Andrew Bailey: The future of money and payments

Speech by Mr Andrew Bailey, Governor of the Bank of England, at the Group of Thirty's 39th Annual International Banking Seminar, Washington DC, 26 October 2024.

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Thank you for inviting me to offer some thoughts on what is not a small subject! I think there are two propositions in the world of payments which attract very broad support. One is that in addition to delivering stability there is a strong need to modernise some key payments practices, and thus an opportunity to improve efficiency and reduce cost. This applies to both domestic and cross-border payments, and wholesale (or high value) and retail. There is a particularly pressing need in the area of cross-border payments, where progress on modernisation continues to be slow. Here more needs to be achieved on speed, cost, transparency and access to cross-border payments.

My second proposition is that, in modernising, we should harness the potential of digital technology. To do otherwise would risk a failure of imagination. I don't claim to be in any sense an expert on this point, but harnessing digital technology to improve strikes me as having real potential, say in areas like solving late payment for firms by enabling automatic release of funds when goods are delivered and more widely using encryption technology to prevent fraud. So, I think the case for harnessing digital technology is made.

I am going to focus on the implications of doing so from an economic and financial perspective. This strikes me as under-examined. Do we need fundamentally to change the money and banking system to enable all of this to happen? My starting point is that as a matter of principle I fail to see why we need to change the system fundamentally, though as a matter of practice there are outcomes under which it may be necessary, but a first best endpoint is that we do not do so.

Let me add a few points on the nature and role of money.

First, payments are, of course, one of the key functions of money – money as a medium of exchange. So, they are core to the interests of central banks.

Second, we have a world where there are two forms of money – central bank money and commercial bank money. A key feature of the system is that they are fully aligned in nominal and real value terms – I call this the singleness of money. This is achieved by a mixture of central bank operations, bank regulation and deposit protection. With the singleness of money, for low value and retail transactions, we should be indifferent at the margin whether a payment is made in commercial or central bank money. Payment can of course be made in something that is not money, but since it would not have an assured nominal value, this is not an efficient or credible means of exchange. This is one reason why, for instance, Bitcoin has not taken off as a general medium of payment.

It follows from this that if we are indifferent whether retail payments are made in central bank or commercial bank money, it is harder to see an anchor role for central bank money in this area. But, that does not mean there is no role. This is not a roundabout way of saying that we see no need for cash. Quite the opposite. We should supply cash for as long as the public want it. And, the evidence is that they do want it, so we will continue to supply it.

Let me turn briefly to the wholesale payment world and the world of payment system settlement. Here I may appear to contradict myself, but my view is the opposite. I do think there is a special role for central bank money in wholesale high value payments and in settlement of payment systems. So, here it is acting as the anchor. Why? The reason is that unlike cash, wholesale payments and settlement take place using the reserve accounts maintained by banks at central banks. This money (like cash to be clear) is directly backed by a promise of the state. Accordingly, this is the core liquid asset of the banking system, and is therefore the anchor of the system. So, there is logically a distinction here. We can be indifferent to retail payments between central bank and commercial bank money but not for wholesale payments and settlement.

From the perspective of the Bank of England, we are putting a lot of emphasis on enabling digital and other innovation in the wholesale world. We want to see innovation and encourage it, around the anchor of central bank money consistent with our core objectives of monetary and financial stability. If you want to know more please see our recent Discussion Paper where we talk about the experiments we are launching, including offering a digitally tokenised form of central bank money.

There are two more steps in my argument.

The first is to ask whether, if we are indifferent on money grounds whether retail payments are made in central bank or commercial bank money, are we likewise indifferent in broader economic terms? My answer to that is no, at least not beyond a small scale. Another way of framing the question is whether we should be indifferent to the balance between central and commercial bank money in respect of retail activity? Why would we want to change this balance? Other things equal we should surely not want to do so. The reason is that commercial banks use their money to extend credit directly, whereas central banks do not. So, changing the mix would at best complicate the credit system, other things equal. This of course is the essence of fractional reserve banking, as underpinned by the singleness of money.

The final step is to ask whether other things really are equal, or whether there are reasons why in the retail space, digital payments need to be done in a newly created Central Bank Digital Currency? A priori, I think the answer to this is that commercial bank money – i.e. banks – is the best home for such innovation.

But if for some reason innovation in unlikely to happen, then the central banks have to decide whether they are the only game in town. For me, this justifies why we must continue to prepare for retail CBDC. We have not yet seen enough evidence that the innovation will happen in commercial banks. As central banks, we should be thoroughly engaged to encourage, and if necessary, provide such innovation – but there is no good reason to be proprietorial on this.

To finish, why might the innovation not happen and thus other things not be equal?

For money as a means of payment or exchange to function effectively, it needs two components. The first (the money) is the train – the economic claim (usually on commercial banks). The second (the payment system) is the rails – the infrastructure or technology with which the claim is exchanged. Historically, some of these infrastructures and technologies have developed in ways that have stymied incentives to innovate including, on occasion, due to concentrations of market power. It is important that these structural factors not stand in the way of innovation. For commercial bank money to function effectively, it must keep pace with the needs of its users. Our work on retail CBDC is considering these trends in the payments landscape closely. Absent innovation in commercial bank money, central banks may be left as the only game in town insofar as retail payments innovation is concerned. That is not my preferred outcome, but not one that we should rule out.

Thank you.

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