Our Views

Need for a Digital Currency – a timely discourse!

On November 8, 2016 just prior to demonetization, India had approximately Rs. 17.97 lacs crore cash in circulation. Immediately post demonetization, while the new notes were still in the process of being introduced, this amount is estimated to have come down to approximately Rs. 3.49 lacs crore. The remaining cash – demonetized currency – should have returned to RBI through the banking channel. Interestingly, the cash in circulation at present is approximately Rs. 27.7 lacs crore. This equation indicates that over the last 4.5 years approximately Rs. 24 lacs crore of net cash has been pumped into circulation and likely withdrawn through the banking channels. In any case, net addition to currency in circulation is Rs. 10 lac crores over this period. Of course, the economy has also grown over this period.

Post demonetization and post-covid, digitization has been reshaping the economy and the way people pay. While this has caused a shift in the payment habits of people, cash still seems to be a popular mode of payment. This increased currency usage has happened despite the concentrated push by the government towards electronic payments – almost all forms of digital payments are free of charge; despite the brilliant technological platform of UPI built by NPCI; and despite India having 56 crores internet subscribers (second largest in the world), 53 crores Whatsapp users, 45 crores YouTube users, 41 crores Facebook users, 21 crores Instagram users and 1.75 crores twitter users.

To further boost a less cash economy, there is a new global discourse to make the **currency digital**. A recent survey shows that around 80% of the central banks around the world are engaged in preliminary work on digital currency. In wake of the rapid growth of digital economy, digitization of currency as a basic infrastructure and core variable of modern economic finance is being globally accepted. In fact, with the integration of the modern digital technologies such as the internet, artificial intelligence, and blockchain amongst others, the concept of money itself is becoming increasingly vague, showing a tendency of redefinition. I am sure our Reserve Bank of India (RBI) would also be evaluating this.

Central Banks of different countries are working on different solutions – there are different ways currency in digital form can be issued. Broadly there are three categories of digital currencies that have potential impacts on the international monetary and financial system: the first is encrypted digital currency represented by **Bitcoins and Ethereum**, the second is private coins such as Libra and, finally the third kind is digital currency is directly issued by the Central Banks.

The most authentic digital currency under discussion at present is the Central Bank Digital Currency (CBDC). The concept and design of CBDC is being investigated by many Central Banks for some years now. Although different Central Banks have different concepts of CBDC depending on their country-specific requirements and utilization, I believe these will converge at some point of time.

One of the methods of CBDC assumes that Central Bank could issue digital currency as a parallel currency to the country's existing currency. One can keep this currency either in a distributed ledger of the central bank or in a wallet as token. This may converge with normal currency over time. At present CBDC is still at R&D stage in various countries and at pilot stage in China. While there are still many issues about CBDC to be studied and proofed, some of its obvious benefits are that it can:

1. improve the competitiveness, efficiency, and resilience of payment systems in the face of increasing concentrated levels of payments in the hands of some of Internet giants.
2. help advance financial digitization and inclusive finance. This will further help in reducing the cash in circulation in the system.
3. greatly reduce the issuance and transaction costs of the monetary base/ currency in circulation, such as printing, transportation, storage, and maintenance.
4. track the full cycle of movement of currency and can record data which will improve the accuracy of the currency issuance and prevent, and control financial risks caused by shadow banking.
5. can also use existing digital marketing channels to achieve universal distribution and to provide a complete ecosystem for digital-technology-based economic and financial activities.
6. ensure a complete the contactless economy.
7. realize a closer integration of monetary and fiscal policy, to achieve a more efficient macro-policy regulatory system and in the long term may enrich and improve monetary policy.

While there are a lot of benefits of CBDC, several challenges and risks cannot be ignored. Given the anonymity and un-traceability of cash today, it would be a challenge to make CBDC completely acceptable. Further, there are 2 potential risks that I foresee – firstly, the risk of a wide scale run on bank savings by CBDC as the Central bank's credit rating would be a notch above that of commercial banks which may cause a disruption to commercial banks if there is any distrust. Secondly, if there is any interest payment on CBDC, it is likely that it will impact the existing monetary policy instruments. To overcome the potential risks, there are safeguards which could be considered such as interest rate of CBDC should be lower than and linked to the bank rates. CBDC and bank deposits are managed as two distinct systems, the two are not automatically fungible therefore, there is no guaranteed convertibility of bank deposits to CBDC on demand.

Given the headstart India has on digital payments compared to many other nations, we must ensure that we keep the edge on digital currency. It is surely time for our central bank to explore and to initiate the discourse of Central Bank Digital Currency.

https://economictimes.indiatimes.com/markets/stocks/news/the-need-for-digital-currency-and-why-should-rbi-have-one/articleshow/81545243.cms

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