The Heritage Foundation

ISSUE BRIEF

No. 5014 | NOVEMBER 22, 2019

SHELBY CULLOM DAVIS INSTITUTE FOR NATIONAL SECURITY AND FOREIGN POLICY

China's Cryptocurrency Plans Are About Power, Not Innovation

Dean Cheng, Norbert J. Michel, PhD, and Klon Kitchen

KEY TAKEAWAYS

The Chinese Communist Party's planned new digital currency is part of its plan to strengthen government control over China's massive digital financial markets.

The U.S. must orient its own policies to creating a prosperous environment for America's financial innovations, or risk falling behind international competitors.

Congress should remove barriers to market entry for alternative monies, and ensure that no single type of money enjoys a regulatory advantage.

In early November, China's economic planning organization—the National Development and Reform Commission (NDRC)—removed cryptocurrencies from a list of industries that are denied assistance from local governments and that could eventually be banned throughout the country. This move appears to be part of a larger effort by the Chinese Communist Party (CCP) to reassert government awareness of, and influence over, the nation's massive digital financial markets.

Beijing Wants In on China's Huge Digital Economy

Complementing the NDRC's action on cryptocurrencies is a plan by the People's Bank of China (PBOC) to issue a digital yuan, potentially becoming the first major central bank in the world to provide an electronic national currency. These two actions are part of a broader initiative by the CCP to shore up perceived weakness in the nation's emerging digital payments industries, as well as giving the government access to valuable data that can be used for economic planning, anti-money-laundering enforcement, and domestic surveillance.

China's digital payments industry is currently worth $27 trillion (nearly 16 percent of the country's gross domestic product), with 94 percent of that market flowing through two firms: Ant Financial's Alipay and Tencent Holdings's WeChat Pay.[1] Each of these companies have more than 900 million users and a large portion of these transactions are mobile-to-mobile payments that never intersect with the state-run banking system, requiring the government to go through private companies if it wants information on those transactions. An official digital currency will likely be different.

While details are sparse, a digital currency issued by the PBOC would likely require users to download a digital wallet, and then receive a cryptographic "token" from the central bank that verifies and attaches its unique identity to all transactions associated with that wallet. It is unclear if other digital payment providers would also have to adopt this digital currency or if the government simply intends to compete against them by making the nation's official currency easer to spend. However, because user adoption will be key to the e-currency's success, forced adoption of the central bank's digital currency seems likely.

But this plan is about more than money. It is about knowledge and power.

China Is Developing Digital Currency, Not True Cryptocurrency

"The central bank is trying to regain the power it lost, as it simply can't allow private companies to dominate payments which lie at the heart of the finance system," says Zhu Chen, a leading Shanghai-based financial consultant.[2] China's central bank governor, Yi Gang, agrees: "Those big tech companies bring to us a lot of challenges.... We have to have the borderline between central bank and big tech companies."[3] But why?

"Currency means interest, power, global politics and diplomacy," says the PBOC's director of research, Wang In. "If a payments tool can provide the function of currency, then it will definitely have impact on legal tender, and affect how a country manages its currency and financial system."[4] Put simply: The Chinese government has concluded that it cannot allow industry to control the nation's financial development and data. This is also why China will not allow a true cryptocurrency.

One of the driving motivations behind the development of cryptocurrencies, such as Bitcoin, Ethereum, and Ripple, is the desire for anonymized transactions. The underlying objective is to move financial interactions away from the traditional banking sector in a way that is still secure and reliable. This contravenes Beijing's interests, and so its planned digital currency will be different.

Using what some Chinese officials have called "controllable anonymity,"[5] China's regulatory, law enforcement, and intelligence services will have full access to all financial data associated with the new currency—while promising to keep that information away from private-sector actors who would use this information for marketing and other services. "As long as you aren't committing any crimes and you want to make purchases that you don't want others to know about," says Changchun Mu, deputy director of the PBOC's payments department, "we still want to protect this kind of privacy."[6]

This added level of control is a central element of the CCP's interest in digital currency. The imposition of an Orwellian "social credit score" highlights the extent to which the government intends to monitor the daily actions and conduct of its citizens. Making all financial transactions observable would clearly serve this effort and would also include countless foreign companies and individuals doing business in China.

The PBOC justifies its need for a digital currency as an effort to protect its "monetary sovereignty and legal currency status,"[7] but these principles imply that a government *should* monopolize money production. This idea is misguided and particularly dangerous when implemented by a government already bent on controlling so many aspects of people's lives.

