Central Bank Digital Currencies: Viewpoints from Tokyo and Washington

Abstract

On Tuesday, December 8, 2020, Sasakawa Peace Foundation USA (Sasakawa USA) welcomed Dr. Robert Dohner, Nonresident Senior Fellow at The Atlantic Council, Mr. Ichiro Oishi, Minister of Financial Affairs at the Embassy of Japan, and Mr. Yasuhiro Yamai, Managing Director of Corporate Planning at MUFG, for a discussion of Central Bank Digital Currencies (CBDC). The panel analyzed key questions surrounding debates by major central banks on the introduction of CBDC, including how the United States and Japan could work together on this issue based on viewpoints from both the public and private sectors.

This talk was presented through Sasakawa USA's Policy Briefing Series and held virtually via Zoom. Attendees included distinguished guests from the Washington, D.C. and Japanese policy communities, academia, and think tanks as well as guests from the Sasakawa Peace Foundation in Tokyo. Dr. Satohiro Akimoto, Chairman and President of Sasakawa USA, moderated the panel and facilitated the Q&A.

American Viewpoint on CBDC from Dr. Dohner

Dr. Dohner began his presentation by stating that digitalization has already changed much of people's daily lives, and the ongoing coronavirus pandemic has further accelerated this process. In addition, the declining use of physical cash has led central banks to take a greater interest in digital currencies. Furthermore, Dr. Dohner added that digital currency has several advantages compared to coins and bills. Digital currency is more secure, faster, and cheaper than physical money as a system of payment, and it could theoretically lead to a more inclusive and efficient monetary system.

However, Dr. Dohner also outlined several risks associated with digital currency. These include the disintermediation of banks, moving them from their traditional role of collecting deposits and making loans, as well as the possibility of greater instability in the financial system as more people become shareholders in the central banking system. Dr. Dohner highlighted that while digital currency is a simple idea, in theory, digital currency comes with significant technical, legal, institutional, and political challenges. As an example of a legal challenge, Dr. Dohner asked what the mechanism for dispute resolution in a CBDC system would be. Overall, on the topic of risks, he highlighted the need to strike a careful balance between privacy and transparency.

Moving on from the pros and cons of CBDC, Dr. Dohner turned toward the current attitudes in the U.S. regarding such a system. First, he noted that the United States is a relatively late entrant to the discussion of CBDC, and the Federal Reserve has no current plans to move forward on digital currency. The presiding sentiment of CBDC is to "do it right" rather than "do it first." With the U.S. financial system and the U.S. dollar as incumbent hegemons in global banking, Dr. Dohner stated that Washington has little incentive to rush into implementing CBDC. With this idea in mind, he added that he expects U.S. financial leaders to focus on improving the current system while monitoring developments regarding CBDC.

Next, Dr. Dohner discussed the financial organization and legacy infrastructure of the U.S. banking system as an explanation for U.S. caution towards digital currency. The United States has a diffuse banking system with over 10,000 domestic banks, whereas Japan has a much more concentrated system. Thus, he stated that both larger banks and community banks form a powerful political lobby in Washington, as do credit card companies. These interests combined form a powerful barrier against the growth of an additional, alternative payment system. Given the entrenched position of these financial institutions, Dr. Dohner expects the CBDC would have to work in concert with them, rather than replacing them.

Dr. Dohner acknowledged that while CBDC would have to overcome the entrenched position of financial institutions, several factors could push the United States to consider CBDC. These include the threat of displacement, the erosion of currency use, and the declining effectiveness of monetary policy. Dr. Dohner also added that the anti-competitive implications of a few private companies dominating payment systems, such as Alipay and WeChat Pay's dominant market hold in China, would necessitate action by Washington. Financial inclusion could also drive adoption of digital currency, as about five percent of U.S. households lack a bank account.

The conversation then turned towards China's efforts to introduce a digital Renminbi (RMB). Dr. Dohner highlighted that China has conducted test runs in several cities with the aim to have a nationwide roll-out ready for the 2022 Beijing Winter Olympics. Some U.S. leaders have characterized China's move to CBDC as a threat that requires U.S. action, but Dr. Dohner was less concerned about the threat posed by the digital RMB to the U.S. position in global finance. Instead, he views digitalization in China as focused on domestic monetary policy, rather than a robust challenge to the global system.

In closing, Dr. Dohner stated the United States could learn a lot from Japan if it decides to pursue CBDC. He emphasized that for a digital currency to work for the United States, it needs to ensure safety, efficiency, and interoperability with the financial systems in Japan and the European Union. Given the importance of the U.S., EU, and Japan to global banking, Dr. Dohner concluded that U.S. decisions on CBDC will have massive influence on future developments.

