Trust: government vs private companies

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A year after their 2019 paper "Understanding Central Bank Digital Currencies" (CBDC), the Cashless Society Working Party is revisiting the topic with a blog series. In this last blog, Orla Ward discusses the importance of trust in the monetary system.

Trust, not money, makes the world go round. While fiat money is not a formal debt of government, its usage relies upon users' faith in government and that the value of money will be maintained. As such it is interesting at this time that the impressive 35% gain in Bitcoin this year is at odds with Central Bank proposals to launch a Central Bank Digital Currency (CBDC). Bitcoin was conceived from the 2008 financial crisis and as we face into another recession it is curious that the cryptocurrency is gaining further traction. In light of the coronavirus pandemic and social unrest against racism, perhaps it is viewed that cryptocurrencies are important in taking back control of the monetary system. Cryptocurrency has the potential to act as a hedge to the volatility experienced in traditional markets. This is in sharp contrast to the actions of central banks acting in unison to spend trillions of dollars on asset purchases to stimulate the economy which has had the effect of further driving down interest rates across the developed world.

Central Banks are exploring the opportunities, risks and practicalities of providing a CBDC. They have stated that a CBDC provides opportunities for improved payments in an increasingly digital economy, the pace of which has only increased due to the pandemic. However, many of us already operate in a digital environment embracing contactless payment, mobile payment, using digital banks (Revolut and Monzo) and the ease of payments through OTTs (Over The Top Players e.g. PayPal, Amazon, Apple).The general public has truly embraced digital payments already and arguably a CBDC is too late to disrupt the private payments market.

Yet there is another driver for a CBDC which the Bank of England has described as "avoiding the risks of new forms of private monetary creation". This is where the conflict between public and private payment systems collides. Facebook's desire to launch Libra, a blockchain digital currency, was halted by US lawmakers and the European Union in July 2019. Libra had the potential to threaten Central Bank monetary policy and some of the functions and oversight of the banks. With Facebook's massive ecosystem, millions of users would potentially have had access to Libra thereby giving private companies unprecedented control over the global economy, partly outside of central bank control. However, the desire of Facebook to launch its own digital currency raises questions as to its motivation - arguably it was seeking the power to use individuals' data and to monetise this information.

The competition arising from the threat of Libra has led to greater calls in the U.S. for the creation of the digital dollar (a US CBDC) with the proposed benefits being financial inclusion and the potential to provide direct stimulus payments to citizens such as during the COVID-19 pandemic. At the US Senate Banking Committee at a hearing titled ‘Examining Regulatory Frameworks for Digital Currencies and Blockchain’ it was argued that the ambitions of cryptocurrency to resolve issues of inequality and inefficiency are not problems of technology but that they are problems of policy which are for central banks to resolve and not a tech company .
The raison d’être of bitcoin, and many similar forms of fintech, is to attract those with a dislike of existing financial structures, including the financial structures within central banks. Where cryptocurrencies have an advantage in allowing transactions to remain anonymous, their weakness is that the currency is not backed by any government or central bank and so the currency is highly volatile. Private players arguably have a market advantage in that OTTs are household names. Facebook’s Libra would act similarly to a CBDC by promising convertibility into notes, eliminating the volatility concern but relying on trusting technology companies. Central banks are keen not to allow fintech innovation outside of banking regulation given their concerns on the potential to destabilise monetary policy.
A CBDC can’t provide the anonymity of a cryptocurrency and given that we already are using OTT payment platforms the desire to adopt a CBDC may be limited. Often the greatest concern raised for a CBDC is the risk that it has the potential to destabilise the commercial banking system but the bigger risk may be attracting usership. A CBDC would have to offer citizens greater benefits than are currently available to have widespread adoption such as higher interest rate payments or for example, their use for helicopter payments. However, the driving force from the central banks’ perspective is not to provide either of these uses in the near term.
It will be fascinating to watch the innovation conflict of public and private players in the coming months and will raise questions within each of us as to whom do we trust most to ensure the world continues to go round.