

Chinas Digital Currency

For the Chinese New Year Festival last year, the Chinese government raffled off 200,000 so-called "red packets" (红包) worth 200 CNY (30 €) each to the population for the first time. In this pilot project, the winners were able to pay with the digital yuan (数字人民币 or e-CNY) at one of the McDonald's branches in Shanghai.¹ China's central bank has been working intensively on a digital currency, the e-yuan, since 2014 and is thus a long way ahead of comparable developments in the USA and Europe. In 2020, the e-CNY was introduced as part of pilot projects. The Winter Olympics in Beijing in February 2022 then offered the opportunity to present the e-CNY to the media when the athletes and attendants were allowed to use it.²

a. What is behind the concept of China's CBDC (Central Bank Digital Currency)?

China's society has already become heavily cashless in recent years. A consistent development for a mobile-first country and a global pioneer in cashless payment systems. The basis of payment transactions is still cash (the money supply M0), even if it has been pushed into the background by transactions between digital payment platforms and banks.

With the CBDC concept, China's central bank now primarily wants to provide a public good, namely digital cash, and integrate it into the financial system, while traditional physical cash is increasingly declining. The new digital e-CNY should further bring fair competition as well as interoperability between the different forms of digital cash. Although the e-CNY will be used mainly for national payments, the concept hints that it could also be used for cross-border payments.³

b. What is the difference between CBDC and traditional cryptocurrencies?

CBDC is fundamentally different from well-known cryptocurrencies. Decentralised cryptocurrencies like Bitcoin rely on blockchain technology for verification with computer networks, but are not recognised as virtual property in China and are therefore not legally protected. The e-CNY, on the other hand, is issued by China's central bank and is a state currency. It can therefore be used in the same way as an existing renminbi banknote, the value is identical 1:1. China's central bank clearly states that the e-CNY is a legal tender, does not require a bank account, supports offline payments and offers "controlled anonymity".²

c. What is the difference between CBDC and existing mobile payment platforms?

Currently, two mobile payment platforms from the two leading tech giants dominate the Chinese market, Alipay (支付宝) and WeChat Pay (微信支付). Alipay was launched in 2003 and belongs to Alibaba (阿里巴巴). Tencent's (騰訊) WeChat Pay then followed in 2011. Both companies have completely revolutionized the payment industry in China with their apps by introducing an alternative payment system. The apps have a payment function and Chinese and foreigners living in China can easily link their bank account to make payments by scanning a QR code with their smartphone. Alipay is used by about 1.2 billion users, and WeChat has surpassed the 1 billion user mark.⁴

According to China's central bank, CBDC is intended to challenge the dominance of the two giants. In addition to the convenience of Alipay and WeChat Pay, which have already become a habit for a large part of the Chinese population, CBDC offers the possibility to pay offline and transfer money offline. Transactions should therefore be possible directly from "digital wallet" to "digital wallet" via the internet, independent of bankers or other intermediaries. Users should even be able to transfer money directly and personally by simply tapping two phones - even without an internet connection.²

d. How far along is the digital euro?

The European Central Bank ECB is currently in a so-called Digital Euro Investigation Phase, which is to be completed in October 2023. Since March of this year, a first report has been available on the payment preferences of EU citizens and their attitudes towards digital currencies. According to the report, citizens want generally accepted online and offline payment methods throughout Europe, prefer direct and contactless person-to-person payments and see high security standards as fundamental.⁵ So while Europe is only in a phase of research and investigation, China is already taking big steps into concrete project phases. The USA, by the way, is the latecomer in this race for digital currencies and continues to debate whether a digital dollar should be introduced.

e. How will China's CBDC evolve?

China will work at high speed to further establish and integrate the digital yuan. Moreover, China is used to tackling megaprojects strategically and over the long

term. The goals are not only ambitious but can also give China an immense lead in further economic and geopolitical development. First, the position of the commercial banks will be significantly strengthened. They will distribute the digital yuan issued by the central bank. The e-CNY can make third-party payment systems like Alipay and WeChat Pay obsolete in the future, opening the door for commercial banks to analyse their customers or users. Currently, payment data is in the hands of the third-party providers. The ability to analyse data through CBDC opens up previously unavailable opportunities for central bank and government control of the economy. Globally, one goal is certainly to challenge the dominance of the dollar as well.

(This post was written by Wolfgang Kohl.)

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Sources:

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² <https://www.reuters.com/technology/around-300-mln-digital-yuan-used-every-day-olympics-pboc-official-says-2022-02-15/>

³ <http://www.pbc.gov.cn/en/3688110/3688172/4157443/4293696/2021071614584691871.pdf>

⁴ <https://www.juniperresearch.com/researchstore/fintech-payments/digital-wallet-research-report>

⁵ https://www.ecb.europa.eu/paym/digital_euro/investigation/profuse/shared/files/dedocs/ecb.dedocs220330_report.de.pdf