Japanese Viewpoint on CBDC from Mr. Oishi

Next, Mr. Oishi presented the stance of Japanese institutions on CBDC. He started by reviewing Japan's major developments regarding CBDC in the past few years. The Bank of Japan (BOJ) started a joint project with the European Central Bank (ECB) to explore technology related to CBDC. Since then, Japan has formed study groups on the matter, conducted experiments, and discussed CBDC with international partners at major multilateral meetings, including the 2019 G20 Summit in Osaka.

Mr. Oishi then turned to outline fundamental principles for implementing CBDC, as based on a report produced by Japan and six other major central banks in 2020: (1) Do no harm to wider policy objectives (2) Ensure coexistence and complementarity of public and private forms of money (3) Promote innovation and efficiency. This report also lists several core features of CBDC, underscoring the importance of efficiency, security, and interoperability. Mr. Oishi emphasized that CBDC remains an important initiative for the BOJ, and there are ongoing discussions regarding its implementation.

Following that statement, Mr. Oishi went over the key points of the G7 Statement on Digital Payments, released on October 13, 2020. Emphasized in this statement are maintaining stability in domestic and international markets while pursuing digital currencies and making continued improvements to existing payment systems. Furthermore, Mr. Oishi highlighted that the joint statement reiterates the importance of "transparency, the rule of law, and sound economic governance" to building confidence in international economic systems.

Next, Mr. Oishi presented five key aspects of CBDC, as outlined by the BOJ in a 2020 report. The first is coexistence with cash, as digital currency will not completely replace physical currency. Second, price and financial stability are crucial, as the BOJ will be careful to avoid disturbing the financial environment. The third is prompting innovation. If the BOJ implements CBDC, they will rely on collaboration with the private sector to provide an interface for users and spark innovation. Fourth, is the relationship between CBDC and privacy. It is important to balance the need for privacy protections and preventing financial crime. Finally, cross-border payments will be central to CBDC. Thus, Mr. Oishi concluded discussion on these key aspects by stating that digital currencies must be interoperable in a globalized world and economic system.

Before concluding his presentation, Mr. Oishi addressed China's efforts to implement CBDC. He observed that the U.S. has not been too concerned with the digital RMB, as it does not present a significant threat to U.S. hegemony in financial markets. However, Japan views the issue slightly differently. Mr. Oishi stated that while the digital RMB is not attractive for international use in most markets, it does have appeal to developing countries for political and economic reasons, and the expanded use of RMB could impact the effectiveness of financial sanctions. He also identified the "first-mover advantage" in setting standards for CBDC rules, regulations, and systems as a factor to consider. Overall, Mr. Oishi thinks there is a growing understanding in the U.S. of the potential issues presented by a digital RMB, and he suggested that concerned countries should make an effort to inform potential users of risks associated with adopting China's CBDC. Concluding his remarks, Mr. Oishi emphasized that the key to success with CBDC is cooperation. Public-private partnerships as well as international cooperation will be central to implementing effective digital currency policies.

Private Sector Perspective on CBDC from Mr. Yamai

Following Mr. Oishi's remarks on the Japanese perspective on CBDC, Mr. Yamai discussed the private-sector views on general-purpose CBDC. He started by outlining the current state of currency in Japan. Physical currency is the only money available to the general public, and Japan has a high amount of outstanding currency. At the present, CBDC is only at the concept level, both in terms of technology and system structure. Depending on the choices made, Mr. Yamai stated that CBDC could serve many different purposes and lead to divergent outcomes.

At the heart of the discussion, Mr. Yamai stated, is one major choice: Is CBDC intended to be a public money upgrade or a private money replacement? The BOJ has provided three main reasons why CBDC should be considered: (1) The replacement of physical currency (2) Interoperability among private money (3) Innovation in payment. The first reason represents a public money upgrade, while the second and third define CBDC as a private money replacement.

From this central question emerge several others, which Mr. Yamai then introduced. First is a business case question. What are the business incentives for Japanese private companies to push CBDC? Mr. Yamai highlighted that financial inclusion is not a major issue in Japan, as most adults have bank accounts, and avenues for fast, cashless transactions already exist. Given these conditions, it does not make sense for companies to pursue wide-scale, general-purpose CBDC at this moment. However, Mr. Yamai added that further innovations could lead to wider use cases.

Next, Mr. Yamai addressed the question of innovation. How would CBDC affect innovation in the Japanese private sector? Most Japanese adults have multiple electronic payment methods, such as cards or mobile apps. Mr. Yamai described the current market as vibrant, with players from tech, retail, and mobile sectors. To ensure continued innovation in the case of implementing CBDC, Mr. Yamai suggested continued private-public dialogue on potential avenues of collaboration.

