The Daily Dish

The Fed and Real-Time Payments

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Eakinomics: The Fed and Real-Time Payments

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The summer heat in the U.S. capital may be the only plausible reason for one odd notion that has seized imaginations in Congress: that the Federal Reserve build and operate a real-time payments platform. The Fed has been considering building such a system for a while, and a couple of bills were recently introduced in Congress, notably including one by presidential candidate Senator Warren, that would compel the Fed to do so. On Thursday of last week we received the clearest sign yet in the form of a letter from Fed Chairman Jerome Powell to members of the U.S. Senate in which he noted that the Fed is "seriously considering" the matter and set out the Fed's justifications for doing so.

A real-time payments system would be unquestionably a public good. Such a system would eliminate the lag that currently exists for many financial transactions—a lag that leads to $15 million in overdraft fees, $9 million in payday lending, and other costs for both individuals and businesses. But the idea that the Fed should build this system has numerous, fatal flaws.

To begin, it is not clear why the Fed should build a new system when the solution already exists in the market. In 2017 The Clearing House, with the Fed's support, rolled out a real-time payments system that currently supports half of all U.S. accounts and is expected to have total coverage by 2020. It seems odd that this should be a priority for the Fed at a time when it has considerably more pressing concerns.

Further, such a real-time payments platform appears to be outside of the Fed's legal mandate. The scope of the Fed's powers in this arena is determined by the 1980 Monetary Control Act, which notes that the Fed should intervene only if "the service is one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity." Although adoption of a real-time payments system has been slow relative to other nations, there is simply no evidence of a market failure that would justify the Fed's intervention.

To participate in, supervise, and regulate the financial system simultaneously is an overwhelming conflict of interest. In a close parallel with what is being proposed here, the Fed provides automated clearing house services while also regulating the industry, and the Fed has systematically lowered its prices to capture the largest customers at the expense of both its competitors and smaller customers. Despite this precedent, proponents of the Fed's involvement ironically contend that the Fed is needed here to prevent anti-consumer monopolistic practices—an argument difficult to make in any event, given the range of private options in this space from companies such as Mastercard, PayPal, Venmo, and Zelle.

And those aren't even the practical concerns. Setting up another, entirely duplicative payment system would potentially cost hundreds of millions of dollars, a cost borne by the taxpayer. The time required to develop, test, and launch this system would, optimistically, take the Fed between three and five years. And even after all that, the Fed's system, which would require significant new expertise at the bank, would likely not be superior to

ones currently being developed in the private market, which has decades of experience and the nimbleness a government body typically does not possess.

Government bodies entering public markets reduce competition, stopping or slowing down innovation. The Fed’s actions have already slowed the adoption of a real-time payment network, as businesses freeze development in the wake of the uncertainty this unnecessary development has created. It can only be hoped that cooler heads will prevail.