

RBI's digital currency plans

Syllabus: Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development and Employment.

Prelims: Features of CBDCs; Blockchain technology application; Global adoption of CBDCs

Mains: Significance and concern associated with the adoption of CBDCs.

Context:

- In the **2022-23 Budget**, the Finance Minister has announced **the introduction of India's Central Bank Digital Currency (CBDC)**.

Central Bank Digital Currency:

- Central bank digital currency (CBDC) refers to the **virtual form of a fiat currency**. A CBDC is an electronic record or digital token of a country's official currency. Hence CBDC is no different from physical cash, except that it would exist in a digital form.
- CBDC would be **issued and regulated by the nation's central bank – the Reserve Bank of India**.
- The CBDC will be held in a digital wallet.
- The digital rupee will not directly replace demand deposits held in banks. Physical cash will continue to be used by banks, and people who wish to withdraw cash from banks can still do so. But they can also opt to convert their bank deposits into the new digital rupee.
- Technologies such as **blockchain** would be used to issue the digital currency.

Significance of CBDCs:

- **Meet the increasing demand for digital currencies:** The digital rupee could help meet the increasing demand for digital currencies as is evident from the rise of private digital currencies such as bitcoin and the increasing use of digital payments.
- **More reliable compared to private digital currencies:** Notably, central bank digital currencies could be a reliable, sovereign-backed alternative to private currencies which are mostly volatile and unregulated.
- **Low/negligible cost of issuing digital currency:** Digital rupee almost eliminates the cost of printing and distributing physical cash as the creation and the distribution of the digital rupee will happen electronically.
- **Increased control over monetary and fiscal policy:** Given that unlike physical cash, which is hard to trace, a digital currency that is monitored by the RBI can be more easily tracked and controlled by the central bank, CBDCs can simplify the implementation of monetary and fiscal policy.
- **Promote financial inclusion:** The CBDCs can also help promote financial inclusion in the economy by bringing the unbanked into the financial system.
- **Boost to Digital Economy:** The digital rupee would give a 'big boost' to the digital economy in India and help India reap the benefits of such a system.

Concerns/challenges associated with CBDCs:

- **Impact on credit creation:** Some economists have pointed out some risks in the transition to a new monetary system based on CBDCs. People may begin withdrawing money from their bank accounts with the increasing popularity of digital currencies. The **large flight of capital from bank accounts to digital currencies** can affect the number of loans created by the banks.

- This may not be an immediate concern for banks in India that offer interest on deposits to account holders.
- **Privacy concerns:** The **centralized form and traceability of digital currencies** have led to serious concerns regarding the privacy of the digital currency holder and this could slow down the adoption.
- **Inability to replace private digital currencies:** The demand for private currencies comes primarily from **people who have lost faith in fiat currencies issued by central banks**. The mere digital version of a national currency like the rupee is unlikely to affect the demand for private currencies. The **need for privacy** is one of the primary reasons for the popularity of private digital currencies. The lack of privacy could impact the popularity of central bank-issued digital currencies.

Recommendations:

- The following measures could be taken to address the possible negative impacts of the introduction of central bank-issued digital currencies.
 - The central banks could **cap the amount of money that an individual can hold in the form of CBDCs**. This would help prevent the mass withdrawal of deposits from banks.
 - Central banks may also have to **inject fresh money into banks** to ensure that the ability of banks to create loans is not affected by depositors' rush to digital currencies.

Global developments with respect to CBDC:

- CBDCs are in various stages of development around the world.
 - In 2020, the **Bahamas launched the world's first CBDC**.
 - Several countries, including the **United States, those in the European Union and China**, have been working towards issuing their own Central Bank Digital Currency (CBDC) in recent years.
 - Notably, a few countries, including Finland and Denmark have cancelled efforts to introduce a digital currency owing to doubts over the efficacy of central bank digital currency.