e.g. no minimum balance and **no monthly fees** on these accounts) to ensure even low-income and unbanked individuals can use them.

- **Account Caps to Limit Size:** To preserve traditional banking functions, each individual's DPP account would be **capped (e.g. \$10,000)**. This cap prevents large-scale migration of deposits from private banks to the Fed system. Most Americans would not be constrained by a \$10k limit for their transactions account – it covers day-to-day cash needs for the vast majority (median transaction balances are well below this). But it dissuades wealthy individuals or businesses from pulling huge sums out of banks to park in risk-free Fed accounts. By setting the cap significantly under the FDIC insurance limit (currently \$250k), the system signals that it is meant for **retail payments and savings**, not wholesale bank disintermediation. The cap could be adjusted over time as needed, but initially it strikes a balance: enough room for most people's liquidity, but not enough to undermine bank lending capacity. In practice, someone with higher cash holdings could still use private bank or money-market accounts for excess funds, maintaining banks' role in credit intermediation. The cap is a critical safeguard for **financial stability**, ensuring the digital dollar complements rather than crowds out the banking sector.

- **Initial Seeding of Accounts:** To jump-start the system and provide an immediate economic boost, the Fed (with Treasury coordination) would **"seed" each account with an initial deposit**. Coronado and Potter suggest a **\$500 grant per adult** (16 and older), roughly amounting to \$130 billion in total – about 1% of bank deposits. This seeding could be financed via a special Treasury issuance (e.g. a **"seed bond"**) which the Fed would purchase, crediting individuals' accounts. The result is an immediate asset for households and a liability on the Fed's balance sheet (new reserves backing the accounts). Crucially,

- because this initial deposit is **new money** (not taken from existing bank deposits), it **stimulates the economy without shrinking private lending**. \$500 per person provides a meaningful cushion or spending boost (particularly for lower-income families) and an incentive to activate the account. The cost to the Fed/Treasury is modest: \$130 billion is a fraction of recent QE programs, and at current interest rates the carrying cost is under \$2 billion per year. This upfront fiscal cost can be seen as an **investment in macroeconomic stability and inclusion**. It ensures rapid user adoption – a critical mass of Americans will sign up to claim their digital dollars. Going forward, the accounts would not regularly be funded unless used as a stimulus tool (discussed below). But maintaining them with a small positive balance encourages usage and familiarity.

- **DPP Operation and Incentives:** DPPs (the private intermediaries managing the consumer interface) would handle account onboarding, KYC (know-your-customer compliance), and payment services (apps, debit cards, etc.). They would transmit customer instructions to the Fed's systems (which actually settle the funds). To sustain the DPP business model with low consumer fees, DPPs would earn **interest on the Fed reserves** corresponding to the accounts. However, to keep the system focused on payments (not a high-yield savings alternative), **interest might be paid only on the "seed" portion** of balances. In other words, the Fed could pay a fixed rate (perhaps equal to overnight RRP rate or similar) on up to \$500 in each account (the initial seed), but not on additional balances. This gives DPPs a modest revenue stream to cover costs and incentivize them to onboard users (since more accounts means more seed balance in aggregate). For balances above \$500, the Fed might pay zero interest to account holders (or a minimal rate), reinforcing that this is a transactions vehicle. Retail users would still benefit from **instant, safe payments** and could always sweep excess funds to higher-yield instruments outside if they choose (which again limits the attractiveness of oversize balances in DPP accounts).

