

# **POSITIVE MONEY – WRITTEN EVIDENCE (CDC0011)**

## **CENTRAL BANK DIGITAL CURRENCIES INQUIRY**

Positive Money welcomes the opportunity to respond to the Economic Affairs Committee's Central Bank Digital Currencies inquiry.

We are a not-for-profit research and campaigning organisation, working towards reform of the money and banking system to support a fair, democratic and sustainable economy. We are funded by trusts, foundations and small donations.

### **Our submission makes the following key points:**

- Central banks' work on CBDC is being driven by the need for new public forms of money in an increasingly digital economy, and by the threat of new private forms of digital money.
- A CBDC could have huge benefits, such as continued access to public money in the digital economy, a more resilient financial system, more effective macroeconomic policy, more efficient and cheaper payments, as well as a more level playing field for financial services. However there are some risks if a CBDC is not designed and implemented in the right way.
- By its very nature, the existing payment system cannot match the benefits of a CBDC.
- HM Treasury and the Bank of England must take privacy concerns seriously and explore the potential of the Post Office providing a trusted 'public option' for CBDC access to mitigate these fears.
- A shift towards new forms of money such as CBDC (and away from bank deposits) may mean the Bank of England playing a greater role in providing liquidity to the financial system and the wider economy, which must be accompanied with greater accountability.
- HM Treasury and the Bank of England must take much greater effort to engage the public in research and development of a CBDC, and increase the diversity of participants in initiatives such as the CBDC Engagement Forum.

### **1. What are the main issues driving central banks to explore CBDCs?**

1.1 The main driver of central banks' exploration of CBDCs is the need to maintain access to a public form of money in an increasingly digitised economy. Public money provides a crucial anchor of trust which underpins private forms of money (namely bank deposits) and the banking system.<sup>1</sup> Public trust in private bank deposits is based on the fact they can be readily converted at par with public money, which serves as a risk-free final form of settlement. Physical cash – the only form of public money available to the general public – currently plays this anchoring role, but cash usage and access is sharply declining. Central banks have therefore recognised the need for a new digital form of public money, and are keen to realise its opportunities and benefits.

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<sup>1</sup> K. Bikas, Z. Livingstone (April 2020). Money We Trust - Designing Cash's Digital Counterpart. Positive Money. <https://positivemoney.org/money-we-trust/>

1.2 Central banks' work on CBDCs has also been accelerated by the emergence of new private forms of money, particularly 'stablecoins' such as the Facebook-led Diem (formerly Libra) project, which would threaten central banks' ability to implement monetary policy, and therefore pose severe threats to countries' monetary sovereignty.

## **2. What are the main benefits and risks of a CBDC?**

2.1 As discussed above, a key benefit of a CBDC is the continued access to public money in an increasingly digital economy. However, this is not the only way in which a CBDC may be necessary to increase the resilience of the financial system and the wider economy.

2.2 As former Bank of England chief economist Andy Haldane has observed, a CBDC "would reduce at source the fragilities in the banking model that have been causing financial crises for over 800 years."<sup>2</sup> This is because the introduction of a CBDC would separate the public good of the payments system from banks' profitable, but risky, lending activities. As bank deposits are currently the only means for the general public to reliably make digital payments, commercial banks receive significant public subsidies, and are 'too big to fail', requiring bailouts in order to protect the payment system and prevent economic collapse, as we saw in 2007-8. The introduction of a CBDC would make individuals and businesses less reliant on commercial banks, and ensure safe payments activities are separate from banks' riskier credit-provision activities.

2.3 As the Bank of England has also explored, a CBDC offers significant benefits for macroeconomic policymaking, in relation not only to monetary policy but a range of other policy areas.<sup>3</sup> For instance, a CBDC would allow transfers from the government directly to households and businesses, which would be especially useful in cases where the government needs an efficient means of distributing payments, as the Covid pandemic highlighted.

