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WILL THE U.S. TAKE THE GLOBAL LEAD WITH A CENTRAL BANK DIGITAL CURRENCY?

The United States Congress and Board of Governors of the Federal Reserve System are examining whether the U.S. should issue a Central Bank Digital Currency (CBDC) in cross-border payments. The research and public engagement on CBDCs is due to a number of developments, including the growth of stablecoins, advancement of foreign CBDCs, and competition between the U.S. and the People's Republic of China in a race to determine which CBDC will be the primary digital form of currency as an alternative to the U.S. dollar as a global reserve currency.

On June 15, 2021, the House Financial Services Committee Task Force on Financial Technology held a hearing titled "Digitizing the Dollar: Investigating the Technological Infrastructure, Privacy, and Financial Inclusion Implications of Central Bank Digital Currencies." This hearing was focused on the overall feasibility and future role of a digital currency issued by the U.S Government. The main topics discussed included financial inclusion, consumers' right to privacy, and what agencies would carry out the implementation of a digital dollar. While there is no legislation tied to this hearing, yet, the bipartisan enthusiasm surrounding the topic suggests this idea will be acted upon in the future.

The chair of the task force, Rep. Stephen Lynch (D-MA), began the session by pointing to the fact that while payment systems evolve as technology advances, "cash still plays a vital role in the financial ecosystem." He outlined how cash is permissionless, meaning no outside entity can regulate how it is used, and it is untraceable. While the concept of a CBDC may sound similar to cryptocurrencies, such as Bitcoin, Rep. Lynch pushed back against this claim with the example of the Sand Dollar, a digital currency issued by the Central Bank of the Bahamas which has enjoyed success in bringing currency to unbanked citizens. China has also begun the pilot phase of its own CBDC program, although it seems to be more focused on collecting information than providing access to currency. Witnesses at the hearing held a common enthusiasm for an American CBDC and had various forms of expertise in the field. The group consisted of:

- Carmelle Cadet, Founder and CEO, Emtech
- Jonathan Dharmapalan, Founder and CEO, eCurrency
- Rohan Grey, Assistant Professor of Law, Willamette University
- Dr. Neha Narula, Director of the Digital Currency Initiative, MIT Media Lab
- Dr. Jenny Gesley, Foreign Law Specialist, Library of Congress

Digital currency systems resulted in increased financial inclusion in the Bahamas, and this specific point was discussed at many points throughout the hearing. When governments create and distribute digital currency that citizens can access via a mobile app or prepaid card, people who live in rural areas or are otherwise unable to go to a consumer bank can have access to non-cash currency and, more broadly, to the financial markets. As Cadet explained in her testimony, "the reality is the banking business model still leaves millions of citizens underbanked, many with no access to basic bank accounts and relatedly no access to cost effective digital payments and online economy." This disparity has only become more apparent during the COVID-19 pandemic, when many people were unable to travel to a bank to open an account or receive assistance in setting up mobile banking services. Cadet also explained how "low-income households … are forced to pay extra for financial services when they find themselves in an illiquid financial position. They are either faced with costly overdraft fees or must resort to the services of illegal or informal money lenders facing predatory costs and conditions." Witnesses explained how these obstacles to financial inclusion have clear solutions in a financial ecosystem that includes digital currency. With the introduction of a CBDC, unbanked individuals would only need a mobile device to access a mobile wallet or could obtain a prepaid card that can directly hold digital currency. Pertaining to the costly fees incurred by low-income individuals who need access to funds, CBDCs would be directly issued by the government and would involve no transaction costs or overdraft fees. Cadet also noted in her testimony that "the Consumer Financial Protection Bureau has found that approximately 26 million Americans are credit invisible, which means that they do not have a credit record, and another 19.4 million do not have sufficient recent credit data to generate a credit score." This issue of credit invisibility may not be fully solved with the implementation of a CBDC system, although unbanked individuals could have the option of including their CBDC history in their credit score "if they wanted their digital cash (CBDC) wallet data to be shared and weighted as a data point in credit ratings." The inclusion of digital cash wallet data would obviously depend on consent from a consumer, but this option could be helpful for unbanked individuals who need to provide a credit history for a major purchase. Lawmakers from both parties and all witnesses seemed optimistic that a digital dollar could help alleviate financial exclusion in the United States economy and provide seamless access to currency for many Americans.

