This Was Another Big Week For Central Bank Digital Currencies (CBDCs)

Description

Another G-7 economy took a big step toward adopting a central bank digital currency (CBDC). **At the same time, the first largish economy to have launched a CBDC, Nigeria, descends further into financial chaos.**

This week, two big things happened in the CBDC arena. One of the world's oldest central banks, the Bank of England, and the British government jointly confirmed that a digital pound would probably be necessary at some point in the none-too-distant future. While they were saying that, lengthy queues were forming at ATMs across Nigeria, the first largish economy to launch a central bank digital currency (CBDC), as most Nigerians struggle to access physical money following the government's disastrous demonetisation campaign.

“A New and Trusted Way to Pay”?

Let’s begin with the UK, whose latest Chancellor of the Exchequer Jeremy Hunt this week described CBDCs as potentially “a new and trusted (state-backed) way to pay” that is likely to emerge some time this decade. John Cunliffe, Deputy Governor for Financial Stability of the Bank of England (not to be confused with the creator of the children’s books and animated TV series, Postman Pat) said:

> Our assessment is that on current trends it is likely that a retail, general purpose digital central bank currency — a digital pound — will be needed in the UK.

With cash usage in rapid decline in the UK, a digital pound would perform the “anchor function” which cash currently carries, allowing the holder access to Bank of England money, Cunliffe said. It would also counter the risks posed by so-called “stable coins”, which are relatively new forms of cryptocurrency that are pegged to the value of a fiat currency (e.g, the dollar or the euro), while also ensuring that certain tech firms are not able to monopolize areas of the online market with their own coins.

These are all classic justifications for launching a CBDC. But not everyone in the UK’s political establishment agrees that they constitute sufficient cause. For example, the former governor of the Bank of England, Mervyn King said in January, 2022: “By far the most important question is what is the problem to which a CBDC is the solution?” King said a number had been proposed but “none of them were terribly convincing”.

Also, the House of Lords’ Economic Affairs Committee recently concluded that it is “yet to hear a convincing case” for why the UK needs a retail CBDC. On the contrary, while a CBDC “may provide some advantages”, it could present “significant challenges” for financial stability and the protection of privacy.

But the Bank of England and the UK Treasury respectfully beg to differ.

“A digital pound would be a very substantial financial infrastructure project that would take several years to complete,” Cunliffe said in a speech to UK Finance, a trade association representing over 300 firms in the UK’s banking and financial services sector. “It would, as many in this audience know, have major implications for the way we transact with each other and, more broadly, for the financial sector and the economy in general.”

An Extra Layer of Operations

One major implication is the impact it could have on the current banking system. As the UK-based economist Richard Werner and author of the critically acclaimed book, Princes of the Yen, has noted, if central banks were to offer retail CBDCs directly to individuals and businesses, meaning they would all be able to hold the equivalent of a current account at the central bank (as long as they have a smart phone and don't engage in the wrong sorts of behavior), it would more or less mean the end of banking as we know it:

> "All you would need is a shock or a crisis. All the money would move from the bank deposits to the central bank and the banking system shuts down."

This would lead to the creation of what Werner calls "mono-banking," in which just one lender, the central bank, is able to operate.

To avoid this outcome, the BoE is considering imposing a limit on the holdings of the new digital pound of £10,000 to £20,000 ($12,017 to $24,033) once it comes into existence. The digital pound would also not bear interest.

The last thing the world's central banks want to do is wipe out large private banks, whose interests they tend to serve above all else. In fact, central banks are working hand-in-glove with many TBTF lenders to set up the CBDC infrastructure. Instead, what the BoE and many other central banks are talking about doing is creating an extra layer of operations within the financial system. And while the BoE (with help from the private sector) will create the currency, private banks will be the main public interface for that new layer, as Cunliffe himself posited in a panel discussion last June:

> We will produce the asset and the rails but the interface with the public would actually be done by private-sector payment providers. It could be banks that will have the customer accounts payable to integrate money into their digital applications…
>
> There are other models. One model is we allow the private sector to do the tokenization, to provide their own money that we back one-for-one with central bank money.

So, CBDCs will probably not be used to supplant the entire private banking system, as some feared. But what they could — and probably will — end up doing is put out of business small, local banks and credit unions, which will not be able to cope with the added layers of regulatory costs, burdens and complexities. In the US, the National Association of Federally-Insured Credit Unions (NAFCU) warned last year that the issuance of a digital dollar could erode financial stability, arguing that the costs and risks associated with introducing a CBDC are likely to outweigh the touted benefits.