- **Optional Fed-Backed Stablecoin:** In addition to holding balances, the system could allow DPPs to issue a **digital token ("stablecoin")**

- that represents the same Fed-backed dollars. This would effectively be a **wholesale CBDC** feature: the DPP network would create a blockchain-based token, fully backed by reserves at the Fed, to facilitate broader use cases (like programmable payments, smart contracts, or transfers outside the DPP member apps). The stablecoin would operate on a **permissioned blockchain** (only DPPs and perhaps regulated partners can validate transactions), ensuring oversight and compliance. Unlike volatile cryptocurrencies, this coin would be pegged 1:1 to the U.S. dollar and redeemable via DPP accounts. Importantly, the Fed would **limit the aggregate issuance** of this stablecoin – initially capping it around the same \$130 billion seed amount. This prevents an unbounded outflow of money into the token form. The Fed can also slow or halt further issuance if demand grows unexpectedly fast. The coin is thus an **optional extension** to enhance functionality: it could enable fintech innovation on top of a **safe, U.S.-regulated digital dollar** (potentially countering the appeal of risky offshore stablecoins). However, it is *not* required for basic operation – the system could launch with just deposit accounts, and only introduce the token once safeguards and technical protocols are vetted. By **controlling the stablecoin supply**, the Fed guards against this digital dollar being used as a global reserve by foreigners or causing unintended bank deposit flight. In effect, the stablecoin would give the Fed a new lever: it could expand digital dollar circulation in a crisis (for more QE potency) or constrain it if needed, maintaining **monetary control**. All usage of the coin would remain subject to AML/KYC regulations and transparency to regulators.

- **Privacy and Security Considerations:** The DPP model balances privacy with oversight. Rather than the Fed directly managing millions of individual accounts (which could raise concerns about government monitoring of personal finances), private DPPs handle customer relationships, similar to how banks do today. **Privacy laws** and perhaps new statutes would govern what data can be shared. Ideally, the system should provide **cash-like privacy** for routine transactions, while still enabling law enforcement to track illicit activity (with warrants) – a

- delicate but achievable balance. Cybersecurity is paramount: the Fed and DPPs would need robust systems against hacking and fraud. The Fed's involvement brings credibility and likely superior security resources compared to purely private payment apps. By offering a **public option** for digital money, individuals may be less exposed to failures of unregulated crypto platforms or fintech outages.

- *Using the Digital Dollar as a Countercyclical Tool: **Once this infrastructure is in place, the Fed would have a** powerful new monetary policy option**: directly crediting households with cash during downturns. This could work in concert with traditional policy or when traditional policy is constrained. For example, if a recession hits and the Fed cuts rates to zero, it could then** activate "quantitative easing for the people." **Specifically, the Fed (or Treasury via automatic stabilizer law) would distribute a certain amount of funds to each DPP account –** instant stimulus **at a nationwide scale. Coronado and Potter propose a mechanism involving** "Recession Insurance Bonds (RIBs)"**: Congress pre-authorizes a stock of special zero-coupon bonds (perhaps equal to some % of GDP). During a downturn, Treasury would deposit these bonds into households' digital wallets, and the Fed would buy them off households in exchange for newly created dollars (credits in their DPP accounts). In practice, from the user's perspective, the Fed would just add money to their account (say \$1,000 per person) once certain triggers are met (e.g. unemployment above 8%, or Fed funds at zero and inflation below target). This *"helicopter drop"* of money would bypass slower channels and **immediately support consumer spending**. The beauty of using the digital dollar system is that **every adult can be reached almost instantly** – no need to wait for IRS bank info or mail checks. The Fed's balance sheet would expand (holding the RIBs as assets, with deposits as liabilities), but this is akin to QE – except the money goes straight to households rather than via financial markets. Research suggests this form of stimulus can be extremely potent: households, especially liquidity-constrained ones, are likely to spend a large share of an unexpected cash infusion, boosting

- demand when it’s most needed. It could also **raise inflation expectations** more effectively than bond-buying, helping prevent deflationary spirals.

For **fiscal policy**, the digital dollar enables building in **automatic stabilizers**. For example, unemployment insurance could be topped up through DPP accounts during recessions, or a basic income dividend could be paid regularly and adjusted countercyclically. The distribution platform is there; it’s up to policymakers to design rules for its use. For monetary policy, the Fed might announce that it will utilize direct transfers under certain conditions, adding credibility to its toolkit (“Fed stands ready to put money in your pocket” is a strong forward guidance). Even the **expectation** of such direct support could boost confidence and stabilize markets in anticipation of downturns.

