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Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

## SAFE Finance Blog

### Lagarde's Proposal of a Central Bank Digital Currency is Worth to Think About

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Oliver Hinz: Christine Lagarde recently argued for a Central Bank Digital Currency. Indeed, there are reasons why central banks should consider this option



Christine Lagarde, Managing Director of the International Monetary Fund (IMF), recently stated at the Singapore Fintech Festival that the Fintech revolution questions cash money and commercial deposits, and that it ultimately questions the role of the state in providing money. She therefore recommended that

central banks should explore the benefits and challenges of a Central Bank Digital Currency (CBDC).

This is certainly an interesting statement and might persuade some decision makers in central banks to think about this possibility in more detail. Lagarde justifies her notable advance with the argument that central banks could achieve public goals with a CBDC that private companies are less motivated to achieve. Lagarde gave the example that CBDCs could help people without bank accounts or could bring services and financial solutions to poorer or rural areas. This would be certainly a laudable achievement. However, I do not believe that this is the main argument for central banks to think about a CBDC. Reports claim that countries like Sweden, Norway and Canada are thinking about issuing a CBDC, countries that are not well-known to be under-banked or to have a low level of financial service provisioning. So there have to be other arguments.

I personally believe that there are two main reasons for central banks to think about a first small-scaled evaluation of CBDC.

### **CBDC addresses potential problems more likely than private digital currencies**

First, a CBDC could (partly) substitute private digital currencies and would be easier to regulate. Lagarde suggests for example that CBDC transactions would be safe and anonymous and would not be revealed to companies or other governmental institutions as long as there is no ongoing criminal investigation. In conclusion this means that CBDC should and would have a built-in backdoor for criminal prosecution. Landmark digital currencies like Bitcoin make criminal prosecution currently very hard although Bitcoin is not completely untrackable. While Bitcoin wallets are not linked to persons, the wallets and the transactions between wallets can easily be observed which gives law enforcement the ability to trace its owner. However, there are other, newer technical approaches that guarantee even more anonymity for the users, opening up a playing field for criminals. Stopping this development could constitute one of the public goals that Lagarde mentions.

Second, private companies that issue digital currencies aim at profit maximization. This means that they also try to run their business with costs as low as possible. A private company maybe would not incorporate all potential risks that are inherent to its digital currency and this could lead to insufficient levels of security. In the worst case – if the digital currency is seriously “hacked” – this could lead to substantial losses for its users and could ultimately destroy trust in the stability of this financial instrument. For the private company this would certainly mean bankruptcy but the problem of the single digital currency could infect other parts of the financial sector. Potentially, the public has to deal with the problem that was actually created by a single private institution. Without doubt, there are parallels to the banking sector.

As long as digital currencies are small and not of fundamental relevance for the stability, this does not constitute a big problem. But as digital currencies grow, one has to take this problem into account. A CBDC could address the two mentioned points better than any private digital currency, so it is worth to think about this option.

However, it is worthwhile to mention that the IMF in general is not that positive about the benefits that a CBDC could offer. A look at the IMF discussion note “Casting Light on Central Bank Digital Currencies” (<https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2018/11/13/Casting-Light-on-Central-Bank-Digital-Currencies-46233>) with particular attention to table Table A1.1 reveals that cryptocurrencies do not offer a lot of advantages to the standard consumer over traditional cash (think of energy too). And I personally share this opinion. Nevertheless, I compliment Lagarde for making this topic a top concern for central banks. We need more research and informed decisions in this area.


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