Other Implications of a CBDC

So, what other ramifications could a CBDC have for households and businesses? At the risk of repeating myself, here is a brief recap of some of the most important ones (please feel free to add more), taken from my previous post, Unbeknown to Most, A Financial Revolution Is Coming That Threatens to Change Everything (And Not for the Better).

CBDCs will grant central banks far more power over our payment behavior. As Agustin Carstens, general manager of the Bank of International Settlements, the central bank of central banks, famously admitted at a 2020 summit of the IMF:

> We don't know who's using a $100 bill today and we don't know who's using a 1,000 peso bill today. The key difference with the CBDC is the central bank will have absolute control [over] the rules and regulations that will determine the use of that expression of central bank liability, and also we will have the technology to enforce that.

Given the key role central bank policy has played in exacerbating wealth and income disparities in recent decades, the idea of central banks grabbing even more power should give serious pause. Indeed, one of the major risks highlighted by the House of Lords' Economic Committee's report on CBDCs is that it would grant central banks "greater power without sufficient scrutiny".

Central banks will be able to "program" our spending. In June 2021, the *Daily Telegraph* reported (behind paywall) that the Bank of England had asked Government ministers to decide whether a central bank digital currency should be "programmable". As the article noted, "digital cash could be programmed to ensure it is only spent on essentials, or goods which an employer or Government deems to be sensible."

Tax evasion, money laundering, terrorist financing and other unapproved transaction would also become more difficult. Fines could be levied in real time. As NS Lyons, a Washington DC-based political analyst and blogger, notes in his article, Just Say No to CBDCs, "a CBDC would allow government to operate at much higher resolution. Targeted microfinance grants, added straight to the accounts of those people and businesses considered especially deserving, would be a relatively simple proposition.

By the same token, Lyons warns, CBDCs could be used to significantly curtail public choice. In a cashless CBDC-dominated world, less socially or politically desirable people or organizations could even be denied access to the financial system — something we already saw happen with the Freedom Convoy in Canada:

> "The most dangerous individuals or organizations could simply have their digital assets temporarily deleted or their accounts' ability to transact frozen with the push of a button, locking them out of the commercial system and greatly mitigating the threat they pose. No use of emergency powers or compulsion of intermediary financial institutions would be required: the United States has no constitutional right enshrining the freedom to transact."

Other potential forms of programming applications include setting expiry dates for stimulus funds or welfare payments to encourage users to spend it quickly.

No limit on negative interest rates. Beyond providing central banks with greater control over people's spending habits, CBDCs would also grant them the possibility of taking interest rates into far deeper negative territory. If there is no cash, there is no means for people to escape negative rates no matter how negative they go. This is one of the benefits often lauded by Harvard economist Kenneth Rogoff of a completely cashless society. Yet central banks continue to insist that physical cash will not be eliminated once the CBDCs are fully operational. But as I've noted previously, central banks are not exactly known for keeping their word.

Greater Government Surveillance of Your Personal Data. As I've repeatedly warned over the past year, including in my book *Scanned*, central bank digital currencies will almost certainly go hand in hand with digital IDs. In 2021, the FT wrote: "What CBDC research and experimentation appears to be showing is that it will be nigh on impossible to issue such currencies outside of a comprehensive national digital ID management system." That will mean even broader and closer scrutiny of your most personal data.

Given as much, it is almost certainly no coincidence that last week — just days before the BoE underscored its interest in developing a digital pound — the UK government quietly unveiled a public consultation on draft legislation for the establishment of a digital identity framework. The government is also proposing subsidising private digital ID schemes. As readers may recall, it has also signed a digital trade agreement, or DTA (yes, they do exist), with the Urkainian government that includes a commitment to collaborate on digital identity.

The British government insists that any future digital ID will not be made compulsory for British citizens. But governments, like central banks, have an annoying habit of breaking promises, particularly on the important stuff.

Greater System Fragility. As the House of Lords report warns, a CBDC risks creating "a centralised point of failure that would be a target for hostile nation states or criminal actors." It would also be vulnerable to power, telecoms and IT outages, which countries are experiencing with ever great frequency.

Meanwhile, the Bank of England bank and UK Treasury insist that the decision to go ahead with a CBDC has still not been taken, and won't be until around 2025:

> The Taskforce's conclusion is that we are not yet at a point where a firm decision can be made to implement a digital pound.

And if you believe that, I've got a digital bridge to sell you.

