COPENHAGEN LEGAL TECH LAB — PODCAST

EPISODE 04 – CENTRAL BANK DIGITAL CURRENCIES

In this episode, Stéphane Blemus, Postdoc at the University of Copenhagen, Faculty of law, Anne-Catherine Bohnert, deputy head of the Digital Money and Innovation Department at the Banque de France, and Saule Omarova, Beth and Marc Goldberg Professor of Law at Cornell University, discuss the opportunities and risks that CBDCs represent, both from the E.U. and U.S. perspective.

00:00:00 Intro music

00:00:01,840
Stéphane Blemus
Hello and welcome to the Copenhagen Legal Tech Lab - Podcast, where we address innovation and the law from free angles: people, technology, and business.
Today we are here at the Law, Innovation and Vulnerability Conference at the Faculty of Law at the University of Copenhagen, together with Anne-Catherine Bohnert, the Deputy Head of Digital Currency, and Innovation Department at the French Central Bank (Banque de France).
And, we have the privilege to have with us Professor Saule Omarova, which is professor at the Cornell University.
So, thank you very much to both of us for joining us for this conversation about Central Bank Digital Currencies or CDBCs.
So maybe to start the dialogue, Anne-Catherine if you could provide us a short definition, from your perspective about CBDCs.

00:01:00,340
Anne-Catherine Bohnert
Thank you very much for having invited me here.
I guess that CBDCs is quite difficult to define. There is no real common definition, but I would say that CBDCs is a form of central bank money, but on a new digital support.
And I guess we could have two definitions depending on the use that is made from CBDCs.
So, if we use CBDCs for retail purposes, so for small amounts purchases, then it could be conceived as a digitalised banknote.

So, meaning the banknote is in the form of a paper. And this time you could actually pay with this form of paper, but on a digital support, meaning a card or a telephone, even a watch, a connected watch.
So, this could be for the retail CBDCs definition.
And for the whole state side the definition is even more complex, as one could say, that whole set of central bank money is already digitalised. Since banks and investment firms have already access to a scriptural form of central bank money on different payment systems. And this time it would be actually to put this central bank money in a different form, meaning on, for example, distributed ledger technology and so that they can settle with central bank money, tokenized assets and exchange and have directly central bank money on their distributed ledger technology. So that could be the definition of a wholesale CBDC.
On Banq de France we actually have worked, on CBDC, and on both uses of CBDC. As I mentioned before
We did some experiments to see whether a wholesale CBDC could have some benefits for interbank settlements.
And we made a call for experiments, and we realized, we completed nine experiments on various use cases.
So, on payment versus payments, on delivery versus payments and with different actors. So, from the private sector and from the public sector.
And we also tested a lot of technologies, distributed ledger technologies. The idea was to test if CBDC could have some benefits for interbank settlements and what we can do with it. So, what are the different use cases? And we tested this in the real world.
So, the experiments were not always in a proof-of-concept mode, but really with real assets. And we wanted to see whether the legal framework actually is fit for DLT or not.
And we came to the conclusions that's some use cases can be done. Others need a change in the law. For example, settling assets that, for example, you need to be settled via a central depository. So, the law doesn't allow that on DLT for the moment.
And we really came to the conclusion that CBDC can be technically put at the disposal of banks and investment firms. It works.
We can also connect to traditional payment systems. So, it also works. And, that it could have recent benefits for cross border payments. As today, cross border payments actually, have a lot of frictions that actually slow and are quite expensive. And by reducing the number of intermediaries and by automating procedures, we could reduce time costs and therefore it could have some real benefits.
And we also tested retail CBDC with the EURO system. As you may know, the EURO system launched on 14th of July last year, an investigation phase for digital EURO. So, this time a retail digital EURO. So, for small amounts of purchase. So destined to the citizens and small merchants.

We participated to experiments that were led by the EURO system on this digital EURO, and we're now actively working with the with the EURO systems during this investigation phase that will last until the end of 2023 to analyse the different use cases that could be covered to see which technical infrastructure we could build and maybe build up a prototype.
Also, see the distribution model, whether banks will be involved in the distribution and how, also the different business case and the legal framework. And that's a big part. It's, uh, to see if we grant this digital EURO legal tender or not. And what are the consequences? What are the consequences and risks on financial stability and on monetary policy?
So that's basically where we are today.

