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Opinion

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Central Banks Face a Moment of Truth on Crypto

Europe and the U.S. might have to pick up the pace if emerging-market digital-currency projects start to bear fruit.



Moment of truth.

Photographer: Chris McGrath/Getty Images Europe

By

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The head of the Bank for International Settlements, Agustin Carstens, recently set out a dark vision for our financial future, quoting Goethe's "Faust" and claiming that the "soul" of money was at stake.

He warned that the proliferation of unregulated cryptocurrencies and the spread of Big Tech firms into payments risked damaging consumer trust and splitting the monetary system. To build a safer alternative, he said, central banks should issue digital cash, which would serve as a bedrock for private-sector payments technology while also curbing the industry's rent-seeking excesses.

The most remarkable part of Carstens' speech wasn't his call for central-bank digital currencies (CBDCs) — the idea has been around for years — but rather his acknowledgment of the head-spinning pace of change in financial technology since the pandemic. Carstens nodded to the metaverse, to DeFi and to stablecoins, showing how rapidly things have moved since Meta Platforms Inc.'s Facebook announced its controversial and eventually aborted Libra currency project in 2019.

We are fast approaching a moment of truth for central banks' ability to get a grip on their role in our crypto future. A record amount of pandemic-fueled venture capital was poured into digital assets last year. Yet central banks' own plans for issuing digital currency, as the map above shows, have been ticking along very gradually. Most remain in the pages of technocratic reports or within laboratory experiments. A digital dollar or digital euro remains years away. Emerging markets, with less to lose, are moving quicker.

It's easy to see why there's a disconnect between the urgent, radical optimism expressed by Carstens and the go-slow ambivalence shown by many countries. A recent U.K. House of Lords report called CBDCs a "solution in search of a problem" and suggested improved regulation, rather than a new form of centrally issued money, would be a better answer to crypto and fintech risks. In the U.S., there's no desire to be a first mover if it destabilizes the dollar. A recent survey by think tank OMFIF also suggests consumers in developed markets seem well-served enough by the current system to view CBDCs with caution.

Given how much central banks are struggling with their core mission of price stability — as inflation runs more than three times above target in much of the developed world — taking on even more powers looks like a big ask.

But it'd be dangerous if ambivalence becomes inaction. If there is a positive case to be made for CBDCs beyond the silent plumbing of wholesale payments, it can surely be made now — especially since the obstacles are mainly about policy rather than technology.

Carstens' vision, if very optimistic, includes some key advantages that regulation might not deliver on its own: A CBDC could function as a backstop to private-sector payments, acting as a safe haven in times of crisis, and also provide a more open and global standard of trusted digital money and identity, lessening the appeal of cryptocurrencies like Bitcoin.

Cornell University Professor Eswar Prasad, in his book "The Future of Money," lays out other advantages. For example, payments could become cheaper and quicker, low-income households and the under-banked could see greater access to digital payments, and there could be less fraud and crime. Plus monetary policy could improve if it were applied directly to individual accounts. Distributing pandemic stimulus might have been easier with digital wallets.

These concepts are disruptive and will certainly have costs. We are used to calling up our bank to complain about an error — imagine trying to call up the central bank. A CBDC would also arguably expand the state's role in the economy, potentially reducing innovation, while impinging on privacy and the role of commercial banks.

But costs can be mitigated, as some projects are showing in real-time. When it comes to privacy, Nigeria's recently launched digital naira allows small payments with only a phone number, imposing tougher checks as transactions increase in size. And when it comes to financial stability, the Bahamas' "Sand Dollar" caps the amount that can be held in digital wallets, reducing their impact. If these emerging-market initiatives bear fruit, it will be time for the U.S. and Europe to ask whether kicking the can down the road for the next few years is the right strategy.

Carstens' speech has pointed to the Faustian pact hovering over central bankers, which is how to strike a bargain with the tech sector that doesn't doom money's soul. A choice has to be made: Either retain absolute control of the plumbing and all aspects of permissible currency, or accept a potentially more reduced role and focus on preserving competition on a level playing field.

If CBDCs offer nothing, then we shouldn't shy away from saying so. But if they can help, we might not have the time to keep debating.

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