In normal times, the presence of Fed accounts also improves monetary transmission: more people have access to interest-bearing safe money, so changes in Fed policy rates can pass through more uniformly. Moreover, with more Americans in the formal digital payments system, the economy becomes **more inclusive** – people avoid payday loans or check cashing fees, potentially improving their financial health (which has long-term economic benefits). This addresses structural issues that weaken consumption during downturns.

- *International Context: **While the focus is U.S.-centric, it’s instructive to note peers.** China’s central bank digital currency (e-CNY) **pilot has already reached over** 260 million users**, demonstrating the feasibility of a large-scale retail CBDC. However, China’s approach is more centralized (offered via state-owned banks) and is motivated partly by payment data control and RMB internationalization. The U.S. can take a more market-driven approach (via private DPPs) to preserve innovation and privacy, while still reaping stability benefits. The** Eurozone **is actively designing a digital euro, with the European Central Bank considering a** €3,000 holding limit per person **to prevent bank disintermediation – a very similar concept to our account cap. This suggests broad recognition**

- **that a** tiered CBDC **(small retail balances widely accessible, big balances discouraged) is the optimal path. Implementing a Fed digital dollar would keep the U.S. at the forefront of monetary innovation alongside these efforts, ensuring the dollar remains the world's digital anchor as it has been in traditional finance. It also provides a** safe U.S. stablecoin alternative**, likely undermining the demand for risky substitutes that could threaten U.S. financial dominance.

In summary, this policy marries the **trust and stability of the central bank** with the **accessibility and innovation of fintech**. It directly addresses the problems identified: speeding up stimulus (the Fed can deposit money at the push of a button), reaching unbanked populations (no-fee Fed accounts for all), and countering fintech risks (by providing a well-regulated digital dollar and integrating stablecoin technology under the Fed's purview). It essentially upgrades the monetary toolkit for the 21st century, creating an **"always ready" pipeline to Main Street** that can be utilized in crises.

Cost-Benefit Analysis

- *Expected Benefits:**

1. **Stronger and Faster Macroeconomic Stabilization:** The primary benefit is a more effective countercyclical policy. The Fed-backed digital currency system enables **near-instant stimulus delivery** at scale. This could **shorten recessions and reduce their severity**. For example, had this system existed in 2020, the Treasury/Fed could have delivered relief in days rather than weeks, softening the GDP collapse and possibly reducing long-term scarring. Quicker support means consumer spending and confidence rebound faster, damping the vicious cycle of layoffs and declining demand. Analytical models (and historical evidence from direct payments) suggest that putting cash directly in consumers' hands yields a high **fiscal multiplier**, especially under depressed conditions. By making this a *monetary* tool, we bypass political gridlock and ensure the aid is

timely, targeted, and temporary (targeted in the macro sense that everyone gets it when needed, and temporary as it's injected only in downturns). The ability to do **"helicopter drops"** in a disciplined way could make recessions **shallower** and **recoveries faster**, achieving the Fed's dual mandate goals more consistently. It would also help avoid deflationary traps by firmly anchoring inflation expectations – if people know the Fed can and will directly inject money to hit its inflation target, it adds credibility to the 2% goal (no more worrying that the Fed is "out of ammo" at zero rates).

