



# Central Bank Digital Currency

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## Why in News

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Recently, the **Reserve Bank of India (RBI)** has proposed amendments to the **Reserve Bank of India Act, 1934**, which would enable it to launch a **Central Bank Digital Currency (CBDC)**, thus enhancing the scope of the definition of 'bank note' to include currency in digital form.

The move has come amid the government's plans to introduce a **Bill on cryptocurrencies in the current Parliament session** that seeks to prohibit **all private cryptocurrencies in India with certain exceptions**.

## Key Points

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- **About:**
  - CBDC is a **digital form of Fiat Currency** which can be transacted using wallets backed by blockchain and is **regulated by the central bank**. It is a **legal tender** issued by a central bank in a digital form.

**Fiat money** is a government-issued currency that is not backed by a commodity such as gold. Fiat money gives central banks greater control over the economy because they can control how much money is printed.
  - Though the concept of CBDCs was **directly inspired by bitcoin**, it is **different from decentralised virtual currencies and crypto assets**, which are not issued by the state and lack the 'legal tender' status.

- **Need:**

- **Addressing the Malpractices:**

- The need for a sovereign digital currency arises from the anarchic design of existing cryptocurrencies, wherein their creation, as well as maintenance, are in the hands of the public.

- By regulating digital currency, **the central bank can put a check on their malpractices.**

- **Addressing Volatility:**

- As the cryptocurrencies are not pegged to any asset or currency, **its value is solely determined by speculation (demand and supply).**

- Due to this, there has been huge volatility in the value of cryptocurrencies like bitcoin.

- **Digital Currency Proxy War:**

- India runs the risk of being caught up in the whirlwind of **a proxy digital currency war as the US and China battle** it out to gain supremacy across other markets by introducing new-age financial products.

- Today, a sovereign Digital Rupee isn't just a matter of financial innovation but a need to push back against the inevitable proxy war which threatens our national and financial security.

- **Reducing Dependency on Dollar:**

- Digital Rupee provides an opportunity for India to establish the dominance of Digital Rupee as **a superior currency for trade with its strategic partners, thereby reducing dependency on the dollar.**

- **Advent of Private Currency:**

- If these private currencies gain recognition, national currencies with limited convertibility are likely to come under some kind of threat.

- **Significance:**

- It would **reduce the cost of currency management** while enabling real-time payments without any inter-bank settlement.

- India's fairly high currency-to-GDP ratio holds out another benefit of CBDC to the extent large cash usage can be replaced by (CBDC), **the cost of printing, transporting and storing paper currency can be substantially reduced.**

- It will also **minimize the damage to the public** from the usage of private virtual currencies.

- It will enable the user to conduct both domestic and cross border transactions which **do not require a third party or a bank.**

- It has the potential to provide significant benefits, such as **reduced dependency on cash, higher seigniorage due to lower transaction costs, and reduced settlement risk.**

- It would also possibly **lead to a more robust, efficient, trusted, regulated and legal tender-based payments option.**

- **Issues:**
  - Some key issues under RBI's examination include, the **scope of CBDCs, the underlying technology, the validation mechanism and distribution architecture.**
  - Also, **legal changes would be necessary** as the current provisions have been made keeping in mind currency in a physical form under the Reserve Bank of India Act.
  - Consequential amendments would also be required in the Coinage Act, **Foreign Exchange Management Act (FEMA)** and **Information Technology Act.**
  - **Sudden flight of money** from a bank under stress is another point of concern.
- **Recent Developments:**
  - **El Salvador**, a small coastal country in Central America, has become the first in the world to adopt Bitcoin, as legal tender.
  - **Britain** is also exploring the possibility of creating a Central Bank Digital Currency (Britcoin).
  - In 2020, **China started testing its official digital currency** which is unofficially called “Digital Currency Electronic Payment, DC/EP”.
  - In April 2018, RBI banned banks and other regulated entities from supporting crypto transactions after digital currencies were used for frauds. In March 2020, the **Supreme Court struck down the ban** as unconstitutional.

## Way Forward

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- The creation of a Digital Rupee **will provide an opportunity for India to empower its citizens** and enable them to use it freely in our ever-expanding digital economy and break free from an outdated banking system.
- Looking into its impact on macroeconomy and liquidity, banking systems and money markets, **it is imperative of policymakers to thoroughly consider the prospects of Digital Rupee in India.**

**Source: IE**