2.4 Not only would a CBDC offer cheaper and more efficient means of payment than those based on existing bank payment rails, but it could also help decrease concentration in the payments market, fostering greater competition and innovation.

2.5 Alongside the benefits, there are also risks if a CBDC is not designed and implemented in the right way. In particular, there may be risks surrounding the collection and use of user data, by both state and private sector actors, which must be managed carefully. A CBDC which relies on private payment service providers (PSPs) could be particularly ripe for exploitation of data by private companies. The more personal data is collected, the longer it is retained, the greater the risks of harm from misuse by the state or authorised firms (including mass surveillance, data leaks, or illegal sale) as well as theft by hackers. These risks would also be amplified by centralisation of data in a single institution or database. However, these risks are not specific to CBDC, as the absence of a

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<sup>2</sup> Andy Haldane (30 June 2021). Speech: "Thirty years of hurt, never stopped me dreaming." Bank of England.

<https://www.bankofengland.co.uk/speech/2021/june/andy-haldane-speech-at-the-institute-for-government-on-the-changes-in-monetary-policy>

<sup>3</sup> Bank of England (07 June 2021). New forms of digital money. Discussion paper. <https://www.bankofengland.co.uk/paper/2021/new-forms-of-digital-money>

CBDC will also see more entrenched market power and data concentration, and a CBDC would allow policymakers to mitigate these issues.

### **3. Could the proposed benefits of a CBDC be achieved through improvements to existing payment systems?**

3.1 As explained above, a key benefit of a CBDC is that it addresses at source the intrinsic instabilities of the traditional banking model. By its very nature, the existing digital payment system based on bank rails will always be less efficient and more expensive than a CBDC. This is because CBDC simplifies the monetary architecture by allowing retail users to have direct claims on central bank money, rather than relying on commercial banks to act as intermediaries for settling transactions.<sup>4</sup>

3.2 The current bank-based payment system has high transaction costs which are often hidden from consumers. Despite the efficiencies and lower costs stemming from technological innovation, card payment fees have not fallen in recent years.<sup>5</sup> The largest providers, Visa<sup>6</sup> and Mastercard,<sup>7</sup> are introducing significant increases in their fees, and are likely to continue to do so as their market power is increasingly entrenched amidst the decline of cash, leading to higher prices for consumers.

### **4. How should the Bank of England and HM Treasury address concerns over privacy and traceability of payments when exploring CBDC design?**

4.1 Widespread adoption of a CBDC hinges on public trust. Ensuring public trust through robust privacy protections should be an area of key concern for the Bank of England and HMT.

4.2 The design of a CBDC should ensure that the Bank of England collects only the minimum data required for operational and regulatory purposes, and the rationale behind, and scope of, this collection must be clearly communicated to the public. There should also be safeguards to ensure HM Treasury and other government departments are unable to access any recorded data, and that law enforcement and security services can only do so through the proper juridical channels (by obtaining warrants, for instance).

4.3 The Bank of England and HM Treasury should also explore CBDC design options which maximise user privacy, such as blind signature technology,<sup>8</sup> or a token-based form of 'digital cash' which mimics the privacy-preserving features of notes and coins, as an accompaniment to an account-based CBDC.

4.4 As well as fears of state surveillance, there are also concerns around private sector data usage which could provide a significant hindrance to CBDC adoption. Even if the state is not collecting or utilising payment data, it is likely that

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<sup>4</sup> Bank of International Settlements (June 2021). BIS Annual Economic Report - Part 3: CBDCs: an opportunity for the monetary system. <https://www.bis.org/publ/arpdf/ar2021e3.htm>

<sup>5</sup> Andy Haldane (18 November 2020). Speech: "Seizing the Opportunities from Digital Finance." Bank of England. <https://www.bankofengland.co.uk/-/media/boe/files/speech/2020/seizing-the-opportunities-from-digital-finance-speech-by-andy-haldane.pdf>

