What History Can Teach Us about E-Money

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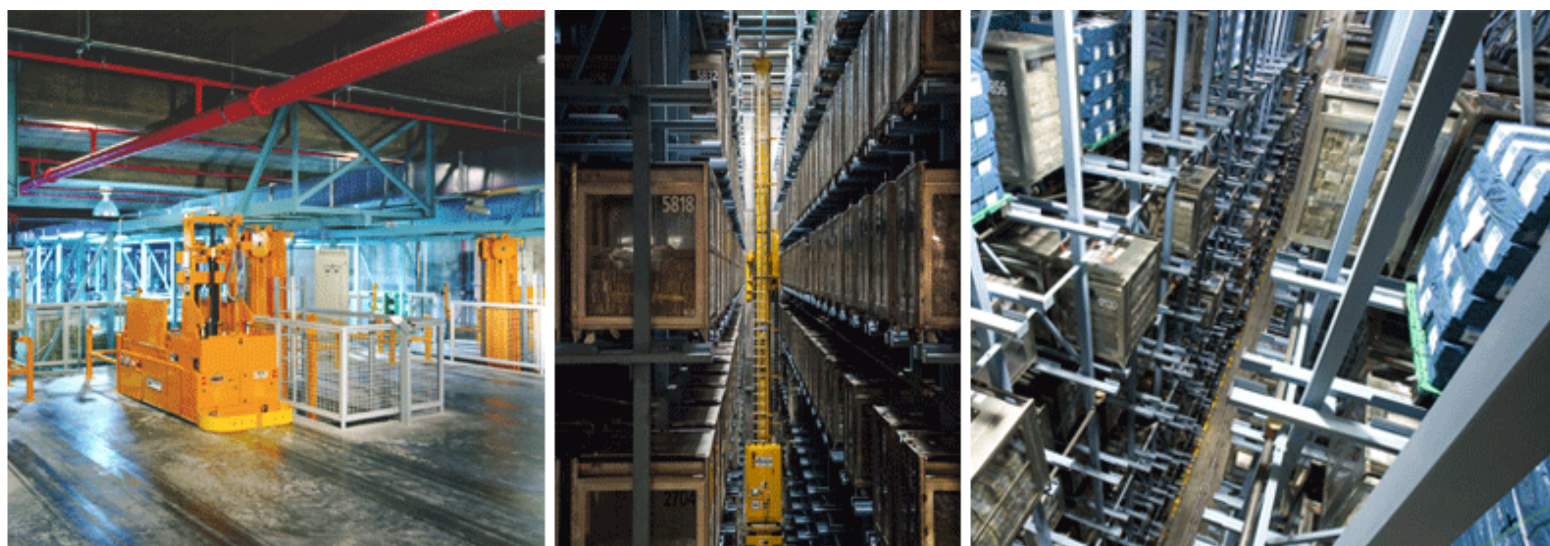
The period from 1914 to 1935 was unique in U.S. monetary history, and not just because it witnessed the Great Depression or the founding of the Federal Reserve System. It was also the only time in U.S. history when government-issued and privately issued bank notes circulated simultaneously. The currency we use today, Federal Reserve notes, was issued starting in 1914 by the newly created U.S. central bank. Privately issued national bank notes, meanwhile, circulated from 1864 to 1935.

Those two decades hold important insights for electronic money, or e-money, says **Warren E. Weber**, an economist and visiting scholar at the Atlanta Fed. They help answer such questions as so, can privately and centrally issued e-moneys coexist?

Federal Reserve notes share important features with e-money, which includes PayPal accounts and prepaid cards. Like e-money, Federal Reserve notes have monetary value, are a liability of the issuer, and are widely accepted as a means of exchange. (Bitcoin and most other cryptocurrencies are not included in Warren's definition of e-money because they do not have an issuer.)

Because of these similarities, the 1914-35 period may hold some important lessons for e-money as it becomes an increasingly popular medium of exchange in many economies. Weber explored some of these lessons in recent work published in the Atlanta Fed's working paper series.

E-money implications tied to central bank independence



When Federal Reserve notes and national bank notes circulated together, one wasn't more desirable than the other, Weber found. So why even issue Federal Reserve notes? Mostly because the Fed needed to issue currency so it could fulfill a key objective–that is, to act as lender of last resort in times of financial stress, he said.

After circulating together for 20 years, national banks notes were eventually removed from circulation because they interfered with the Fed's ability to control the amount of bank reserves in the economy–a key tool of monetary policy.

So, could government-issued and privately issued e-money coexist? Based on the 1914 to 1934 experience in the United States, the answer is definitely yes, writes Weber. Yet there's also an important reason for the central bank to be the sole issuer of e-money. That is, if privately issued e-money were to significantly crimp demand for Federal Reserve notes, in turn eroding the profit the central bank earns from issuing money, "then this would be a strong argument for prohibiting them," he explained.

The Fed earns a large share of its income from interest on U.S. government securities that it trades through open market operations. It also earns interest on foreign currency investments and collects fees from the services it provides to depository institutions. Importantly, these independent sources of income give the Fed operational independence, insulating it from short-term political pressures and helping it more credibly commit to promoting price stability and maximum employment in the long run.

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