RBI’s digital currency plans

(Mains GS3 : Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development & Achievements of Indians in Science & Technology; Indigenization of Technology and Developing New Technology.)

Context:

In the Budget presented for 2022-23, the Finance Minister had announced the introduction of India’s Central Bank Digital Currency (CBDC) and that the digital rupee would give a ‘big boost’ to the digital economy.

Central Bank Digital Currency:

- CBDC or Central Bank Digital Currency is a legal tender issued by the Reserve Bank of India.
- A CBDC is an electronic record or digital token of a country’s official currency, which fulfills the basic functions as a medium of exchange, unit of account, store of value, and standard of deferred payment.
- According to the RBI website, CBDC is the same as currency issued by a central bank but takes a different form than paper (or polymer).
- It is sovereign currency in an electronic form and will appear as liability (currency in circulation) on a central bank’s balance sheet and it should be exchangeable at par with cash.

Issuing digital currencies:

- Central banks, faced with dwindling usage of paper currency, seek to popularize a more acceptable electronic form of currency as Central bank digital currencies are promised as reliable, sovereign-backed alternatives to private currencies which are volatile and unregulated.
- Central banks seek to meet the public's need for digital currencies, manifested in the increasing use of private virtual currencies, and thereby avoid the more damaging consequences of such private currencies.
- Central banks also believe that the cost of issuing digital currencies is far lower than the cost of printing and distributing physical cash.
- The RBI can create and distribute the digital rupee at virtually zero cost since the creation and the distribution of the digital rupee will happen electronically.
- 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.

Concerns of digitisation:

- Experts said that the demand for private currencies comes primarily from people who have lost faith in fiat currencies issued by Central banks because governments across the world have been debasing their respective currencies by printing them in excessive amounts, thus forcing many to switch to private currencies whose supply is limited by design.
- So the mere digital version of a national currency like the rupee or the U.S. dollar is unlikely to affect the demand for private currencies, they believe.
- A digital currency that is monitored by the RBI can be more easily tracked and controlled thus has raised various concerns regarding their privacy and could slow down their adoption as the need for privacy has been one of the primary reasons behind the switch to private digital currencies.

Becoming common:

- It is worth noting that several countries, including the United States, those in the European Union and China, have been working seriously towards issuing their own Central Bank Digital Currency (CBDC) in recent years and the Bahamas already launched the world's first CBDC.
- However, a few countries, including Finland and Denmark have taken a step back and have said they had cancelled efforts to introduce a digital currency, according to CBDCTracker.org.
- In a 2017 note, Denmark's central bank indicated that it was "unclear what central bank digital currency would be able to contribute that is not already covered by the current payment solutions."
- It added that the potential benefits of introducing CBDC in Denmark were not "assessed to match the considerable challenges that this introduction would present."

Risks associated:

- **RBI Deputy Governor** flagged the concern that people may begin withdrawing money from their bank accounts as digital currencies issued by Central banks become more popular.
- Many people currently use bank accounts to safely store their cash but when the digital wallet offered by the RBI can serve the same purpose, people could very well begin converting their bank deposits into digital cash.
- One thing that could prevent any large flight of capital from bank accounts to digital currencies is the fact that bank accounts, unlike digital currencies, offer interest on deposits.
- But in developed economies, where interest rates are near zero or even negative, the risk of people rushing their money out of bank accounts and into digital currencies is real.

Create fewer loans:

- The withdrawal of bank deposits can also affect the amount of loans created by banks; however, this could happen not simply because banks will have fewer cash deposits to lend to borrowers.
- The reason banks will be able to create fewer loans is that when customers convert their bank money into CBDCs, banks will be forced to surrender at least some cash and will thus possess an even smaller base on which to create loans.
- Also, when bank customers convert their deposits into digital rupee, the RBI will have to take these liabilities from the books of banks and onto its own balance sheet.

Conclusion:

- Country looks forward to the beginning of another chapter in the digital payments landscape in India.
- However, when the plan is rolled out, Central banks need 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.