Under this type of digital currency regime, the government would exercise unlimited control over the means of payment for all goods and services. People would have no alternative to the electronic accounts held at the central bank, meaning that they would ultimately have to rely on the government to put money into the accounts and hope that the government refrains from taking the money out.

Given governments' historical track record as a steward of money,[8] the principle of monetary sovereignty should be replaced with one of consumer sovereignty. Rather than suppressing alternative forms of money, the government should protect people's ability to decide what the best means of payment are through a competitive process. Nothing can provide as powerful a check on the government's ability to diminish the usefulness of money as allowing competitive private markets to provide money.[9]

Policy Recommendations

The United States cannot assert significant influence over how China proceeds with its digital currency plans. It can, however, orient its own policies to create a prosperous environment for America's financial innovations. Failing to do so heightens the risk that the U.S. will fall further behind international competitors in the evolving financial technology markets. To that end, Congress should remove barriers to entry in the market for alternative monies, and ensure that no single type of money enjoys a regulatory advantage. At minimum, Congress should:

1. **De-criminalize the use of money.** The Bank Secrecy Act/anti-money-laundering laws have effectively criminalized the use of money, and the presumption of innocence is all but gone. These laws force financial firms to file millions of reports per year on law-abiding citizens; it is incredibly expensive and appears to have been an enormous waste of resources. Surely Congress can develop better ways to help law enforcement catch criminals while allowing financial technology companies to prosper. Regardless, Congress should ensure that producers of alternative monies are not held to higher or lower regulatory standards than traditional financial companies.

2. **Amend "legal tender" laws.** Congress should amend legal tender laws because they allow courts to force acceptance of a certain amount of official currency to satisfy debts even if a contract calls for delivery in another means of payment.[10]

3. **Eliminate capital gains tax disadvantage.** Since the Internal Revenue Service treats (effectively all) alternative currencies as assets, every such transaction is a taxable event and is reportable on Schedule D of the taxpayers' Form 1040 (or, if a business, the analogous business tax form). Congress should amend the Internal Revenue Code to provide that gains or losses attributable to the purchase or sale of alternative currencies are not taxable.

4. **Modify private coinage statutes.** Congress should modify statutes concerning coinage to clarify that they do not prohibit the honest production of alternative monies for use in private transactions.[11]

Dean Cheng is Senior Research Fellow in the Asian Studies Center, of the Kathryn and Shelby Cullom Davis Institute for National Security and Foreign Policy; **Norbert J. Michel, PhD,** is the Director of the Center for Data Analysis, of the Institute for Economic Freedom; and **Klon Kitchen** is Senior Research Fellow in Technology, National Security, and Science Policy in the Douglas and Sarah Allison Center for Foreign Policy, of the Davis Institute, at The Heritage Foundation.

Endnotes

1. Lulu Yilun Chen and Zheping Huang, "Alipay, Tencent Beware: China's Digital Yuan Is Closing In," Bloomberg, October 24, 2019, https://www.bloomberg.com/news/articles/2019-10-24/alipay-tencent-beware-china-s-digital-yuan-is-closing-in (accessed November 16, 2019).
2. Ibid.
3. Ibid.
4. Ibid.
5. Raymond Zhong, "China's Cryptocurrency Plan Has a Powerful Partner: Big Brother," *The New York Times*, October 18, 2019, https://www.nytimes.com/2019/10/18/technology/china-cryptocurrency-facebook-libra.html (accessed November 15, 2019).
6. Ibid.
7. Timothy B. Lee, "China Is Close to Releasing a Libra-Like Digital Currency," ArsTechnica, September 6, 2019, https://arstechnica.com/tech-policy/2019/09/china-is-working-on-its-own-digital-currency/ (accessed November 17, 2019).
8. Norbert J. Michel, "The Curse of the Cash Stewards," *Forbes*, October 18, 2016, https://www.forbes.com/sites/norbertmichel/2016/10/18/the-curse-of-the-cash-stewards/#76838e6e28de (accessed November 17, 2019).
9. Norbert J. Michel, "Improving Money Through Competition," Heritage Foundation *Issue Brief* No. 4730, July 7, 2017, https://www.heritage.org/sites/default/files/2017-07/IB4730_0.pdf.
10. See 31 U.S. Code § 5103.
11. See, for example, 18 U.S. Code, §§ 485, 486, 489, and 490.