2. **Enhanced Financial Inclusion and Efficiency:** A Fed digital dollar is effectively a public option for essential banking services. With low fees and no minimums, it would draw in millions of unbanked or underbanked Americans. This has social benefits – safer saving options for families, less income lost to predatory fees – and macro benefits: **financial inclusion** can increase the marginal propensity to consume (households with access to accounts can smooth consumption better and engage in the economy more fully). The IMF notes that greater inclusion means **monetary policy reaches more households** and can be more effective. Additionally, an efficient digital payments system could reduce transaction costs economy-wide, akin to an upgrade in financial infrastructure. The U.S. payments system has long lagged (e.g. high credit card fees, slow ACH transfers); DPPs could leverage modern tech for **real-time payments** at low cost. This boost in payments efficiency is like improving the "plumbing" of the economy – facilitating commerce and innovation (imagine easier e-commerce, better access to credit history through account data, etc.). These efficiency gains, while hard to quantify, accumulate over time and improve U.S. competitiveness.

3. **Resilience of the Financial System:** Paradoxically, giving consumers a risk-free digital money option can **increase overall system stability**. During periods of bank distress or panic, small depositors could shift within the Fed-backed system (which is fully safe) rather than hoarding cash or exacerbating a bank run. The **account cap** ensures this safety valve doesn't turn into wholesale flight – but for individuals, it provides peace of mind that they can access government-guaranteed money

beyond just \$250k FDIC limits, in a convenient form. This might **reduce the likelihood of runs** on banks for amounts under the cap, because if trust erodes, people have somewhere to go that doesn't involve mattress cash or risky crypto. Moreover, by **heading off deeper recessions**, the system indirectly keeps banks healthier (since loan defaults and losses are lower in a milder downturn). The optional stablecoin component, if implemented, also **preempts private sector risks** – it offers a safe, regulated digital dollar for crypto markets, likely shrinking the market share of opaque stablecoins that could implode. This mitigates potential spillovers from the crypto realm into the traditional financial system. In essence, the proposal creates a **publicly overseen digital finance ecosystem** parallel to (and integrated with) the banking system, diversifying the sources of financial robustness.

4. **Monetary Sovereignty and Dollar Leadership:** In the geopolitical arena, a U.S. CBDC would help secure the dollar's role as the **preeminent currency** in a digital age. As other countries launch CBDCs, the dollar must adapt or risk gradual erosion of its usage. A Fed digital dollar, widely adopted domestically and potentially available for foreign holdings at least in limited form, would reinforce the dollar's ubiquity. It could also become a platform for cross-border improvements (faster remittances, direct foreign aid transfers, etc.), extending U.S. influence. While not the main focus, this is a long-run strategic benefit: maintaining currency leadership supports the U.S. ability to finance deficits cheaply and impose financial sanctions effectively.

5. **Data and Policy Innovation:** With appropriate privacy protections, aggregated data from the DPP system could give policymakers **better real-time insight** into economic conditions. The Fed could observe spending patterns quickly (similar to how private card networks glean data) and calibrate policy with less lag. Also, the system could allow for **more creative policy experiments** – for instance, negative interest on balances could be tested in the future if ever needed (since digital money could, in theory, be charged interest, unlike cash – though the current proposal is not about negative rates, it at least opens that door slightly by digitization). Likewise, targeted stimulus to certain groups (if legally

authorized) could be done via these accounts to address specific regional or sectoral downturns. The flexibility is high once the basic infrastructure exists.

- *Expected Costs and Risks:**

1. **Implementation and Administrative Costs:** Standing up the DPP network and the Fed's supporting infrastructure would require significant upfront investment. The Fed and Treasury would need new systems for retail account management, cybersecurity, customer service (though much of front-end service would be handled by DPPs), and oversight of potentially dozens or hundreds of DPP institutions. The **technology build** is non-trivial: a secure, scalable ledger or database to support hundreds of millions of transactions. However, the Fed's ongoing FedNow instant payment service and experience with large-scale systems (like Social Security payments via Treasury) provide a starting point. Budgetary cost could be a few billion dollars spread over initial years – relatively minor in the context of federal spending (and possibly partially recouped via slight seigniorage or fees to merchants). The private sector (banks/fintech) will also incur costs to become DPPs or to connect to the system, but many may repurpose existing digital banking apps. Over time, operating costs would be covered by the interest margin the Fed provides on seed reserves, etc. **Net cost to taxpayers is likely low**, especially compared to the macroeconomic benefits of faster recovery (which implies higher tax revenues than otherwise). Still, careful project management is needed to avoid IT failures or cost overruns (lessons can be learned from other countries' pilots).