Finally, Mr. Yamai looked at the question of disintermediation. Would a CBDC system disrupt the current system of deposits? CBDC is safer than traditional bank deposits, so CBDC and public money could potentially dominate money creation in an extreme case. Mr. Yamai emphasized that private money creation is critical as the basis for continued economic growth in normal times and forms an important lifeline in crises. He also offered the current economic crisis caused by COVID-19 as a case where private money creation has proved vital.

Overall, Mr. Yamai described CBDC as a "potentiality," not a current initiative. There are still questions that need to be solved before it can become an everyday service. Research, experimentation, and dialogue in the public and private sectors are needed to build a CBDC system that works with the current financial environment and maintains cross-border interoperability. Mr. Yamai closed by stating that he expects that the U.S. and Japan will be central to these future initiatives.

Moderated Q&A with Attendees

Dr. Akimoto began the Q&A portion by asking the panelists how closely Japanese and U.S. views align on how to approach China in regard to CBDC. Dr. Dohner first answered by explaining that there is a tendency in the U.S. to view any action by China as a threat that requires a response. Instead, he suggested caution, urging that it is important to consider what issues are most important and "pick your shots" concerning China policy. Dr. Dohner stated that digital RMB represents potential risks to emerging markets and developing countries, but increased use of RMB in global finance is not necessarily a major issue. Rather, it is a concern if countries get "locked-in" to RMB. Mr. Oishi added that the digital RMB presents a more long-term challenge rather than short term, as China is focusing first on introducing CBDC for domestic use. However, he emphasized that the growing use of digital RMB in global transactions could undermine the current status and power of the U.S. dollar. Dr. Dohner then responded by adding that the main question is whether China is willing to pay the cost of creating an exclusive RMB trading area, but he doubted that China would want to limit itself to a closed system.

Next, Amb. Kurt Tong, Partner at The Asia Group, asked a question regarding Diem, a cryptocurrency project formerly known as "Libra" proposed by Facebook. He inquired whether central banks are going to allow private companies to create their own digital currencies and what are the implications of these private digital currencies? Dr. Dohner first answered that there was extreme reluctance from authorities across the G7 when Diem was first proposed, particularly the idea of a mixed currency. Even the revised proposal has left much uncertainty whether it will satisfy regulatory authorities, as non-official stable coins, as proposed in the Diem project, are not necessarily stable. Any introduction of Diem would certainly be accompanied by a significant amount of regulation, and Dr. Dohner expressed doubts that the project would move forward to implementation. Mr. Yamai added that global standards around these kinds of mixed currencies will likely be developed in the next two years, so these projects will take time. In addition, other companies are working on similar stable coin CBDC projects, so there should be progress in the next few years. Lastly, Mr. Oishi added that security and privacy will be critical to implementing any kind of stable coin backed by a private company.

Next, Dr. Akimoto asked how the United States and Japan can effectively involve private sector stakeholders in discussions on CBDC. Mr. Yamai said that both private and public groups agree that there needs to be closer coordination and continued discussion going forward. However, with experiments and test runs for CBDC coming in the next few years, there is an urgency to get these discussions going with all relevant parties. Mr. Yamai stated that the key issue is what is the specific use case of CBDC, as that will guide future experiments and research. Dr. Dohner agreed that all parties need to agree on fundamental principles such as use cases if there is to be public-private coordination on CBDC, and Mr. Oishi added that banks will play a critical role in current conceptions of CBDC, so they must be involved as well.

Closing the Q&A session, Dr. Akimoto asked a question regarding the digitalization initiatives pushed by the administration of Japanese Prime Minister Yoshihide Suga. Mr. Yamai said that digital currency is not currently part of the agenda of the new digital agency. However, he was open to the possibility that CBDC could become part of the digitalization movement in the future.

Conclusion

Near the end of the event, the participants offered their closing remarks. Mr. Yamai reiterated the importance of cooperation in pursuing CBDC, stating he was grateful to hear the perspectives of Dr. Dohner and Mr. Oishi. Then, Dr. Dohner said that it is clear that CBDC and changes in computer technology have raised new questions for financial systems, and he expects CBDC implementation efforts to proceed carefully. Finally, Mr. Oishi said he looks forward to seeing how different countries and private sector partners continue to collaborate on the development of digital currency.

Sasakawa USA is grateful to Dr. Dohner, Mr. Oishi, Mr. Yamai, the Q&A participants, and attendees for the thoughtful discussion on CBDC.

The views summarized herein are entirely the work of Sasakawa USA and do not represent the official positions of any of the speakers.

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