As the BoE itself notes, the process of building the infrastructure for a digital pound will be painstaking, and will probably take a number years. Yet we are to believe that it won't be until the infrastructure has actually been built that the decision will be made as to whether to use it. It's a bit like sending troops halfway across the world to the border of a country you are thinking of invading, such as, say Iraq, but putting off the decision as to whether to actually invade until the very moment that all the troops are amassed.

Creating a Global Monetary Laboratory

“CBDCs could equip central banks with new tools to significantly help soften the impact of forthcoming financial crises, given they would provide a real-time view of risks and currency outflows,” Martin Hargreaves, chief product officer at blockchain firm Quant, told Bloomberg.

Martin Hargreaves is also a member of the steering committee of the Digital Pound Foundation, which describes itself on its website as an “independent organisation whose mission is to work with a variety of stakeholders and participants towards the implementation of a well-designed digital Pound and an effective and diverse ecosystem for new forms of digital money.”

The organization was incorporated less than two years ago, on June 22, 2021. On its home page, the foundation’s chairman, Jeremy Warner, says the following in a short video:

> The world has become a global laboratory, trying to understand the ramifications of this fast growing phenomenon. Governments and private enterprises are developing something that will serve humankind better than any past or current forms of money. This new form of money is only possible because technology is transforming all the interactions between human beings, which themselves need money, and money must therefore adapt to serve those interactions. The ramifications of this will affect every one of us.
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> It is unlikely that we will see a global version of this form of money until we have a form of global government so nation states, regional governments and private enterprises are also working on their own versions.

So, unbeknown to most people, we are living in a global monetary laboratory. We are being steered through a financial experiment that threatens to change just about everything (and for most of us, not for the better).

According to the Atlantic Council’s CBDC tracker, 114 countries, representing over 95 percent of global GDP, are exploring a CBDC. That’s up from 35 countries in May 2020. Eighteen of the G20 countries are now in the advanced stage of development. Of those, 7 countries, including China and India, the world’s two most populous nations, are already in pilot. Eleven countries have fully launched a digital currency, with the latest being Jamaica, and China’s pilot is set to expand to most of the country in 2023.

A Warning from Nigeria

But only one largish economy has actually fully launched a CBDC, and that is Nigeria. And the results have so far been disastrous.

The eNaira has so far been a total flop, as I reported for NC in July and November last year. One year after its launch, in October 2021, fewer than 0.5% of the population had downloaded an eNaira wallet — a thoroughly underwhelming number in a country with an estimated population of 225 million people. Worse still, only 282,600 of those accounts were currently active. Meanwhile, interest in cryptocurrencies has surged.

To try to salvage its monetary experiment and essentially force people to use digital means of payment, preferably the so-called “eNaira”, Nigeria’s government launched an all-out assault on cash in December. Taking a leaf out of India’s book, the government began issuing redesigned high value notes from mid-December and gave residents until the end of January to turn in their old notes. When it became clear that the banking system wasn’t even close to ready to disburse the new notes, the deadline was extended to Feb 10 (i.e., today).

According to the Nigerian Central Bank and government, the demonetisation campaign is intended to mop up excess cash liquidity, stay ahead of counterfeiters and take greater control of Nigeria’s money in circulation, more than 85% of which is currently outside the vaults of the country’s banking system. But another key goal is to salvage Nigeria’s floundering central bank digital currency, the eNaira. And the result has been total chaos.

In a country that was already grappling with a currency crisis, soaring inflation and fuel shortages (despite being Africa’s largest oil producer) and whose sovereign rating was recently downgraded even deeper into junk territory, there is now an acute shortage of money. As in India, the result has endless lines at ATMs. Commuters in the capital and beyond have been left stranded with no cash to pay for transportation back home. Many small businesses, which represent the lion’s share of the economy, and predominantly rely on cash payments, have had to shut down as their customers have no money to pay.

Astonishingly, as the central bank has withdrawn the old notes from circulation, Nigeria’s mint has not come even close to replenishing the money supply with new notes. In fact, the central bank does not even know how much new currency is being printed. When grilled by members of the House of Representatives during a plenary session, Aishah Ahmad, the deputy governor of CBN, admitted she had no idea “how much was printed of the new naira notes”.

This is a monetary experiment going very badly wrong in real time, and one which other central banks will presumably be learning from. But even as Nigerians’ lives and businesses have been plunged into chaos, the government and central bank see it as a small price that is well worth paying. Godwin Emefiele, the CBN governor, has hailed the experiment as a success, given that 80% of the $7.2 billion previously held in private hands had been deposited with financial institutions, which he labels a success. Finance Minister Zainab Ahmed concurred, saying: “The only sore point is the pain it has caused to citizens.”

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