2. **Impact on Banks and Credit Provision:** A major concern is that moving some deposits to the Fed system could reduce banks' funds for lending, or raise their funding costs. However, the **scale is limited by design**. The initial seed (about \$130B) is new money, so it doesn't come from banks. Even if the entire \$130B stayed in the DPP accounts and then doubled with new deposits, plus maximum stablecoin issuance, it's under 2.5% of bank and money market fund deposits. So the **deposit outflow from banks is small** relative to a \$17 trillion system. Furthermore, banks can adapt: if a few percent of deposits shift, banks could replace

some funding via wholesale markets or by offering slightly higher deposit rates on larger accounts (since small savers might keep up to \$10k in Fed accounts, banks might compete more for amounts above that). The Fed could also counteract any credit tightening by providing banks with ample liquidity (through its discount window or open market operations) – effectively recycling the reserves. In equilibrium, the impact on interest rates should be minor. **Credit allocation** might shift a bit: banks might focus on loans funded by more stable core deposits or market funding, but they already manage liquidity under Basel III rules. Notably, smaller community banks might worry about losing customers to digital accounts, but those same banks could become DPPs themselves, thus retaining the relationship (just offering the Fed-backed account as one product). Moreover, by helping unbanked people save and transact, banks could actually gain new customers who eventually graduate to needing loans or larger accounts beyond the Fed cap. The proposal explicitly **limits flight-to-quality risk** in crises by the cap, but one must acknowledge that in a severe panic, people could still try to withdraw more than \$10k from banks to split among family members' Fed accounts or other tricks. The Fed would need contingency plans (e.g. temporarily raising the cap or providing emergency guarantees on bank deposits, as was done in 2008 and 2023). This risk is not new – it exists with or without CBDC – but an easy digital option might facilitate faster movement of retail funds. However, as noted, SVB showed that even without a CBDC, technology enabled a \$42B one-day run. So the key is **managing crises with broad tools**; a CBDC could even be used to **rapidly distribute "deposit insurance backstop" funds to individuals** if needed. On balance, while banks will face slightly higher competition for deposits, the regulated rollout and small limits make the **system impact quite modest** – essentially trading a bit of bank profitability for much greater systemic stability and public benefit.

3. **Potential Inflationary Effects:** Some critics might argue that giving the Fed a direct distribution tool could lead to overuse and inflation, effectively "printing money" to solve every problem. However, the framework would be constrained by clear **rules or emergency criteria**.

The Fed would not randomly drop money in normal times – it would do so only to fulfill its mandate (similar to how it uses QE or rate cuts). In fact, a benefit is that it might achieve the 2% inflation goal more symmetrically (preventing too-low inflation as well as too-high). Any injections could be retracted over time (the Fed can later sell assets or raise rates to sterilize, or Congress could institute taxes to soak up excess money after recovery). The initial seeding is a one-time permanent increase in money supply (\~1% of M2) – likely harmless in an environment where digital payments demand is rising (and it pales next to the 40% jump in M2 during 2020–21, which the economy largely absorbed). As with any macro tool, restraint and data-driven use are key. Historical precedent for "people's QE" is limited, but wartime finance and pandemic responses have shown that direct money-financed transfers can be done without hyperinflation if output slack exists. If anything, this tool might reduce the need for massive prolonged QE and ultra-low rates that arguably fueled asset bubbles in the 2010s. So **inflation risk is manageable** with proper governance. The Fed's independence in executing this tool would need to be maintained, perhaps with a pre-set formula or a joint Fed-Treasury board to authorize uses in extreme scenarios.