As with most debates regarding an expansion of the federal government, several lawmakers and witnesses expressed concerns about consumer privacy. The main debate surrounding the digital dollar is whether it should remain an untraceable form of currency like cash, or whether limited information should be collected in order to prevent money laundering and illicit payments. There seems to be bipartisan consensus that giving the U.S. Treasury or Federal Reserve unchecked surveillance powers over a digital dollar would infringe on individual liberties, but there is disagreement over the extent to which a digital dollar should be private and permissionless. In the hearing, Cadet expressed hope that a balance could be struck between consumer privacy and anti-money laundering efforts, describing "a thoughtful CBDC design that, like physical cash, offers strict privacy, while leveraging embedded governance to combat money laundering with the use of CBDC." Other witnesses had a different view of the government's role in maintaining a CBDC system, such as Rohan Grey, who remarked, "In the context of digital financial privacy, the best way to limit the risk of data abuses is to not collect it in the first place." Unlike Cadet, Grey expressed in his testimony that one of the most important features of a digital dollar must be transactional anonymity. This position seemed to agree with Ranking Member Warren Davidson, who at the onset of the hearing, stated in plain terms that "the government must refrain from collecting consumer data" if a digital dollar were established. While there is not complete consensus on the government's role in maintaining a digital dollar, there is agreement that if regulators compromise consumer privacy, it will lead to distrust of the entire eCash system.

Rohan Grey also spoke about peer-to-peer payments, which were not discussed in depth by other witnesses or lawmakers at the hearing. Peer-to-peer payments describe transfers between users, which would in this case consist of one user sending another user digital dollars. Grey took the position that peer-to-peer payments should be allowed with no third-party approval, meaning that any person would be able to send digital dollars to anyone they choose. Grey remarked that while this opinion may sound "radical," it is, in essence, preserving the "permissionless" feature of cash. He supports this position by stating, "Preserving the right to hold currency and make peer-to-peer payments directly without third-party involvement or approval is a small-c conservative response to the socially disruptive effects of digitization and the internet." While others did not express disagreement with this position, it can be inferred that those who support government surveillance for crime prevention would not agree, such as Chairman Lynch, who emphasized in his opening statement the need for a balance between privacy and preventing misuse. Dr. Neha Narula, in response to a question from Ranking Member Davidson, stated that "the ability to track bad actors is tied to incomplete privacy." Narula acknowledged that if the Congress were to implement safeguards to prevent illicit use of the currency system, this would have to infringe on consumer privacy, to some extent.

Another point of debate throughout the hearing was the discussion of specific duties of federal agencies in a digital dollar system. While some participants were quick to place the onus on the Federal Reserve and Treasury to carry out a digital dollar system, others suggested the involvement of a slew of other federal agencies. Jonathan Dharmapalan gave a decisive opinion in his testimony, stating "The responsibility to securely produce notes and coins is placed on the Treasury of the United States. Extending that responsibility to the production of CBDC would be a natural extension of the role of the Treasury. The Federal Reserve can then fulfill its subsequent role as the issuer and distributor of the CBDC." Similarly to Dharmapalan, several of the other witnesses, such as Dr. Jenny Gesley and Ms. Cadet, established the Central Bank as the main distributor of currency in a CBDC program. In the United States' case, it can be assumed that "Central Bank" refers to the Federal Reserve. Grey, on the other hand, pushed back against this assertion and calls for a "polycentric digital Dollar architecture," stating, "other public agencies, such as the Treasury and the Postal Service, have unique needs, priorities, and expertise that should also be considered when evaluating the appropriate division of executive branch responsibilities for digital fiat currency infrastructure." After his testimony, several Republican members of the subcommittee expressed their disagreement with the suggestion that the United States Postal Service should be involved in consumer banking due to perceived fiscal inefficiencies within the department. There was not a clear consensus among the hearing participants about what agencies would be responsible for issuing and distributing digital dollars, but it seemed to be agreed upon that the Federal Reserve and Treasury would have primary roles in the system.

In this hearing, there was widespread enthusiasm for the creation of a government-issued digital currency. This topic is exceedingly relevant as China develops its own digital yuan and attempts to challenge the U.S dollar as the default global reserve currency. Possibly the most important point agreed upon by both parties was the fact that the United States should strive to be the most thorough when creating digital currency, rather than being the first.

Financial services firms should stay updated for developments within the digital currency space to adjust their strategies accordingly; banks will be valuable partners to the government when digital currency eventually needs to be distributed to consumers.

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