RSTV BIG PICTURE SUMMARY: CENTRAL BANK DIGITAL CURRENCY(CBDC)

CONTEXT: In the recent past interest in cryptocurrency has risen. Recent Survey says **86% of the central banks across the world are actively researching in cryptocurrency**. And **60% are engaged in CBDC, 15-16% have put in pilot projects.**

WHAT IS CBDC?

- A central bank digital currency (CBDC) is an **electronic record or digital token of the official currency of a country.**
- The introduction of cryptocurrencies paved the way for central bank digital currencies.
- The main advantages of CBDCs are that they **promote financial inclusion and simplify implementation of monetary and fiscal policy.**
- The main disadvantages of CBDCs are that **they are a centralized form of currency and can erode the privacy of citizens.**
- Many countries around the world are exploring the introduction and use of CBDCs in their economy.
- CBDC is a **high-security digital instrument; like paper banknotes, it is a means of payment, a unit of account, and a store of value**.
- And like paper currency, each unit is uniquely identifiable to prevent counterfeit.
- It is a **liability of the central bank just as physical currency is.**
- It's a **digital bearer instrument that can be stored, transferred, and transmitted by all kinds of digital payment systems and services**.

TYPES OF CBDCS

- Depending on the actors involved in the transaction, there are two types of CBDCs.
  1. **Wholesale CBDCs:** used to settle transactions between existing financial transactions. They use the existing tier of banking and financial institutions to conduct transactions. An example of wholesale CBDC transactions is one which involves transfer of assets or money between two banks, subject to certain conditions.
  2. **Retail CBDCs:** involve the transfer of central government-backed digital currency directly to consumers. In doing so, they eliminate the intermediary risk or the risk that banking institutions might become illiquid and sink depositor funds.
- Depending on the type of access they provide, two variants of retail CBDCs are possible:
  1. **Value or cash-based access:** CBDCs are passed onto the recipient through a digital wallet that is pseudonymous.
  2. **Token- or account-based access:** This type of access is similar to that provided by a bank account.

NEED FOR A CBDC:

- The **growth of cryptocurrencies such as Bitcoin, Ethereum etc has raised challenges to fiat currencies.**
- Along with their other vulnerabilities made the central bank of each country explore the possibility of introducing their own digital currencies.
- The **need for inter-bank settlement would disappear as it would be a central bank liability handed over from one person to another**.
- **India is a leader in digital payments, but cash remains dominant for small-value transactions**.

- India has a fairly high currency-to-GDP ratio. An official digital currency would reduce the cost of currency management while enabling real-time payments without any inter-bank settlement.

ADVANTAGES OF CBDCs:

- CBDCs **simplify implementation of monetary policy** by making it easier to propagate money through the economy.
- A well-designed CBDC system has **the potential to revolutionize the remittance industry** by making it easy and simple to transfer money across borders using the rails of technology.
- Disbursement of money through intermediaries introduces a third-party risk into the process. What if the bank runs out of cash deposits? A **CBDC eliminates third-party risk**.
- It is **possible to calibrate privacy features in a CBDC system**.
- One of the roadblocks to financial inclusion especially in developing and poor countries are the costs associated with developing banking infrastructure to enable access the financial system. **CBDCs eliminate the need for expensive infrastructure**.
- CBDCs **minimize effort and processes to other government functions, such as distribution of benefits or calculation and collection of taxes**.
- CBDCs can **prevent illicit activity because they exist in a digital format and do not require serial numbers for tracking**

WHY IS CBDC PREFERRED OVER CRYPTOCURRENCY?

- **Cryptocurrencies** pose risks to consumers. They **do not have any sovereign guarantee and hence are not legal tender.**
- Their **speculative nature also makes them highly volatile.**
- A **user loses access to their cryptocurrency if they lose their private key**.
- In some cases, these private keys are stored by technical service providers (cryptocurrency exchanges or wallets), which are **prone to malware or hacking.**
- Cryptocurrencies are more **vulnerable to criminal activity and money laundering**.
- A **central bank cannot regulate the supply of cryptocurrencies in the economy**.
- Since **validating transactions is energy-intensive**, it may have adverse consequences for the country's energy security.

DISADVANTAGES OF CBDCs:

- **CBDCs do not solve the problem of centralization**. Reserve bank, is still responsible for and invested with authority to conduct transactions.
- Government (or third-party provider) would become privy to all monetary transactions for a person. Such a **system could open up a Pandora's box of privacy issues**.
- The **legal and regulatory issues pertaining to CBDCs are a black hole**. What will be the role of such currencies in an economy, and who will regulate them? Should they be regulated across borders?
- The portability of CBDC systems means that a **strong CBDC issued by foreign country could end up substituting the local currency of a weaker country**. For example, a digital U.S. dollar could substitute the local currency of a smaller country or a failing state.

SC GARG COMMITTEE RECOMMENDATIONS (2019):

- **Ban anybody who mines, hold, transact or deal with cryptocurrencies in any form.**
- It recommend a **jail term of one to 10 years for exchange or trading in digital currency**.
- It 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.
- However, the panel said that the **government should keep an open mind on the potential issuance of cryptocurrencies by the Reserve Bank of India.**

CONCLUDING REMARKS:

- Digital currency is part of the money, which is not passed physically but digitally. Eg: Bitcoin.
- Bitcoin is fraud because it can't be valued, but it has technology which can be profitably used.
- Currency has a bearer, owner, transaction between 2 parties: which cannot be traced in bitcoin.
- RBI, if used Digital notes, **can save 35,000 crores of rupees which are spent for note fraud / fake / torn notes.**
- In physical currency every note has a number which is different, and it not possible to trace it. **Digital currency can be traced**.
- During monetary crisis people want to hold physical currency, If one has CBDC wallet, RBI /bank can largely control the leakage from the bank deposit. This will save from the crisis.
- According to RBI, **CBDC is not an cryptocurrency and it is also not digital transaction which is linked to physical cash.**
- RBI and government both are willing to promote Digital Currency. Government is working on Bill.
- The **launch of CBDCs may not be a smooth affair and still requires more clarity in India**.
- There are still a lot of misconceptions about the concept of digital currency in the country.
- The **effectiveness of CBDCs will depend on aspects such as privacy design and programmability.**
- There is a **huge opportunity for India to take a lead globally via a large-scale rollout and adoption of digital currencies.**

https://youtu.be/6FW99rZBBWk

https://www.investopedia.com/terms/c/central-bank-digital-currency-cbdc.asp

https://timesofindia.indiatimes.com/business/cryptocurrency/blockchain/will-india-soon-have-its-own-central-bank-digital-currency/articleshow/85972407.cms