00:06:59,040
Stéphane Blemus
Okay, thank you very much Anne-Catherine about these views about both the French central bank views and the work that is currently assessed by the ECB.
Professor Omarova, in contrast, what is your perception on CBDC debate from an academic perspective and potentially also could you give us you’re your views about the current CBDC debate in the United States?

00:07:36,720
Saule Omarova
Well, first of all, thank you so much for having me here join both you and Anne-Catherine and this interesting conversation.
You’re absolutely right. I'm an academic from the U. S. So, I don’t have the privilege of working at the Federal Reserve. So, I cannot really give you the inside sort of inside ball game on what is going on in the US with respect to digitising U S dollar.
But generally speaking, the debate in the U. S. has been proceeding, at least in my view, perhaps along two major dimensions.
So, one dimension is sort of similar to what is happening in other central banks. There is this sort of conversation between the Federal Reserve and other policymakers, other regulators in the U.S., on the one hand, and the industry market participants on the other, with to if or when the United States goes down the route of creating a CBDC digital dollar. What kind of design should the US choose, given the size, the depth, the complexity and the political power of the US financial sector?
So, that debate involves a lot of economists, central bank economists in particular, and it sort of goes along the more predictable lines, right? Do we want to go with wholesale CBDC, to we want to go with retail; is going to be sort of direct or indirect. And the concerns are primarily with basically creating all the beneficial consequences that a CBDC can create, like, for example, just like Catherine said, you know, faster settlement, perhaps less friction driven cross border

payments and so on so forth. Without, on the other hand, disrupting the existing tools of monetary policy, the existing channels of monetary policy and also the existing institutional arrangements. And this is where the key is, at least to me as an academic that the CBDC holds the potential to completely revolutionise the institutional structure and arrangements that we've been living with for decades, if not for centuries.

So, the second dimension of the debate in the U. S. is a lot less prominent. Perhaps it's kind of more either academic or, quite frankly, sort of on the political activism side.

And this this this debate is about the potential of digitising dollar as a way of perhaps increasing access to central bank money, sovereign money, safe money for various marginalised communities and people and businesses who otherwise may not have access in today's system and perhaps even making sovereign money truly sovereign through the Democratic.

So, this is more a debate about democratising money through creating CBDC and using the convenience, the speed and ease of access to technology as a way of basically equalising economic rights in a way.

And, uh, the two conversations, the technical one, and the sort of democratising finance one are not always coinciding or they don't not necessarily overlap.

But increasingly they have to overlap because the more time passes and the more the Federal Reserve, for example, is signaling that, you know, we are thinking about it, we're trying to figure out what design we choose.

The more stark the choice becomes as between directive CBDC or indirect CBDC, wholesale or retail. In other words, if we have that ability to provide access to the safest money, the ultimate settlement assets for everyone, every business, every household, every citizen, for example, why not do it.

And that's the question that needs to be answered. And there are, of course, of couple of approaches, right?

So, one group of people says, well, the reason we shouldn't be changing the way the current system operates is that, you know, first of all, we may not trust the government to basically run bank accounts for everybody because the government is a political organisation. So, they might actually use the access to individuals' finances for political purposes. Right? And one can imagine, for example, that if the government doesn't like a particular political position, they might actually start using access to the people's bank accounts to kind of force them to change their position or somehow cut them out of financial transactions.

So that's one set of fears. Another set of fears is that the governments don't have experience offering, for example, accounts and currency effectively settling transactions for retail users of financial services. Because that's a tremendous undertaking. Just on a day-to-day basis. Who's going to run the IT? Who's going to know your customer? Verifications and so on so forth. So maybe we should keep the private banks and other financial institutions maybe tech companies as kind of agents of the central bank in administering that CBDC.

And of course, there is a purely political economic pushback from the industry itself: banks do not want to be “disintermediated”. They don't want to be replaced by the Federal Reserve. And, of course, the new fintech crypto industry also do not want the government to take over and replace them.
Well, on the other hand, the group that sort of is kind of more supportive of the idea of a direct CBBC issues. They see this as an opportunity to actually use the power of technology, perhaps to correct or address a lot of the deep, systemic and structural problems in the financial sector that we've seen play themselves out in the 2008 crisis, for example, and still haven't been resolved.
So perhaps, for instance, if we have that access for everybody directly to, the safest, now fastest money, for example, digital money that is issued directly by the central bank, by the Federal Reserve, for instance, then we don't need to rely on private banks as much. There will be fewer, the demand for, for example, bank accounts, bank departs, the council will go down. Most people might choose the safest account directly at the Fed. Some people may not, but most people would.
And if that's the case, then perhaps some of the concerns with the contagion of the risk and private banks, for example, using the access to public subsidy to generate speculative trading in various risky assets and then perhaps potentially endanger the stability of the system would be lower. And that would change the political economy altogether. Right? So maybe we will not have, that drive towards consolidation in the financial sector.
So maybe now we'll go back to something like we used to have before the 1980s or 1970s, when there were smaller boutiques that specialised, perhaps in underwriting securities and trading and broken dealer type of business and asset managers would be smaller and banks depositing institutions would be smaller also and less powerful and less risk, and so and so forth.
So, perhaps that is possible. So, this is where we are. It's not yet clear what will happen in the next few years. Chances are we will go with some form of intermediated, indirect, perhaps retail, type of CBDC.
But it's not going to be directly available through opening bank accounts directly at the Fed. I don't think there is political appetite for that in the United States, so we shall see how how life goes.

