RBI & Central Bank Digital Currency (CBDC): The Advent Of Legitimatised Digital Currency

written by Siddartha Karnani | July 21, 2022

Central Bank Digital Currency

In the past few years, we have witnessed the explosive instabilities of the private cryptocurrency market and the high risks that come with trading such assets. Regulation of such a volatile market is challenging but at the same time, the crypto market cannot simply be left unchecked by authorities. There has been a growing need to establish an alternative to cryptocurrency – a stable one that can be regulated by banks.

The concept of centralised ‘digital currency’ was floated and as of late, taken shape more strongly as governments around the world pivot sharply towards shaping their own virtual currencies in a bid to outdo private, decentralised (and largely eruptive) cryptocurrencies. Such government-legitimated digital assets have come to be more widely known as central bank digital currencies i.e., CBDCs.

What Are CBDCs?

A central bank digital currency (CBDC) is the digital form of a country's fiat currency. It is issued and regulated by a nation's primary financial authority or central bank, which in India’s case is the Reserve Bank of India (RBI). CBDCs purportedly promote financial inclusivity and make the implementation of governmental fiscal policies easier to implement.

According to the latest Union Budget, the Central Bank Digital Currency (CBDC) is being rolled out in phases in India during the current fiscal year. As stated by the governor of RBI, state-issued cryptocurrency will be introduced gradually, ensuring its conformity with India's monetary policies and financial ecosystem. [1] Further, the RBI released a consultation paper on the concept behind introducing CBDC. [2] Given these developments, a discussion on the nature and legislative implications of CBDC is worth engaging in.

CBDC: Advantages and Challenges

Blockchain technology initially rose to prominence due to its many advantages. [3] Several additional developments that have their roots in the idea of blockchain's decentralized structure were made possible by developing such a revolutionary technology. The concept of cryptocurrency – digital money supported by a decentralised network – was first suggested by exploring other blockchain uses. These virtual currencies had a high level of

volatility because private, independent economic actors were issuing them.
The CBDC issued by the government will be done so on the blockchain network, using blockchain technology. As defined by RBI in the consultation paper, CBDC is a legal tender issued by a central bank in digitised forms. It is the same as a fiat currency and is exchangeable one-to-one with the fiat currency. Only its form is different. Several countries, like Senegal, Venezuela, Ecuador, and others, have already launched their regulated digital currencies with other countries like South Korea and Jamaica to follow.
[4]
The numerous advantages that cryptocurrencies have to offer are drawing the attention of governments all around the world. Some of the main highlights are:

- A blockchain network's transactions are decentralized and immutable, meaning that the records cannot be changed. Therefore, deploying it throughout the process of generating and using cash would help limit the opportunity for supporting illicit activities and tax evasion.
- The widespread use of cryptocurrencies would make transactions more practical since they could be conducted entirely online in a shorter amount of time. The increased flow of money into the market will result in liquidity.
- International payments would be simpler and more affordable since the decentralized network would simplify the intricate structure of money transfers. However, it will necessitate a global monetary system that is uniform.
- Due to the easy payment process, the percentage of financial inclusion would increase significantly with this. Since all payments could be performed independently, the necessity for banks and other financial institutions in remote places would no longer be a problem.

Challenges
There are several difficulties in implementing a state-issued cryptocurrency. For instance, Ecuador was recently forced to abolish this currency since it lacked the advanced technological infrastructure to support its CBDC. The centralized cryptocurrency was also unable to attract many users, according to the officials, for a variety of reasons, such as the assumption by the government that many people are eager to accept these technological developments in the financial system.
India might circumvent such barriers since Unified Interface Payment (UPI) systems of payment are increasingly popular in the country. However, several sources corroborate that India's UPI app usage rate is still on the lower end even with the increased popularity of the method of payment due to how straightforward it is to use.
As such, the primary objection levelled towards CBDC is whether the people will embrace it. A high adoption rate may be unlikely due to the technological complexities of a digital currency. Furthermore, a sizable portion of those who engage in private cryptocurrency transactions do so for reasons of investment, and because they seek the volatility of cryptocurrency, admire its decentralised aspects and desire financial privacy and independence.
Most individuals might also not be motivated to use CBDC issued by the government since admittedly, a digital currency transaction is not much different than a typical internet banking transaction apart from it being recorded on the blockchain network.

Will Other Forms Of Currency Be Discontinued?

It is not feasible to discontinue other forms of currency, paper or otherwise. The circulation of paper-based and other computerized processes to exchange money will continue since eliminating all kinds of currency is impossible. Strict laws, such as a limit on the use of paper money, can be implemented to enforce CBDC usage.

However, this might make things more complicated – upsetting users, alienating the financial system users and burdening the authorities.

State vs Private Cryptocurrency

When state and private crypto issuers are at odds, many disputes arise. Countries that have introduced state-issued cryptocurrencies have taken two opposing stances:

- Forbidding all other private participants while releasing a centralized currency
- Permitting private crypto assets while establishing a regulatory framework for them

Indian officials have firmly said that they believe private players should not be allowed to issue currency. Recently, the deputy governor of RBI hinted toward curbing all types of private cryptocurrency after the introduction of CBDC. However, as the proponents of private cryptocurrencies contend, this restricts the financial freedom granted to all citizens. Imagine people once again using the "barter system" as a way to exchange products to understand the situation better.

The government does not have the power to forbid individuals from acting in this manner in this situation. In that sense, private cryptocurrencies are nothing more than a citizens' preferred method for trading financial tokens. Instead of outright banning it, a complete system must be created to monitor the inadequacies of the development mentioned above.

Recognizing the validity of the regulators' legitimate concerns is equally crucial. The extreme volatility of these assets poses the greatest risk to the financial market. A balanced approach has to be taken with these points in mind.

What Lies Ahead?

Despite the advantages of a state-issued cryptocurrency, it is crucial to remember that for it to become widely accepted, there would need to be significant infrastructural development and stringent control. It could be worthwhile to look at other options rather than limiting the notion of digital currency to the medium of cryptocurrencies. Like different types of money, such as bank deposits, cryptocurrency is merely a subset of the broader category of digital money.

This argument has also been supported by the IMF report on central banks' digital currencies, which urges a thorough examination of all viable options. [5] The idea of dematted notes was recently suggested by SC Garg, former union finance secretary of India, that will use a digital wallet enabled by blockchain technology to operate them. Additionally, to maintain a free market economy, policymakers must seek to provide a supportive yet controlled environment for private cryptocurrencies.

If CBDCs are designed prudently, they can potentially offer better resilience, safety, availability, and lesser costs in contrast to private, unbacked crypto assets. There is no universal playbook for CBDCs since each country’s economy functions differently. RBI’s controlled approach is wise, but is yet to offer any concrete data to analyse the validity of an Indian CBDC.

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