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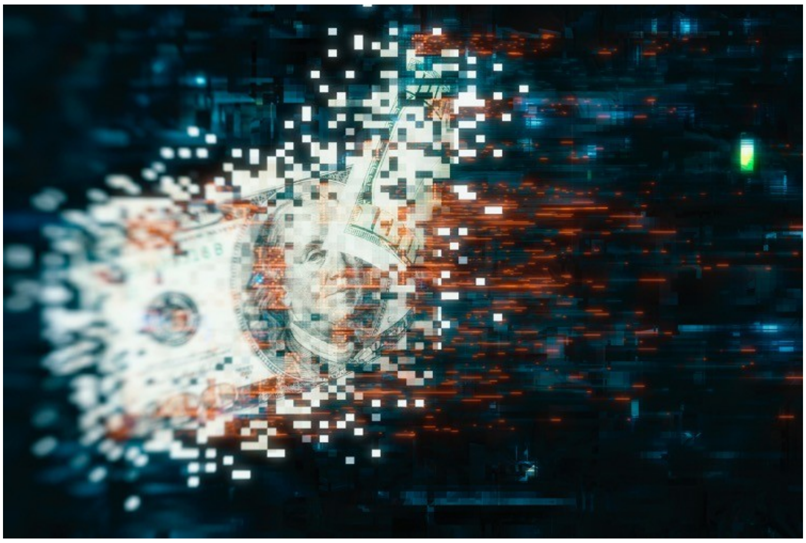
Central Bank Digital Currencies: Say Goodbye to Financial Privacy



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In a new study carried out by the Bank of International Settlements (BIS), the central bankers' central bank headquartered in Basel, Switzerland, an overwhelming majority of the world's central banks indicated interest in developing Central Bank Digital Currencies (CBDCs). CBDCs are now being promoted by governments and banks as an alternative to the burgeoning international market in private digital currencies such as Bitcoin and Ethereum, as well as the even-newer "stablecoins," i.e., private digital currencies tied to some commodity or national currency in order to provide additional stability. The enormous popularity of private digital currencies in recent years stems from their ability to completely evade government tracking measures; Bitcoin and other digital currencies have proven extremely helpful in moving money around the world outside the scrutiny of both government and banking authorities.

In response, a number of countries have begun developing digital versions of their own national currencies, with China's advanced digital yuan project already in the beta testing stage in some parts of China. China's motivation, of course, is to completely replace traditional currency with digital currency, thereby stripping away from Chinese citizens every last vestige of financial privacy. Under China's coming digital-currency regime, every single transaction, domestic and international, will be tracked by government authorities, and no one will be able to move money inside or out of China anonymously.

China at least is straightforward about its intentions; other government and banking authorities are promoting CBDCs as merely more reputable alternatives to the unregulated "Wild West" of private digital currencies. But in the end, all CBDCs will serve purposes similar to the digital yuan: as a foolproof tool to guarantee that financial privacy is a thing of the past.

Besides China, the list of states that have or are about to release CBDCs is still very small: Bahama's "Sand Dollar" (2020) and Nigeria's eNaira (2021) are two of the very first such, with the Eastern Caribbean Currency Union close on their heels. But according to the BIS survey, more than 90 percent of the rest of the world's central banks have expressed interest in, or are actively working on, some type of CBDC. This represents a continual upward trend in interest among central banks over the five years that the BIS has run the survey on CBDCs. Already in 2017, over 60 percent of responding institutions indicated some level of interest, but now, in the wake of the financial disruption of the COVID pandemic and soaring interest in private digital currencies, CBDCs are looking more and more like an idea whose time has come, in the eyes of the global central-banking community.

CBDCs, unlike other forms of digitalized payments, but similar to physical cash, represent direct claims on central banks rather than on a private banking institution. CBDCs are divided into two types: "retail," to be used as literal money by the general public, and "wholesale," to be used only by financial institutions to settle interbank payments or transactions with central banks. While the exact functionality of CBDCs has yet to be worked out, since most CBDCs are still in the early stages of planning, the number of central banks in late stages of development jumped dramatically since last year, from 14 percent to 26 percent. Not surprisingly, work on retail CBDCs is far more advanced compared to wholesale CBDCs, reflecting an obvious preference for monitoring the transactions of the general public over streamlining bank-to-bank transactions.

