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Lawmakers trip up over privacy and security of digital dollar

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Lawmakers from both parties say the Federal Reserve needs legislative authority to issue a digital dollar, but the two sides have so far been unable to find a balance between privacy and security that could overcome the partisan divide.

The gap also appears to be widening, potentially stopping a digital currency before it ever gets issued. At least one Republican who three years ago warned the U.S. could fall behind without a Fed-issued digital dollar is now not so sure. Another Republican, **Tom Emmer** of Minnesota, introduced legislation (**HR 6415**) in January that would prohibit the Fed from issuing a digital dollar to an individual.

Rep. **Bill Foster**, D-Ill., chair of the House Financial Services Task Force on Artificial Intelligence, said privacy, identification and anonymity will be the thorniest policy questions Congress will have to answer about a digital dollar.



“You can see it simply by the fact that all of the big proposals on this tread very lightly on the identity aspects of it,” Foster said in an interview. He said a central bank digital currency should offer privacy up to a point, but needs a way to unveil ownership in case of a crime.

That may be a tough sell for Republicans wary of the potential for government overreach.

Advocates of **a central bank digital dollar** see it as a modernization step in the financial system. Not only would the new technology enable some transactions to clear more quickly than they do today, but it could ensure the U.S. role in a global financial system that is becoming more digital.

With no proposal on the table, the details of a central bank digital dollar aren't clear. But it could involve millions of Americans—and potentially foreigners—using digital cash issued by the Fed to pay bills, dispensing with or at least reducing the need to carry notes and coins. A digital dollar could bypass parts of the traditional financial system and potentially open digital commerce to those without bank accounts or credit cards.

There are also potential downsides. Its reach could be limited by internet access or technological literacy. Like other forms of electronic money, the digital dollar could be more vulnerable to fraud and theft carried out from anywhere on the globe.

Democrats say the risk of fraud and theft in such an electronic world means legislation has to provide a way to follow the money — as is currently possible with electronic payments such as credit cards. Republicans say providing a way to track the money poses a threat to privacy that is still available for those who opt to use notes and coins.

As recently as 2019, a small, but bipartisan group of lawmakers began to urge the Fed to study a digital dollar. The concern was that China's work on a digital yuan and Facebook's plan for a stablecoin could undermine the dollar's paramount global role. But Facebook scuttled its stablecoin plans and China's digital yuan has had no real impact on the dollar's global standing.

As the fear of competition from China and Big Tech recedes, they're being replaced by worries about the privacy intrusions posed by a government-backed digital dollar.

'People want privacy'

Foster and Rep. **French Hill**, R-Ark., illustrate the growing chasm between the two parties over a government-backed digital dollar. Both House Financial Services Committee members were among those who sent a letter to Fed Chairman Jerome Powell in 2019 urging him to examine the idea.

Now, while Foster favors a digital dollar with limited anonymity, Hill says he doubts whether the government should issue a digital dollar at all.

“Many people are concerned about government-backed accounts at the Fed,” Hill said in an interview. “Government-directed central bank digital currency, in the most pure definition of that, is that you immediately have tracking, more big data, more privacy issues.”

Privately issued, regulated stablecoin cryptocurrencies pegged to the dollar may suffice to keep the dollar competitive on the global stage, he said.

“The summer of 2019, nobody had ever mentioned a private stablecoin to me,” Hill said. “If that's done properly, that might give you what many are looking for innovationwise, which is a dollar-based, liquid token to build some innovation. Some argue that will preempt the need for a central bank digital currency.”

Stablecoins also come with issues, including problems maintaining stable value. Hill and Foster's 2019 letter warned that leaving the development of digital currencies to the private sector could result in loss of control over monetary policy and make it harder to police money laundering.

House Financial Services ranking Republican **Patrick T. McHenry**, R-N.C., said it's not clear what problems a digital dollar would solve, especially in light of the privacy trade-offs it would entail. McHenry is expected to become the panel's chairman if Republicans retake the House next month.

“That's the primary question that needs to be answered, and no one's answered it. We have a largely digitized dollar without the utility of a blockchain,” he said, citing peer-to-peer

digital payment apps, such as PayPal and Venmo.

“There are an enormous number of trade-offs, civil liberties protections being the most evident one,” McHenry said in an interview. “People want privacy on some level, and they want their property rights preserved. Those are the difficult things that have to be balanced.”

‘License plates’

Foster is still pushing the government to move forward in creating digital identification, a key prerequisite for his vision of privacy, security and anonymity in a central bank digital currency.

He introduced a bill (**HR 4258**) last year that would establish a cross-government task force to develop methods for validating identity securely online. The Financial Services Committee in July advanced the bill for consideration by the full House.

“If you're going to authenticate a wide range of people around the world to use a central bank digital currency, you have to have a means of preventing the bad actors from having access to it,” Foster said. “It's clear that the existing know-your-customer standards that are set for ordinary bank accounts are not sufficient.”

Anonymity should exist up to a point, but a trusted court system needs to be able to unmask the ownership behind a digital dollar if there's evidence of a crime, Foster said. He likened a digital ID for digital assets to license plates for cars.

“Why do automobiles have license plates? Donkeys don't have license plates. Pedestrians don't have license plates, and the difference is the speed of escape from the scene of the crime,” he said. “You have no idea who was driving the car, but you can write down the license number, take it to a trusted court system, [and] unmask the perpetrator who is driving a car that ran over your dog.”

Digital assets need a license plate too, Foster said. If someone mugs you, you know roughly what they look like and where they are. You can report the crime, cordon off the area and

potentially track them down, Foster said.

“If someone puts a gun to your head and says, ‘Transfer your crypto assets to some account on my cellphone,’ then it's gone and it's gone instantaneously. That’s the difference,” he said. “Ultimately, every crypto wallet is going to have to have a license plate on it. We won't have to know under normal circumstances who the owner is, but we have to be able to inspect it, make sure it's a valid license plate, and thereby know that if something goes wrong in the transaction, you have the ability to demonstrate a crime has been committed and unmask them.”

‘Google knows’

Brandon Neal, chief operating officer at Euler Labs, said the public should consider privacy risks carefully before moving forward with a central bank digital currency. Neal, who worked for the Federal Reserve Bank of New York before joining the cryptocurrency company, said he has yet to see a digital dollar design that adequately protects privacy.

“There are many privacy-minded advocates within the Fed. I just know that institutions can change,” Neal said in an interview. “You could have the most well-intentioned people in an institution today, but different people might be in charge of that institution tomorrow, and their ideas might be rather different. So privacy is by far the top concern in my mind.”

Jennifer Lassiter, executive director of the Digital Dollar Project, said a solution will present itself as the U.S. does more research into technical designs for a central bank digital currency.

“Privacy and security are at friction with each other often, which is okay,” she said in an interview. “We can move along that scale to find the right technical design choice that will meet more broadly the needs of privacy for both parties.”

Ridge Barker, a partner at the law firm Withers, said the U.S. is heading toward issuing a digital dollar. Privacy concerns are valid, but the reality is that we’ve already given up a lot of privacy when it comes to money, Barker said.

“Google knows where you're spending your money. Amazon knows where you're spending your money. Your bank knows where it's going. Your credit card, Visa, Mastercard, and it's not hard for the government to get that information. Some of it already gets reported to the IRS. Some of it needs to be reported by banks if there's a suspicious activity report,” he said in an interview. “I don't think a Federal Bank coin changes that all that much.”

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