<sup>6</sup> N. Megaw, D. Thomas (19 March 2021). "Visa set to raise fees after removal of EU cap post-Brexit". Financial Times. <https://www.ft.com/content/4820b619-4d35-4c6a-8523-fc685c047374>

<sup>7</sup> D. David (25 January 2021). "Mastercard to push up fees for UK purchases from EU." BBC News. <https://www.bbc.co.uk/news/business-55796426>

<sup>8</sup> David Chaum (September 1992). Achieving Electronic Privacy, Scientific American. <https://groups.csail.mit.edu/mac/classes/6.805/articles/money/chaum-electronic-privacy.html>

Payment Service Providers (PSPs) providing front-end access to CBDC will seek to monetise personal data as part of their funding models. Growing concerns around tech companies' misuse of data (such as the Cambridge Analytica controversy) could be particularly amplified with the potential uses for payments data. Much more elaborate profiling of users' payments behaviour can now be pursued by firms, with significant social consequences for users, such as rejections for loans and insurance, or discriminatory pricing and usage fees.

4.5 To prevent CBDC adoption being limited by mistrust of PSPs, HM Treasury and the Bank of England must ensure the existence of a trusted and free 'public option' for CBDC access which does not rely on personal data collection as a means of funding. As a widely admired public institution<sup>9</sup> which currently plays a leading role in providing banking services to communities across the UK, the Post Office may be particularly well-placed to deliver this role. Parallels can also be drawn with the success of the Girobank in offering free banking services and adding competitive pressure for other private sector alternatives to improve their service.<sup>10</sup> We therefore recommend that HM Treasury and the Bank of England explore the potential for the Post Office to provide front-end CBDC account services.

## **5. What effects might a CBDC have on the financial sector?**

5.1 As the Bank of England's recent discussion paper explored, a further shift away from bank deposits and towards new forms of money (either public CBDCs or private stablecoins) could reduce the role of commercial banks in the financial system and the wider economy.<sup>11</sup> A shift away from traditional bank lending and towards market based finance is already well underway, as illustrated by the increasingly systemic role played by the shadow banking sector.<sup>12</sup>

5.2 Due to the high costs of the current bank-based payment system, payments may instead be made with cheaper and more efficient forms of money, such as CBDCs, with commercial bank deposits primarily being used as remunerated stores of value, as former Bank of England governor Mark Carney has suggested.<sup>13</sup>

5.3 There are some concerns that depositors moving funds away from bank deposits and towards new forms of digital money (whether a CBDC or stablecoin) could inhibit banks' ability to create credit. However, very little of banks' credit creation currently benefits the 'real' economy, with only around 2-5% of going to SMEs before the Covid pandemic, and the vast majority going towards unproductive assets, such as mortgages secured on extant properties.<sup>14</sup> Therefore the impact of a CBDC on lending for the real economy is likely to be muted.

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<sup>9</sup> Post Office (2020). The Economic and Social Impact of the Post Office. Executive Summary. <https://postofficeimpact.publicfirst.co.uk/>

<sup>10</sup> Simon Youel (May 2021). "Banking for People: Lessons from the UK's Girobank." Positive Money. <https://positivemoney.org/2021/05/banking-for-people-lessons-from-the-uks-girobank/>

<sup>11</sup> Bank of England (June 2021). New forms of digital money. Discussion paper. <https://www.bankofengland.co.uk/paper/2021/new-forms-of-digital-money>

<sup>12</sup> Gabor, D. (2020). Critical macro-finance: A theoretical lens. Finance and Society, 6(1), 45-55. <https://uwe-repository.worktribe.com/output/6726597>

<sup>13</sup> Mark Carney (28 June 2021). Lecture: "The Art of Central Banking in a Centrifugal World." [https://www.bis.org/events/acrockett\\_2021.htm](https://www.bis.org/events/acrockett_2021.htm)

