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CBDC THREATEN PRIVACY

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Numerous governments across the globe have begun adopting central bank digital currencies, more commonly known as CBDCs, and many more are considering doing so. This is an ominous development for citizens since CBDCs represent a gateway to surveillance and control that will prove irresistible to most governments. They are a serious threat to financial freedom and privacy.

The CBDC is a response to the rise of cryptocurrency,[1] a private-market financial innovation providing alternatives to national currencies and the political influences that impact their long-term values. Cryptocurrencies also provide the ability to transact outside of the traditional financial sector and with more privacy. In response to the popularity of this innovation, governments are pursuing the exact opposite: more centralisation, surveillance and control.

Fortunately, the current chair of the U.S. Federal Reserve (the Fed) seems to recognise these risks. When I spoke to Fed Chair Jerome Powell during the Cato Institute's 40th annual monetary conference,[2] he acknowledged the privacy concerns with a CBDC. He noted, for instance,[3] "We would not want a world in which the government sees, in real-time, every money transfer that anyone makes with a CBDC."

But I suspect Powell, like many others, also recognises the threats CBDCs represent to central banks themselves. Implementing a retail CBDC—even an intermediated one—would entangle the Fed with the public in a way that would radically alter the relationship between the central bank and American citizens.
The most obvious problem is that involving the Fed in directly providing money to individuals would politicise monetary policy beyond anything yet seen, ultimately destroying what is left of the Fed's political independence.

Others at the Fed understand this, too. Governor Michelle Bowman,[4] for instance, recently warned that there is "a risk that this type of control could lead to the politicization of the payments system and, at its heart, how money is used". Bowman's words surely understate the significant risks adopting a CBDC would pose to financial privacy and economic freedom, particularly due to the existing legal framework that underlies all financial transactions.

In fact, implementing a CBDC could exacerbate many of the existing privacy violations that are already built into the financial system. The United States is often heralded as a free country with substantial protections for civil liberties, but the reality often does not live up to such expectations or constitutional dictates. And this is especially true in the financial arena.

Personal and financial privacies are key components of citizens' lives, and in a free society, they must be respected and safeguarded. Individuals are supposed to enjoy private spheres free of government involvement, surveillance and control. The Fourth Amendment to the Constitution of the United States embodies the idea that a citizen should be free to live his or her life unmolested and unsurveilled by the government *unless* there is a reasonable suspicion that he or she has committed a crime. Little by little, this key principle has been cast aside[5] in financial markets.

Unfortunately, this reality is not well known. A Cato Institute survey in 2022 found that 83 percent[6] of Americans believe a warrant should be required for the government to access an individual's financial data, a standard that ended in the 1970s with the Bank Secrecy Act of 1970 (BSA) and the third-party doctrine. Now, all kinds of "financial institutions", including pawn shops, car dealers and jewellers, must collect detailed personal information about their customers and share it with the government upon request.

The federal government regularly collects records on millions of these transactions[7] without warrants. In the case of a suspicious activity report (SAR), which is effectively an accusation of possible wrongdoing, the financial institution is forbidden from discussing the report with the accused customer. The existing regime is the culmination of a sweeping, warrantless surveillance initiative that has steadily grown over decades.

Despite this regrettable situation, a CBDC would endanger financial privacy to an even greater degree. It would serve as the capstone for more than 50 years of expanding financial surveillance, making every financial transaction available to the government by default.

In fact, many of the purported benefits[8] promised by CBDC advocates depend on complete visibility into individual transactions. It makes no difference, under existing laws, if a financial-transaction database is held by a private financial institution or the central bank itself. Private firms have been co-opted into this surveillance system.

Virtually no central bankers talk publicly about rolling back this surveillance system. So, it's not a surprise that, at the same time, most of them openly espouse the purported benefits of a CBDC and seem completely unconcerned with the privacies or freedoms of their citizens.

In fact, Augustín Carstens, the general manager of the Bank for International Settlements (BIS), has bemoaned the privacy of paper currency by pointing out that with a CBDC, the central bank "will have absolute control on the rules and regulations that will determine the use of that expression of central bank liability, and also we will have the technology to enforce that". Bo Li, the deputy managing director of the International Monetary Fund (IMF), has advocated for the implementation of CBDCs because they will "allow government agencies and private sector players to program…targeted policy functions", such that "money can be precisely targeted for what people can own".

Such pronouncements make it clear that a CBDC is ill suited[9] to serve the public's needs for freedom and privacy. CBDCs are being developed precisely because they provide governments with increased control and power. This kind of threat to individual rights will naturally drive people toward private solutions, while governments are sure to work hard to thwart such alternatives since they undermine the increased government control and power CBDCs create.

Fortunately, these fundamental problems, and many more,[10] seem to be hampering the rise of CBDCs. For example, Nigeria's CBDC has failed[11] to gain adoption, and even China's CBDC seems stuck in a perpetual pilot phase. Governments worldwide may be busy evaluating and launching CBDCs, but perhaps such challenges will provide them with the opportunity to realise it is a mistake to forge ahead.

In the United States, a CBDC would embroil the Fed in politics in a way that would make the governors long for the days of the dual mandate's maximum-employment component. There is no doubt that members of Congress would constantly push the Fed to do more with a CBDC, as in providing more money to more people for an ever-expanding set of tasks. It would be impossible for a central bank to maintain any semblance of political independence in such an environment.

Some supporters still believe CBDCs can be designed so that privacy *is* protected, but this view is naïve because government officials would not be able to reap the supposed benefits of CBDCs if they enabled anonymous transactions. This view also ignores the fact that supposed CBDC benefits won't be realised if people have alternative payment options. Governments would not be able to programme citizens' spending, for instance, if people could use cash instead of CBDCs.

It is also very difficult to believe governments will implement CBDCs with fewer requirements than they've placed on private firms in the name of safety and security. The only way CBDCs could provide a privacy advantage over transacting with traditional mediums of exchange is if the government ditches the existing anti-money laundering (AML) framework. The truth is, central bankers are not about to engage in anonymous transactions with members of the public, something governments have already outlawed for private financial institutions.

Again, central bankers' words only serve to heighten these concerns. Christine Lagarde,[12] president of the European Central Bank (ECB), said last year that when Europeans were surveyed on the topic, privacy topped the list of their concerns.
"Privacy is first and foremost on their mind when we divvy up the digital euro," said Lagarde. "[But] there would not be complete anonymity as there is with [cash.]"
Her attitude shows that while people *want* privacy, a CBDC will not protect it. In fact, the citizen's privacy will be undermined. The central governments of the world are bent on using CBDCs to secure firmer control over their currencies and additional policy tools that enhance their powers. They're simply not worried about securing citizens' privacies and freedoms.

But while central banks may benefit from these newfound powers in the short term, their leaders would be well advised to recognize the downsides CBDCs portend, not just for individuals but for the central banks themselves.

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