

RBI launches pilot projects for Official Digital Currency

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The Reserve Bank of India (RBI) has indicated the possibility of conducting a pilot launch of its digital currency in wholesale and retail segments in the near future. Like other central banks, RBI has also been exploring the pros and cons of CBDCs since quite some time. In this regard, let's understand the issues involved with digital currencies.

In news: RBI plans digital currency pilots soon

Placing it in syllabus: Economy

Dimensions:

- RBI Project
- What is Official Digital Currency?
- Global Developments
- Its need and importance
- Challenges Involved
- Suggestions

Content:

RBI Project:

- The Reserve Bank of India will soon start **pilot projects to assess the viability** of using **digital currency to make wholesale and retail payments**.
- These pilot projects aimed to help calibrate RBI's strategy for introducing a full-scale **central bank digital currency (CBDC)**.
- The RBI is currently working towards a **phased implementation strategy** and examining use cases which could be implemented with little or no disruption.

It is examining the **validation mechanism** –

- whether token based or account based, distribution architecture,
- whether direct issuance by the RBI or through banks and degree of anonymity.

Some key issues under examination are **regarding the scope of CBDCs** –

- whether they should be used in retail payments or also in wholesale payments and the underlying technology
- whether it should be a distributed ledger or a centralised ledger, for instance, and
- whether the choice of technology should vary as per use cases.

What is Official Digital Currency?

- A **Central Bank Digital Currency (CBDC)**, or **national digital currency** or **Official Digital Currency**, is simply the digital form of a country's fiat currency.
- Instead of printing paper currency or minting coins, the **central bank issues electronic tokens.**
- This **token value is backed by the full faith and credit of the government.**

SC Garg Committee Recommendations:

- The committee recommended **banning private cryptocurrencies and allowing an official digital currency.**
- Further, the committee also drafted a bill Banning of Cryptocurrency & Regulation of Official Digital Currency Bill.
- The panel recommended banning anybody who mines, holds, transacts or deals with cryptocurrencies in any form. Further, the panel recommended a **jail term of one to 10 years for exchange or trading in digital currency.**
- The panel also **proposed a monetary penalty of up to three times the loss caused** to the exchequer or gains

made by the cryptocurrency user whichever is higher.

- It recommended **completely banning all private cryptocurrencies in India.**

However, the panel said that the **government should keep an open mind on the potential issuance of cryptocurrencies** by the **Reserve Bank of India.**

Global Developments:

- According to the Bank for International Settlements, more than 60 countries are currently experimenting with the CBDC.
- There are few Countries that have already rolled out their national digital currency.
- **Sweden** is conducting **real-world trials of their digital currency (krona)**
- The **Bahamas** already issued their digital currency "**Sand Dollar**" to all citizens
- **China** started a **trial run of their digital currency e-RMB** amid pandemic. They plan to implement pan-china in 2022. This is the **first national digital currency operated by a major economy.**

Challenges with Private Cryptocurrencies:

- **Safety challenges:** Mt Gox bankruptcy case is a highlight of this issue. Mt gox is a Tokyo-based cryptocurrency exchange. After the cyberattack, several thousands of bitcoins went lost and the company is yet to settle the claim.
- **Use for illegal activities:** There are some cryptocurrency regulators who often indulge in money laundering and terrorism financing. Further, they are immune to the Central Bank regulation of various countries.
- **High Volatility of cryptocurrency:** Many cryptocurrencies have only a limited amount of coins. For example, Bitcoins fixed the maximum possible number as 21

million. This creates an increase in demand with each passing day and creates instability in exchange rates. This made the cryptocurrency more volatile in nature.

- **Challenges of investor protection:** Since the cryptocurrency transactions are anonymous in nature, there is no investor/consumer protection in cryptocurrencies.

Conflict of interest: Globally, crypto-currency exchanges act as both custodian and a regulator. So, their own interest and consumer protection get into conflict.

Its need and importance:

- The growth of cryptocurrencies such as Bitcoin, Dogecoin, Ethereum etc raised challenges to fiat currencies.
- The potential and vulnerabilities of these cryptocurrencies forced the central banks to explore the possibility of introducing their own digital currencies.

Importance:

Developing an Efficient Financial System:

- As the currency in digital form, it can provide an efficient way for financial transactions.
- India's fairly high currency-to-GDP ratio holds out another benefit of CBDC
- Digital currency solves the challenges with Cash and coins – i.e. expenses in storage and inherent security risks like the recent heist in the RBI currency chest.

Investor & Consumer Protection :

- There are about 3,000 privately issued cryptocurrencies in the world.
- According to the IMF, the key reason for considering national digital currency is to counter the growth of

private forms of digital money.

- There is a possibility of these companies going bankrupt without any protection. This will create a loss for both investor and creditor.
- But the National Digital currency has government backing in case of any financial crisis.

Improving Financial Services:

- Transacting with CBDC would be an instantaneous process as the need for inter-bank settlement would disappear.
- it would be a central bank liability handed over from one person to another.
- They could enable a cheaper and more real-time globalisation of payment systems
- This will improve the services to people.

Reduce volatility:

- The national digital currency will be regulated by the RBI. So, there will be less volatility compared to other digital currencies.

Better macroeconomic management:

- Current RBI's work on inflation targeting can be extended to national digital currency also.
- Since India is planning to ban other cryptocurrencies, the RBI can better regulate digital and fiat currency.
- Thus upgrading to digital currency and balancing the macroeconomic stability.

Challenges Involved:

Cybersecurity Vulnerabilities:

- India is already facing many cyber security threats.
- With the advent of digital currency, cyberattacks might increase and threaten digital theft like the Mt Gox bankruptcy case.

Digital illiteracy:

- As per Digital Empowerment Foundation in 2018 report, around 90% of India's population is digitally illiterate.
- So, without creating enough digital literary awareness, introduction of digital currency will create a host of new challenges to the Indian economy.

Regulatory and Taxation Challenges:

- Introduction of digital currency also creates various associated challenges in regulation, tracking investment and purchase, taxing individuals, etc.

Invasion of Privacy:

- The digital currency must collect certain basic information of an individual so that the person can prove that he's the holder of that digital currency.
- This basic information can be sensitive ones such as the person's identity, fingerprints etc.

Suggestions:

- ***Capital Gains Tax on digital Currencies:*** The government can follow the western concept of treating digital currency as property and imposing capital gains tax.
- ***Create digital financial Awareness:*** The government has to create enough to reduce the digital divide and literacy. Awareness campaigns that inform people about identifying fraudulent methods are the need of the hour.
- ***Bolstering Cybersecurity:*** Government must create robust policy on information processed in digital currencies, as well as train and equip its law enforcement agencies to handle cyberthreats.

Mould your thought: Critically evaluate the utility of National Digital Currencies in India.

Approach to the answer:

- Introduction
- Define National Digital Currencies
- Mention their need and importance
- Discuss the potential benefits for India
- Discuss challenges involved
- Conclusion