China's new payments system threatens US financial leadership

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Late to the payments race: the US and its allies try to catch up

BRICS finds a way to thwart the West

It's easy to shrug off announcements from BRICS, an organization that some view as a geopolitical rival to the US and its allies. Since its first summit in 2009, BRICS hasn't accomplished much besides increasing membership from four to nine countries (Brazil, Russia, India, China, South Africa, Egypt, Ethiopia, Iran and United Arab Emirates). But a <u>statement from</u> its 22-24 October 2024 summit in Kazan, Russia expressing interest in an independent cross-border payment system called BRICS Clear is worrisome.

Worry is called for because three BRICS countries have intense motivation to develop Clear as a competitor to SWIFT, the western-controlled global payments system. Russia and Iran lost access to SWIFT as punishment for <u>Russia's invasion of Ukraine</u> and Iran's nuclear weapons development and sponsorship of terrorism. Because doing business in a dollar-centric world without SWIFT is difficult (Russia must <u>barter</u> some transactions), Russia and Iran would find a payment system that was beyond the reach of the US and its allies highly desirable.

The third country, China, is envious of the power the US gains from its dominant position in world finance. Offering an alternative cross-border payments platform to other nations would enhance China's financial leadership and boost its global power.

Delegates attend a session of the 16th BRICS Summit held in Kazan, Russia.

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BRICS SUMMIT 2024

New technology gives BRICS an advantage

Adding to worries is the likelihood that BRICS Clear might benefit from technical expertise gained by the People's Bank of China as a participant in the Bank for International Settlement's Project mBridge, a cross-border payments platform.

BIS is a Swiss-based organization that supports central bank monetary and financial stability and provides financial services to its member banks. Beginning in 2021, BIS and its partners - the central banks of Hong Kong, Thailand and the United Arab Emirates and the Digital Currency Institute of the People's Bank of China (China's central bank) - developed mBridge.

The aim of mBridge is to evaluate a multi-central bank digital currencies payments platform to reduce the time of receiving a payment from days to <u>instantaneous</u> settlement. The project is designed to lower transaction costs, improve payment efficiency and enhance financial inclusion. The result is a single platform connecting central banks to make payments faster, cheaper, accessible and final.

In June 2024, BIS announced that mBridge had reached the minimum viable product stage. MVP means the platform is ready to handle real-value transactions in a controlled and limited environment. This phase will allow users to gain experience, add and test new features and evaluate use cases and connectivity to other systems.

In a related and disturbing move, BIS handed over mBridge to the participating central banks on 31 October 2024, declaring the project was "so successful" that it was at a level that the central banks could manage it themselves. Western nations fear that technology for a competing global payments system is now in the hands of those who are outright antagonists if not covert enemies of the west.

Agustin Carstens, the BIS General Manager, downplayed the project transfer, saying that despite the minimum viable status, mBridge would need many years of work. "mBridge is not mature enough to start operating."

Those statements are surprising because the commercial Bank of China (Hong Kong)announced on 29 October that it was integrated with mBridge and completed its first fully automated inbound and outbound transactions. The Bank said it will use the platform for select corporate customers. And a UAE official said in October that the platform has processed hundreds of transactions valued at billions of dollars and growing rapidly.

USD dominance threatened?

We should have listened

In October 2022 at a Harvard Law Schoolsymposium on digital currencies and national security, Daleep Singh, former deputy secretary of the US Treasury for Financial Markets, urged the US to quickly develop a central bank digital currency. He noted that Russia and China had the interest and ability to challenge the US-led international order, and that influence over other nations increasingly took an economic form. China, Singh said, was a peer economic competitor that had developed a CBDC. Singh warned that without a Federal Reserve CBDC, the primacy of the US dollar was threatened.

Christopher Waller, a member of the Federal Reserve Board of Governors, minimized CBDC concerns at the symposium. He didn't see a compelling need for a CBDC, claiming that the dollar's primacy wasn't because of technology. Instead, the dollar makes up 60 percent of foreign reserves and is the most widely used currency in foreign transactions.

Things have changed since Mr. Waller's statements. Given a production version of mBridge and China's CBDC, the US's chief economic competitor is positioned to challenge America's financial dominance. BRICS could soon have a payments system that makes transactions faster and cheaper than SWIFT. That would attract payments customers and nations who might worry about running afoul of the US and suffer crippling economic sanctions.

Project Agorá

Belatedly, the US Federal Reserve and allied central banks started Project Agorá. Led by the BIS, Agorá is designed to create a multi-currency platform to improve the efficiency and reduce the cost of cross-border payments (the same goals as mBridge) using tokenized assets, including commercial and central bank money.

<u>Tokenization</u> of commercial bank money is a key difference between Agorá and mBridge. Tokenized commercial bank money is used for payments and then those payments are settled in CBDCs. Tokenized central bank money is <u>another way</u> of saying central bank digital currency.

Project Agorá is scheduled to release a final report at the end of 2025. In the meantime, China and BRICS nations have a head start on cross-border transactions. The lack of Chinese yuan liquidity and the absence of governance and operational regulations may limit transactions, but China can work on those problems while demonstrating global financial leadership to other nations interested in an alternative to the US-led payment system.

The US dollar has been the <u>dominant global currency</u> for about a century. It – and the US's financial leadership – may be seriously challenged.

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