<sup>14</sup> New Economics Foundation, Positive Money (June 2021). Greening Finance to Build Back Better: A UK Roadmap Ahead of COP26. <https://positivemoney.org/publications/greening-finance/>

5.4 The shift to market-based finance may mean SMEs that are unable to issue bonds or shares face even greater difficulty obtaining the funds they need. HM Treasury and the Bank of England (as well as other departments, such as BEIS) should therefore consider proposals which would help meet the needs of SMEs, such as a UK Development Bank operating on a decentralised basis, as suggested by former Bank of England chief economist Andy Haldane.<sup>15</sup>

5.5 A CBDC also offers opportunities for a level playing field in financial services. Opening up access to digital central bank money would mean that banks would no longer have exclusive access to digital public money in the form of central bank reserves, which currently enables banks to extract high levels of economic rent. This would increase competition in payments and financial services, and unlock the potential for greater innovation in financial intermediation, such as peer-to-peer lending.

## **6. What effect might a CBDC have on competition and innovation in the payments and fintech sectors?**

6.1 The Bank of England currently provides services to banks that reinforce their dominant position in the payments market, including interbank settlement systems and emergency lending facilities. A CBDC would open up the Bank's services to a wider array of market participants, empowering smaller firms to compete. Free and straightforward switching between CBDC PSPs (facilitated by a similar mechanism to the Current Account Switch Service) would further support competition.

6.2 Smaller financial firms with novel business models, products and services could operate as CBDC PSPs, pursuing innovation while holding customers' funds risk-free on the Bank's balance sheet. Such firms may prove competitive with incumbent banks and technology companies, but also draw users away from risky and volatile cryptoassets.

6.3 If a public company such as the Post Office were supported to become a CBDC PSP, it would set a competitive floor for the digital payments market. Incumbent firms such as Visa and MasterCard would no longer be in a position to raise fees to extortionate rates, as a public alternative would be available.

## **7. How might a CBDC affect monetary policy?**

7.1 A CBDC would increase the effectiveness of monetary policy by introducing a direct channel for transmission, rather than relying on commercial banks to pass on interest rate changes indirectly. Competition from a CBDC could also provide greater market discipline to the banking system, encouraging banks to pass on interest rate changes to attract depositors, as well as generally improving their services.<sup>16</sup>

7.2 A CBDC could be used to impose negative interest rates, but doing so may prove counterproductive. Widespread adoption of a CBDC is dependent on public trust, and there are growing fears that a CBDC would force savers to accept

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<sup>15</sup> Andy Haldane (30 June 2021). Speech: "Thirty years of hurt, never stopped me dreaming." Bank of England. <https://www.bankofengland.co.uk/speech/2021/june/andy-haldane-speech-at-the-institute-for-government-on-the-changes-in-monetary-policy>

<sup>16</sup> K. Bikas, Z. Livingstone (April 2020). Money We Trust - Designing Cash's Digital Counterpart. Positive Money. <https://positivemoney.org/money-we-trust/>

negative rates.<sup>17</sup> The Bank of England risks hindering adoption if it continues to highlight negative rates as a 'benefit' of CBDC, thereby reducing the potential for monetary policy benefits to be realised. The Bank of England should instead emphasise other monetary policy tools that CBDC could support, such as 'helicopter money'<sup>18</sup>, which would be more effective at meeting policy objectives than negative rates, but would also be much more appealing to the public.

## **8. How might a CBDC change the Bank of England's role and responsibilities?**

8.1 A shift away from bank deposits towards new forms of money (including a CBDC) may mean the Bank of England playing a greater role in providing liquidity to the financial system and the wider economy.

8.2 The growing importance of market-based finance (which new forms of digital money may accelerate) means that the Bank of England is being required to play an even greater role in providing liquidity to capital markets and acting not only as lender of last resort, but as the Bank's Andrew Hauser has outlined, 'market maker of last resort', with significant ramifications for macro-financial policymaking.<sup>19</sup> To ensure a commensurate increase in accountability, we recommend the Bank adopt a more formal and transparent framework to guide future liquidity support for financial markets, particularly the market for government bonds.

