

Expectations between Elections and Infections Budget

As the Hon. Finance Minister will rise to present her next Union Budget, Elections and Infections will take up a significant portion of her mindshare. Both these are exceptionally overwhelming situations for her to ignore. Despite this, I think, this year's budget may make some bold moves of building blocks towards our 100 years of independence in 2047. These may include further strengthening the digitization initiatives of the Government. In this regard, I think there could be decisive move on Central Bank Digital Currency, Digital Bank and Crypto currency.

Digitization of currency as a basic infrastructure is being globally considered and approximately 80% of the central banks around the world are engaged in preliminary work on it – primarily digital currency directly issued by the Central Banks (Central Bank Digital Currency or CBDC). 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. A Central Bank could issue digital currency as a parallel currency to the country's existing currency and it can be held either in a distributed ledger of the central bank or in a wallet as token. This may merge with normal currency over time. As the concept evolves, some of its obvious benefits include financial digitization and inclusion; reduced cash in circulation and its related issuance costs; tracking of currency movement and control on shadow banking; a completely contactless economy; and a more efficient and resilient payments system. It would also help 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.

However, given the anonymity and un-traceability of cash today, complete acceptability of CBDC will be a challenge. Further, there are two potential risks that I foresee. First, 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. This may cause a disruption to commercial banks if there is any distrust. Second, any interest payment on CBDC may impact the existing monetary policy instruments. To overcome these, the interest rate of CBDC could be set lower than the bank rates; CBDC and bank deposits could be managed as two distinct systems and any guaranteed conversion of bank deposits to CBDC on demand could be avoided. Given the head start India has on digital payments, the Finance Minister surely may have something in the Budget to keep the country's edge on digital currency.

The second area of focus towards digitization could be a Digital Bank. Banking, today, is already on our fingertips. From here on, I believe, banking can also be an Anybank, Anywhere and Anytime experience. A customer could open an account with any bank of her choice, and a **Central Banking Depository** (CBD) could maintain 'Universal Bank Account' of customers. It would keep records of all banking transactions of an account holder, eliminating the need for multiple account keeping at multiple banks. This would provide inter-operability where customers can change banks while retaining the same account number – very similar to the current stock data keeping by the depositories.

A **common central KYC agency** would not just be a repository of data submitted by the Banks but would be authorized to carry out various levels of KYC checks on an account holder. This would ensure a seamless on-boarding of the accountholders for banking services with a uniform KYC process by an expert organization.

Our Views

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In line with the growing trend of shared infrastructure, to bring down costs and to improve resource utilization, a **white-labelled branch network** could carry out banking services and retail operations of various banks in a non-discriminatory manner – quite like the VFS application centres which provide visa application services for multiple countries under the same roof. These could also provide last mile reach to digital banks. A **banking settlement agency/ clearing agency** could do interbank settlements of fund positions based on transactions in the 'Universal Bank Account'. The **rating agencies** could also access the transaction flows in individual accounts to strengthen their assessment of individuals. Of course, this will require significant think through of the entire concept, process and the technology architecture.

Finally, Crypto has been another hotly discussed topic which may find place in the Budget. In the history of mankind, crypto has been the fastest asset creation – creating almost \$2 to \$3 trillion in the 10 years since Bitcoin was launched in 2009. A typical crypto could include crypto currencies, virtual assets, digital currencies etc. However, for the purpose of this discussion I am focussed on crypto coins, tokens and their derivatives which are cryptographically secured in a distributed ledger. Given the digital nativity of these currencies, lack of transparency about trades and traders, and the global ubiquity of the crypto platforms, an unregulated crypto could be a big systemic challenge. It could lead to situations like a person purchasing crypto coins in foreign currency abroad and selling to someone in India, earning large sums of money avoiding taxation of the country and getting away without any checks of KYC, AML or foreign exchange regulations. Effectively, unregulated crypto could mean unfettered money laundering, unregulated outflows and inflows of forex and a side door to fully convertibility of the currency. As an alternative currency, it could pose threat to monetary policy, and cause issues related to investor protection and fair market practices, security and technological risks.

Therefore, the big question that most regulators across the globe are grappling with is how to regulate this market. Different countries like the UK, Japan, and Singapore have taken different approaches. China, on the other hand, has announced a ban on cryptocurrency transactions and is conducting a multi-year experiment with its CBDC (e-CNY). In my view, India could define the regulatory framework depending on whether it views crypto as a currency, an asset, or a commodity. The overall regulatory framework/ response could include a detailed KYC & AML framework, an adequate taxation framework, and securities laws if it is considered a security or a commodity.

I think the Budget will have something to take forward on the CBDC, the digital bank infra, and to decode the cryptic crypto.

<https://economictimes.indiatimes.com/markets/stocks/news/a-budget-buffered-by-elections-and-infections/articleshow/88929753.cms>

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