Spotlight on stablecoins & CBDCs: Part 3

March 24, 2022

Examining the implications of central bank digital currencies worldwide

This is the third installment in a series exploring stablecoins and central bank digital currencies. Previously, we discussed fundamental similarities and differences between these two novel financial instruments, followed by a spotlight on stablecoins. In this article, we focus on the implications of central bank digital currencies (CBDCs) and their worldwide status.

Snapshot of what it is

Every advancement in the history of money and payments borrows and retains concepts of its predecessor paradigm. In a reductive way, CBDCs are "simply" (fiat) money in digital form.

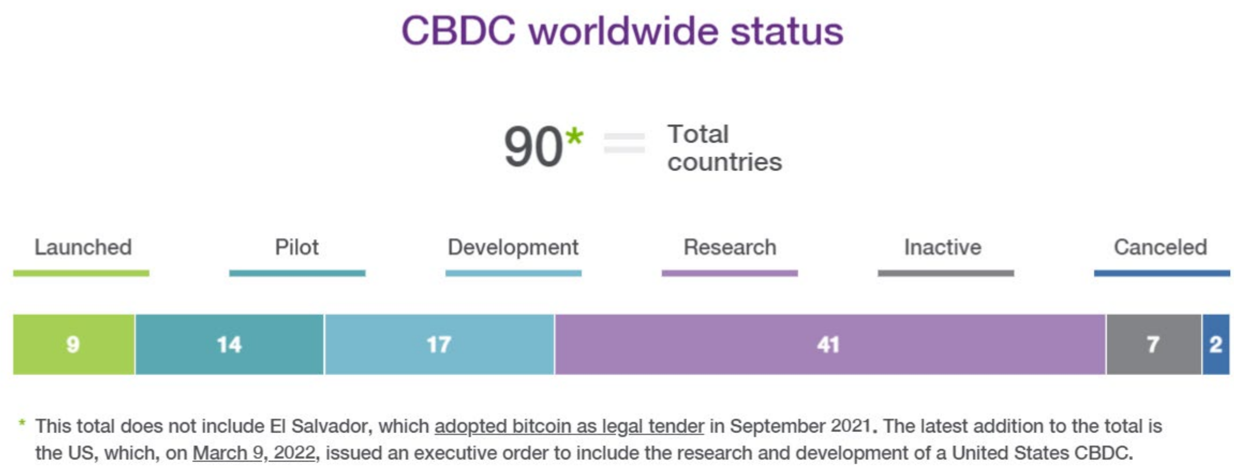
CBDCs around the world are:

- digital money backed and issued by a central bank; the digital format of a fiat currency for a particular nation or region;
- an electronic record or digital token of a nation or region's official currency that is issued and regulated by its monetary authority;
- a medium that allows citizens to make digital payments and store value; and
- designed to be universally accessible as a way to make payments (equivalent to cash).

The global origin story

The advent of CBDCs around the world differs depending on whom you ask and from where you are asking. Along with the ongoing development of stablecoins, Facebook fired the starting pistol in 2019 when it announced the launch of Diem (formerly Libra) (the project would have offered users a method to make payments with a currency "centralized" by Facebook). The regulatory scrutiny that followed revealed significant concerns from monetary authorities in the U.S. and around the world, and ultimately lead to the end of the Diem project; meanwhile, governments began considering what issuing digital currency in their own countries would look like.

In May 2020, 35 countries were considering the prospect of their own CBDCs. By 2021, a survey by the Bank of International Settlements identified that 86 per cent of central banks in the world were actively researching the potential for CBDCs. As of February 2022, we have identified 90 countries that have engaged with CBDC development in some way.



Worldwide motivators: monetary sovereignty and financial inclusion

We have looked at CBDC development in 90 countries to identify motivations behind the pace of interest in this novel payments system. We summarized a few main reasons for CBDC development in our first installment, which range from increasing financial inclusion, increased efficiency to promulgate monetary policy, and a reduction of certain costs and risks inherent to current financial systems.

At the same time, gleaned from the issues regulators raised when considering Facebook's Diem, a universal motivator for the development of CBDCs around the world is the preservation of monetary sovereignty. If successfully co-ordinated as a rail for cross-border money movement, the portability of CBDC systems means that a strong CBDC issued by a foreign country (or a company) could potentially substitute the local currency of a weaker country.

Other notable motivators depend on existing realities and needs of a country's banking and payments infrastructure, and a nation's prevailing social priorities. Financial inclusion is one of the most cited objectives by governments engaged with CBDC development. Countries and their related CBDCs include, but are not limited to, Nigeria's e-Naira, the Bahamas's Sand Dollar, China's e-CNY, Ghana's E-cedi, Malaysia's E-Ringgit, Ukraine's E-hyrvnia and Brazil's Digital Rael. The Bhutan government, in partnership with the payment protocol, Ripple, has stated goals for the Digital Ngultraum to increase financial inclusion in that country to 85 per cent by 2023.

A functioning CBDC should simplify the implementation of government monetary and fiscal policy (for example, secure, reliable and swift disbursements of COVID-19 or other relief to individuals and businesses), and promote financial inclusion by enabling under-banked regions with safer and easier access to money and banking services. The cost of developing banking infrastructure, including the safeguarding and transportation of physical cash, has long been a roadblock to financial inclusion for unbanked populations.

Of course, there is no one-size-fits-all solution for all the problems and frictions of current financial systems. In Japan, Project Stella emphasizes the ability to execute payments offline, with the hindsight of natural disasters disrupting payments systems in mind. Regions that lack broadband access will have similar priorities for their CBDC.

Many central banks are taking a measured approach before launching a CBDC. For Canadians, the Bank of Canada has stated that it will consider launching a CBDC if certain scenarios materialize or become likely. These scenarios are:

1. if the use of bank notes were to continue to decline to a point where Canadians no longer had the option of using them for a wide range of transactions; or
2. if one or more alternative digital currencies—likely issued by private sector entities—were to become widely used as an alternative to the Canadian dollar as a method of payment, store of value and unit of account.

Reach out to any of the authors or key contacts below if you have questions about stablecoin regulations or central bank digital currencies.

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