Would a Digital Dollar Hurt Banks?

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There are folks in the crypto world who would prefer that decentralized finance and traditional finance remain separate entities. These folks just got an ally, as traditional banks are opposed to the development of a United States digital currency. The US Treasury and Federal Reserve have been considering the idea of a digital US currency and weighing the pros and cons. Banks are looking at the downside of a digital dollar. Would a digital dollar hurt banks? Such an entity could end up sucking out bank deposits and putting a lot of banks out of business.

Getting a Governmental Handle on the Digital World

Banks are increasingly against **US digital dollar plans**. To understand their concern you need to back up a bit and get the history behind this idea. In 2022 President Biden issued an executive order about the future of **US money and payment systems**. In this order, Biden ordered governmental agencies like the Securities and Exchange Commission, the Commodity Futures Trading Commission, the US Treasury, and the US Federal Reserve to get their ducks in a row regarding digital currencies. On one hand this gave stronger impetus to efforts by the SEC and CFTC to regulate the crypto world. It also sped up consideration of a digital US currency.

What Is a US Digital Currency?

Crypto has come from virtually nothing to being a measurable part of the world's and nation's financial pictures. When Biden issued his executive order, crypto was still worth a trillion dollars. It has fallen since. But it has the potential to recover and cause havoc with the traditional financial system. Thus, the government got interested in the issue and started thinking about ways to integrate crypto into the world of traditional finance. Part of this was for the Federal Reserve to issue its own digital currency that would work like the ideal stablecoin because it would not just be backed by the US dollar but would be the US dollar. The Fed would be the issuer and holder of these crypto or digital assets.

A Digital Dollar Could Cause a Banking System Collapse

A digital currency would compete directly with bank deposits and drain money out of the banking system. That is the argument of US banks. Banks make money by paying interest on deposits and charging more interest on loans. If they have no money from deposits they cannot make loans. They go out of business. The government is concerned about supporting the status of the US dollar as the world's reserve currency. This is turn has ramifications for the US economy and the US standard of living. Other nations (China) are moving towards developing digital currencies and some in the government think this could leave the US at a disadvantage. Thus we have a rush to check this out and put a digital asset system in place. Meanwhile, banks are panicking.

Banking With the Federal Reserve

The issue that banks have with a proposed US digital currency has to do with whose assets these are. If one made their digital currency deposits with their local bank, the bank could not pay them interest or charge interest on loans based on those deposits. That would be because the digital assets would be assets of the Federal Reserve and not anyone in the banking system. When we read about bank runs and banks collapsing (Silicon Valley Bank) we can see how folks want to make sure that their money is safe. The problem with folks like depositors at SVB was that they had far more than the amount insured by the Federal Deposit Insurance Corporation in the bank. So, why not just put your money on deposit with the Federal Reserve (who can simply print money) instead of with a local bank? Banks see this as a rather unfair situation.

Maybe We Won't Have a Digital Currency

Good news for banks is that not everyone in charge at the Federal Reserve thinks that a digital currency is a good idea. Federal Reserve Governor Michelle Bowman recently said that the risks of having a central bank digital currency for use by everyday Americans might be greater than the benefits. Governor Bowman allows that such a vehicle might be useful for intra-bank transactions. She highlighted the possibility of draining assets out of the traditional banking system as one of the risks. As such, banks can heave an at least temporary sigh of relief as can those in the crypto world who would just as soon that the Fed stayed out of the crypto and digital currency business.

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