All of this raises the question: Is the U.S. Federal Reserve among the central banks interested in developing a CBDC? While the banks that responded to the BIS survey are not listed by name, there can be no question whatsoever that the Federal Reserve is now actively pursuing the development of a retail CBDC of its own. In January 2022, the Federal Reserve released a comprehensive study for public comment, "Money and Payments: The U.S. Dollar in the Age of Digital Transformation," which lays out the case for a CBDC version of the U.S. dollar. While assuring readers that no policy decision has been made to create a CBDC, and that any future digital U.S. dollar would "complement, rather than replace, current forms of money" as well as "protect consumer privacy," it is also made clear that any American CBDC would possess tracking and security features that would "protect against criminal activity" — i.e., compromise the financial privacy of anyone using a CBDC. The Federal Reserve study touts the potential benefits of a digital dollar, which would supposedly include:

- "provid[ing] households and businesses a convenient, electronic form of central bank money, with the safety and liquidity that would entail";
- "giv[ing] entrepreneurs a platform on which to create new financial products and services";
- "support[ing] faster and cheaper payments (including cross-border payments)"; and
- "expand[ing] consumer access to the financial system."

Some of the risks detailed in the report that could offset these putative benefits include the overall stability of the financial system, the cost and availability of credit, and the effectiveness of monetary policy. Interesting, the risk to consumer financial privacy is not listed among potential risks. Elsewhere, though, the paper gives some idea of how consumer privacy would be prioritized, to wit: "Protecting consumer privacy is critical. *Any CBDC would need to strike an appropriate balance, however, between safeguarding the privacy rights of consumers and affording the transparency necessary to deter criminal activity*." (Emphasis added.) A few paragraphs further on, the paper elaborates:

> Financial institutions in the United States are subject to robust rules that are designed to combat money laundering and the financing of terrorism. A CBDC would need to be designed to comply with these rules. In practice, this would mean that a CBDC intermediary would need to verify the identity of a person accessing CBDC, just as banks and other financial institutions currently verify the identities of their customers.

"Intermediary" here refers to any Fed-authorized institution, such as a commercial bank, through which CBDCs would be transacted on behalf of the Federal Reserve (with which private citizens are not permitted to deal directly).

Interestingly, two of the supposed benefits of a digital dollar that receive heavy emphasis in the Fed's study are its ability to facilitate cross-border movement of money and its enhancement of the U.S. dollar's status as the world's reserve currency. Cross-border movement of money is also cited in the BIS survey results as the number-one motivation among central banks worldwide for developing CBDCs, given the current cumbersome and time-consuming methods for moving money around the globe. A future worldwide regime of CBDCs would be designed for seamless international monetary mobility — a sort of "free-trade agreement" for currencies. And as with more traditional "free trade agreements," which so often turn out to be pretexts for international government blocs such as the European Union, any state of affairs rendering the international movement of national currencies instantaneous and seamless could easily be converted into a single global currency or basket of currencies under global authority. Since the establishment of a global currency is a long-sought goal of internationalists from John Maynard Keynes to the present day, the potential for an efficient system of CBDCs to be transformed into a global currency is a serious concern — and one that is conveniently left unmentioned in both the BIS and Federal Reserve reports. It is, however, strongly implied in both, as, for instance, in the BIS report's observation that

> Cross-border payments efficiency is another driver that has grown in importance over the past year, especially for central bank work on wholesale CBDCs. An ambitious, multi-year G20 programme is under way to make cross-border payments faster and cheaper, as well as more transparent and accessible. CBDCs could play an important role here…. *Indeed, building block 19 of the G20 programme is tasked with exploring how to factor an international dimension into CBDC design*. The CPMI, in collaboration with the BISIH, IMF and World Bank, will deliver a report to the G20 in July 2022 in which they identify and analyse options for accessing and interlinking CBDCs with a view to improving cross-border payments. [Emphasis added.]

According to the Federal Reserve's report, meanwhile:

> CBDC has the potential to streamline cross-border payments by using new technologies, introducing simplified distribution channels, and *creating additional opportunities for crossjurisdictional collaboration and interoperability*. Realizing these potential improvements would require *significant international coordination to address issues such as common standards and infrastructure*, the types of intermediaries that would be able to access any new infrastructure, *legal frameworks*, preventing illicit transactions, and the cost and timing of implementation. [Emphasis added.]

In short, a digital dollar is clearly being planned, although an act of Congress will be required to authorize its implementation. No doubt much of the recent impetus is China's drive to digitize its own currency, but the emphasis on ease and speed of international convertibility with other CBDCs should be a warning flag that, in all likelihood, a worldwide network of digital currencies is being considered as a stepping-stone to a single global digital currency. Any move to digitize the dollar should be regarded with apprehension, since it will likely entail significant concessions of individual financial privacy and, in the longer run, of national monetary sovereignty.