00:16:14,190

Stéphane Blemus

Perfect.
Perhaps a last question for both of you. Just about the timeline.
We discussed the potential uses for CBDC, what is for you the credible timelines for potential is a prototype deep thinking or creation of CBDC, both in the EU and the US.

For the EU, it seems that the timeline appears to be more clear as to the next deadlines. And from the US perspective that there was this first report we don't know yet the timeline, but maybe your perception from both the US and the EU.

00:16:56,529

Anne-Catherine Bohnert

On the EU side. So, we launched last year on 14th of July, an investigation phase of two years to investigate a bit the use cases, the technical infrastructure, and the distribution model.

And this all these analysis, as I mentioned before, should inform the Governing Council at the end of 2023 give all the information and the tools to decide whether or not to launch a realisation phase.

And if the Governing Council decides to do so, which is, for the moment, not the case. It's not decided. But if it decides next year to do so, then they could launch a realization phase that could, could last two or three years so we could end up, I am really using the conditional, in 2025-2026 with a retail digital EURO.

So that's a bit of perspective from the European side for the moment, of course.

00:18:14,140

Saule Omarova

Well, um, that's really good to hear that. At least you can have some form of a timeline. In the United States we don't have any timeline.

That report that came out from the Federal Reserve, many of us watching the space found rather disappointing on many levels. There is no clear indication that there will be any specific movement anytime soon.

Having said that, however, right, there are a couple of factors in the US that kind of effect that timeline.

One is that there is definitely a shift in the discourse very recently by the significant shift toward more focus on perhaps regulating and encouraging stable coins privately issued a sort of digital assets that are supposed to be linked or backed by central bank money.

So, perhaps the sense here is that look for the United States, with our very vibrant and strong and deep and perhaps somewhat too strong private, financial sector. This might be a political compromise of some sort that would relieve the federal authorities and the central bank the Federal Reserve of that responsibility to actually take the dive and take the fire for whatever it does.

Because if we if we have this thriving suite of stable coins that they're kind of private, they're kind of existing on the on the current platform. And yet there they would have all the benefits of digital assets: frictionless, fast, convenient, and so and so forth.

What worries me

about that, of course, is that there is no such thing as free lunch, Right? So, whoever controls that that ecosystem and what are the ecosystem of stable coins would look like, well, basically have tremendous impact on the Federal Reserve and what it will have to do, for example, to support that system.

So, the second factor that would affect or might affect the timeline in the United States is one never knows what kind of external push might be experienced by the Federal Reserve in that respect or by Congress, for that matter.

So, in the U.S. typically, major regulatory or legislative action comes after some kind of a big crisis or a near failure, right? We don't know. So right now, we're chugging along, we're sort of taking it slow watching what Europe does watching what China does, watching what Elon Musk does.

We do all of that, right. But what if something happens six months from now and it creates a major backlash politically.

I can see the possibility of central bank or even the Treasury, perhaps being forced to kind of move towards creating some form of digital sovereign sovereign money.

So, who knows? We have no idea.

Another external shock might actually be where the EU moves and maybe accelerates the timeline or even stays within its timeline.

And suddenly the digital EURO becomes an instrument of choice for many transactions in the global economy. Would the US stand by and let that happen, or would they want to kind of jump in?

So, these are the factors that nobody can really predict with certainty, but we should certainly watch carefully.

00:21:44,940

Stéphane Blemus

Perfect. So, thank you to both of you. For your conversation on CBDC.

Thank you for having listened to our deep conversation.

This was the Copenhagen Legal Tech Lab - Podcast. Thank you.

00:20:50,740 - outro

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