

Chapter 11

Legal Tender in the Age of Central Bank Digital Currencies

Adekunle Alexander Balogun

 <https://orcid.org/0000-0001-9683-8964>

University of Ibadan, Nigeria

ABSTRACT

This chapter explored the traditional concept of legal tender and the role of the central banks in the issuance and promotion of a country's currency in relation to the monetary policy obligations in the era of digital currencies. The chapter examines the jurisdictional opportunities and limitations inherent in the CBDC in view of the legal tender concept as a default means of settlement of financial obligations in a country. The chapter demonstrated that the benefits of CBDC becoming an acceptable legal tender are contingent upon a robust financial architecture and acceptance of the token by the population. It is recommended that central monetary authorities should leverage current digital technology and innovations in collaboration with the private financial institutions for an efficient transition to the digital financial system.

INTRODUCTION

The modern monetary system is gradually moving from the physical currency (coins and banknotes) to embracing digital notes as a medium of exchange for transaction due to advances in technology. The reality that virtual currencies are making it to the mainstream of financial transactions has pushed central banks to establish mechanisms, legal frameworks, and infrastructure to support the issuance of central banks digital currencies (CBDCs) as legal tender backed by government law. According to Boar et al. (2020) (as cited in Mohammed & Yusuf, 2023), the CBDC is typically issued by a central monetary authority, such as the central bank, as a form of money, which operates side-by-side existing money, like cash.

However, there have been questions on the legality or ideal legal tender in the face of digital money - which transcends jurisdictions and space - just as there had been controversies on the meaning of legal tender itself. Bossu (2020) contended that legal connotes that currency issued by the authority, that has been offered for payment within the jurisdiction, must be accepted by the creditor because of the legal tender status, which authorizes the payer to fulfill the monetary obligations. On the contrary, based on

in depth analysis of various conceptual understanding of legal tender and the understanding of legal requirements of same, Goldberg (2009) argued that the previous literal definitions of legal tender are faulty.

Indrawati (2023) contended that the role of a country's currency as a legal tender has waned in the current times due the emergence of digital currencies. As was noted by the Committee on Payments and Market Infrastructures (CPMI, 2018), central banks in some countries do not have legal authority to issue CBDC. The emergence of financial technology based payment structures has altered the notion of currency which central banks are being driven to acknowledge and embrace in order to give effect to the monetary policies and control of the macroeconomics (Foster et al., 2021; Song, 2023).

Additionally, the evolution of electronic payment systems and the acceptance of privately developed electronic monies as a store of value for diverse segments of the modern society are causing the attention of the monetary authorities on the necessity to actively monitor and control the financial systems including the issuance of CBDCs (Bossu et al., 2020; Shirai, 2020; Ngo et al., 2022; Auer et al., 2022; Balogun et al., 2024). Therefore, it is imperative for a study to be conducted to evaluate CBDC about the traditional function of money's legal tender in society.

Review of Literature

The emergence of CBDC has been the focus of scholars over the years with various studies conducted on the future of the monetary and payment systems across the world with different conclusions. Tong and Jiayou (2021) deduced that digital currency has an insignificant substitution effect on bank deposits in China but has a positive relationship with economic growth, which has the potential to reduce systemic risks in the financial system. Ngo (2022) discovered that the awareness and acceptance of CBDC by the populace hinges on the level of digital proficiency, economic inequality and, other macroeconomic factors such inflation and government economic achievement. Ree (2023) found that the launch of CBDC in Nigeria has not gain appreciable adoption by the population because of the huge effect of mobile money, in spite of the initial enthusiasm and despite the great potential for financial inclusion in that country. Similarly, Tan (2023) established that low liquidity risk, the huge size of the assets of the financially excluded population and the prospect of CBDC as a means of payment and store of value for households could increase the potential of CBDC to accelerate lending in an economy.

Also, there have been researches on the issues of central bank digital currencies and the general legal questions. Nabilou (2019) analysed the legal issues surrounding the issuance of CBDC in the euro area with the conclusion that the financial systems and the intermediation role of the commercial banks as well as the monetary policy mechanism will be adversely affected without proper resolutions of the legal issues, especially the amendment of the Treaty on the Functioning of the European Union (TFEU). Bilgi (2022) investigated the significant components, benefits and limitations of CBDC introduction as legal tender in India. The study concluded that private digital monies are typically not centrally issued by the monetary authorities, while the demand for digital currencies for transactions are generally increasing due to safety, speed of operations, and limited operational charges. Consequently, these factors should be considered by the central monetary authorities in the establishment of CBDC as legal tender for the smooth adoption by the populace. Also, adequate technological infrastructure and comprehensive legal framework are required to make the launch effective.

Again, Xiang (2023) explored the functions of digital currency in comparison to fiat money in relation with money supply and demand and the direction of money. Using data on cash ratio, level of digital currency as well as interest rate, the study concluded that changes in the velocity of money is obtainable in

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