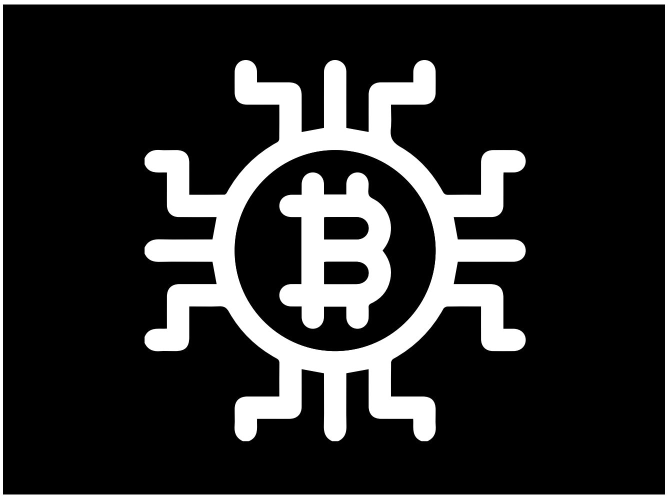
THE PAYMENT ASSOCIATION'S PROJECT INCLUSION BLOG:

Digital Currencies and Inclusion



In a little over a decade, digital currencies have become mainstream across the world, with $2 trillion invested in cryptocurrency alone. Household names like Bitcoin and Ethereum are an important part of this new ecosystem but they don't represent everything that is possible when finance moves into the digital world.
This could have a profound impact on financial inclusion. While traditional finance has a one-size-fits-all approach, decentralised finance is hugely varied, meaning that anyone with a digital device can find a solution that fits them:

Cryptocurrency

By far the most common form of digital currency, but paradoxically one of the least useful for many people. Although it was initially touted as a fully digital replacement for fiat currency in the original Bitcoin whitepaper, only 33% of Bitcoin payments are used to purchase goods, and it is more often used as an often quite volatile investment vehicle. Buying cryptocurrencies can also be difficult or expensive, limiting its appeal to people who are likely to underbanked.

Stablecoins

Although they are not nearly as common as other forms of digital currency, Stablecoins are potentially very useful. Their key differentiator from other forms of crypto is the fact that their price is tied to existing fiat currencies – Tether is pegged to the US Dollar for example. This means that it is much easier to use in real-world applications, since it largely sidesteps the extreme volatility of cryptocurrency.

CBDCs

Central Bank Digital Currencies are digital currencies created and issued by governments – China, Barbados, Nigeria and many other countries have already instituted their own CBDCs or are in the late stages of doing so. Like Stablecoins, they avoid the volatility of cryptocurrency, but thanks to government backing they have the advantage of legitimacy, investment in infrastructure and mass awareness. Although these are by their nature centralised, they could still be part of a wider digital ecosystem.

Customers have access to a huge and growing range of tools to buy, sell, trade, spend and save all the above asset types and any others that may emerge in the future. One thing we have seen is that underbanked people are not financially inactive – they come up with innovative ways of managing their finances outside of the centralised banking system. Decentralised finance adds tools with which they can do this that, when done right, has the freedom of the ad-hoc arrangements people make outside of the financial mainstream with the protections and digital infrastructure that are common in developed countries.

What do digital currencies mean for inclusion?

Everyone is included

Mobile phones are common in even the least developed parts of the world, while bank branches are often inaccessible. Digital currencies can be used by anyone with an internet connection. Although banks would still be needed to cash out digital currency, it would be ideal for peer-to-peer transfers.

Instant remittances

Money can be transferred across borders instantly, at any time. This is ideal for immigrant communities sending money home and for workers in informal economies, where workers are hired by the day instead of on contracts.

Cash-like flexibility

In developing countries, it is far more common to be paid cash-in-hand than by bank transfer, and digital currency would allow employers to pay their employees weekly or daily. It is also potentially very easy to send money to friends and family.

Security and transparency

Keeping money in the form of cash is risky, but digital currencies are much more difficult to steal and do not degrade like paper money. This also gives governments oversight of how much money they really have in circulation.

Privacy

For many people in developing countries a distrust of the government is rooted in experience, so the privacy inherent to crypto and stablecoins is a draw – though it may slow the adoption of CBDCs. The possibility of avoiding tax also needs to be addressed.

"I look at the business cases – we saw across a lot of the frontier markets, specifically in Africa, how a mobile wallet really enhanced financial inclusion. The only problem with a traditional wallet is that you have to get a traditional currency into it, but those currencies aren't digital. Imagine that you now converted those currencies into a digital format so now physical currency ever needed to change hands."

Bhairav Trivedi, CEO at Crown Agents Bank

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"I can see from the last two decades that the [financial] system is visibly failing and excluding many communities. I'm not saying that centralised banks don't have a role - many people are happy with the safety of their banks, Decentralisation is very powerful, but it requires you to take responsibility for yourself, and how many people are ready for that I don't know but I believe consumer protections can be 'baked' into a DeFi system so that even if I am managing my own wealth I can still be protected"

Khalid Howladar, Chairman at MRHB DeFi

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Many people exist outside of the financial mainstream, either from lack of infrastructure or by choice, and making them use a centralised financial system like a CBDC might cause pushback, especially in countries with a history of authoritarianism and corruption. Decentralised finance gives them access to a palette of tools that they can use for their specific needs, reproducing digitally the informal economies that many people rely on and giving billions of people access to financial tools taken for granted throughout much of the world.

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