8.3 If a CBDC impacts bank credit provision to the real economy, market-based finance may be unable to fill the gap. Smaller firms which are unable to issue bonds or shares could find it even more difficult to obtain affordable funding under a shift to market-based finance. The Working Group on Productive Finance — which the Bank of England co-convenes — should therefore consider how productive investment could be supported through other lending channels, such as community banks, publicly-owned lenders or stakeholder banks. For example, public banks could be established with the ability to issue bonds eligible for purchase by the Bank of England. In this way, public money creation to finance real economy lending could make up for shortfalls in credit provision from both commercial banks and market-based finance.

8.4 If there is a wider shortage of money and credit, the Bank of England should be equipped to use monetary policy tools which could help meet the funding needs of the real economy. The Bank and HM Treasury should consider a range of policy options which could meet its primary and secondary objectives more effectively than the Bank's current toolkit. This could include the Bank crediting the government with new funds to invest directly (through the Ways and Means facility, for instance). Alternatively, the Bank could capitalise public infrastructure or development banks with newly created central bank reserves, or provide 'helicopter drops' of CBDC directly to households.

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<sup>17</sup> Ross Clark (25 July 2021). "Don't fall for Rishi Sunak's 'Bitcoin'." The Spectator. <https://www.spectator.co.uk/article/Don-t-fall-for-Rishi-Sunak-s--Bitcoin->

<sup>18</sup> B. Dyson, G. Hodgson (January 2016). Digital Cash: Why Central Banks Should Start Issuing Electronic Money. Positive Money. <https://positivemoney.org/publications/digital-cash/>

<sup>19</sup> Andrew Hauser (7 January 2021). Speech: "From Lender of Last Resort to Market Maker of Last Resort via the dash for cash: why central banks need new tools for dealing with market dysfunction." Bank of England. <https://www.bankofengland.co.uk/-/media/boe/files/speech/2021/january/why-central-banks-need-new-tools-for-dealing-with-market-dysfunction-speech-by-andrew-hauser.pdf>

## **9. How should HM Treasury and the Bank of England engage with the public on the research and development of a CBDC?**

9.1 It is crucial that HM Treasury and the Bank of England make greater efforts to engage the public in research and development, to ensure public trust in a CBDC, which will be crucial to its functioning. One of the main barriers for CBDC adoption will be fears around privacy. The Bank of England must make it clear that it will only collect a minimum of data for operational and regulatory purposes, and that other arms of the state will not be able to access this data without due process and oversight. Another barrier will be suspicions that a CBDC will replace cash or impose negative interest rates on ordinary savers. It is therefore important that the Treasury and Bank of England make meaningful commitments to protecting cash, and calm fears around negative interest rates.

9.2 We strongly recommend greater consultation with civil society and consumer interest groups, as well as those representing vulnerable and excluded demographics. Positive Money welcomed the ambition of the Bank of England's Engagement Forum, but we have since been disappointed with the lack of diversity in the current membership. The Forum is currently dominated by incumbent banks and other businesses with vested interests in CBDC design features which may conflict with the public interest. In contrast to the Forum's terms of reference,<sup>20</sup> there is very little representation from civil society and consumer groups, nor independent think tanks and NGOs.<sup>21</sup>

*14 October 2021*

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<sup>20</sup> Bank of England (2021). CBDC Engagement Forum terms of reference.

<https://www.bankofengland.co.uk/research/digital-currencies/cbdc-engagement-forum>

<sup>21</sup> Bank of England (September 2021). Membership of CBDC Engagement and Technology Forums. <https://www.bankofengland.co.uk/news/2021/september/membership-of-cbdc-engagement-and-technology-forums>