4. **Privacy and Government Overreach Concerns:** Some will worry that a Fed digital currency means "Big Brother" watching all transactions or the government having the power to freeze individuals' money. These are valid concerns to address via legislation. The system can be designed to **mimic cash privacy for small transactions** – e.g. the Fed/DPPs need not report individual transaction details to authorities unless suspicious activity triggers existing AML thresholds. In fact, large banks and credit card companies today already see and sometimes share a lot of our financial data; a well-regulated public system could potentially have *better* privacy standards (not monetizing data, etc.). Education and transparency will be needed to assure the public that this isn't a surveillance tool. Clear legal firewalls on data use should be established. **Cybersecurity** is another risk – a breach in a national digital currency platform would be very damaging. Thus, top-tier security investment is non-negotiable, and continuous monitoring (possibly including quantum-resistant encryption

down the line) will be needed. The **benefit-risk tradeoff** here still seems favorable: the U.S. already largely operates on digital money (bank accounts, Venmo, etc.); this proposal moves some of that into a safer, regulated space. Done right, it can actually *reduce* fraud (through Fed verification systems) and *improve* privacy (by offering an alternative to Big Tech payment platforms which might misuse data).

- *Fiscal Impact: **In the short run, aside from initial IT costs, the main fiscal impact is the** \$130 billion seed transfer**. This increases government debt by \$130B (or the monetary base by that amount) but is not a recurring cost. The interest on that debt or money (\~\$2B/yr at 1.5% interest, for example) is effectively the "carry cost" of maintaining the seed. However, this could arguably be netted against the seigniorage income the Fed earns on its broader balance sheet. If the program leads to more currency or reserve demand, the Fed's remittances to Treasury might actually rise in the long term. If we get technical, the consolidated government balance sheet is fine: Fed created money to give to people, and they hold an asset (the RIB or just the implicit asset of future withdrawal of money via taxes or Fed tightening). In** plain terms, \$130B is small** – about 0.5% of GDP – and well worth the insurance it buys against deep recessions.

- *Benefit-Cost Conclusion: **The long-term** gains in economic stability, inclusive growth, and policy effectiveness **far outweigh the relatively minor fiscal and administrative costs. By spending on this infrastructure now, the U.S. could save potentially** hundreds of billions in output** that might be lost in future recessions. The policy also has a self-liquidating aspect: when the economy is stronger and inflation higher, the Fed wouldn't be distributing money; it might even slowly drain some if needed – so it's not an ever-growing liability. Meanwhile, the social benefits (every citizen having a safe account, fewer people falling through cracks in crises) bolster the nation's economic resilience and cohesion.

Independent studies (Fed or academic simulations) would likely show that even a small improvement in stabilizing the business cycle yields large welfare gains. For instance, avoiding just 1 percentage point of excess unemployment in a recession can keep perhaps 1–2 million people employed, maintaining income and skills. If this tool can shorten a typical recession by a quarter or mitigate the peak unemployment, that's hugely valuable. Furthermore, confidence in the Fed's toolkit itself has unquantifiable benefits – if businesses and consumers trust that downturns will be buffered, they may invest and spend more freely, sustaining growth.

- *Political and Industry Considerations: **There will be lobbying by banks concerned about competition, and political actors skeptical of empowering the Fed or of anything that sounds like "free handouts." To address this, the policy can be framed as a** stabilization insurance **– much like deposit insurance, it's a safeguard that benefits everyone by preventing disasters. Banks can be included as partners (many will become DPPs), and perhaps given small compensation for their role. It's important to note that** no bank failed purely due to lack of retail deposits** – they fail due to bad assets or liquidity mismanagement of much larger sums; so this will not put healthy banks out of business. On the contrary, by expanding the economy and improving payments, banks can find new opportunities (more lending to a healthier consumer base). Education will be key to avoid misunderstandings about "Fed accounts" – the average American might not care who backs their Venmo balance, until it disappears; this ensures it never disappears.

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