



Launching Digital Rupee - Challenges and Opportunities

This editorial is based on [“RBI Shouldn’t Rush the Launch of India’s Official Digital Rupee”](#) which was published in Livemint on 09/02/2022. It talks about the significance of digital rupee and the associated challenges of its hasty launch.

For Prelims: Economic Development, Digital Rupee, Cryptocurrency, Blockchain, Central Bank Digital Currency (CBDC), Reserve Bank of India (RBI).

For Mains: Central Bank Digital Currency (CBDC), Digital Rupee - Arguments in Favor and Against.

Recently, in its [Budget 2022-23](#), the Government of India announced that its central bank will issue a [digital currency](#) as early as 2022-23. It is one crucial decision that most major economies are refusing to make in a hurry.

The arguments in favor of digital rupee claim that an **electronic representation of India’s legal tender will boost its digital economy**. However, it is also important to evaluate the **risks associated with a hasty transition** to a [Central Bank Digital Currency \(CBDC\)](#).

India’s Own Digital Currency

What is Digital Rupee?

- The [Reserve Bank of India \(RBI\)](#) will issue the digital currency in the next fiscal which will be called [Digital Rupee](#).
 - A central bank digital currency (CBDC) uses an electronic record or **digital token to represent the virtual form of a fiat currency** of a particular nation (or region).
- The digital rupee will allow users to **transfer purchasing power from deposit accounts into smartphone wallets** in the form of online tokens, which like cash will be a **liability of the Reserve Bank of India**.
 - A digital rupee will be like banknotes, minus ATMs.

What are the Arguments in Favor of the Digital Currency?

- CBDC aims to **bring in the best of both worlds** - the **convenience and security of digital forms** like cryptocurrencies, and the **regulated, reserved-backed money** circulation of the traditional banking system.
- The digital currency will **mitigate the risk of losses that Indian depositors face** when dealing with commercial banks.
- Consumers may find an **e-rupee to be a safer alternative to bank deposits**, which underpin ₹76 trillion in annual real-time payments via apps like PhonePe, Google Pay and Paytm.
- As purchases go online, the basis of trust in demand deposits, that they convert to cash at face

value, may get reduced to a theoretical construct.

- An **e-currency could keep the notion of convertibility grounded** in daily reality.
- It could **eliminate the need for an expensive network** of correspondent banks to settle cross-border payments.
 - For Indians working abroad, **sending money home will become simpler and cheaper** resulting in huge savings for [India, the world's top recipient of remittances](#).

What are the Arguments Against the Digital Currency?

- If e-cash becomes popular and RBI places no limit on the amount that can be stored in mobile wallets, **weaker banks may struggle to retain low-cost deposits**.
- Even as these small banks lose that cushion, **lenders may be reluctant to shed their loan assets** and sacrifice profits.
 - Their **less-liquid balance sheets** could leave them vulnerable to bank runs.
- All economies are mindful of the threat to financial stability and the advanced nations also worry about the **dwindling use of banknotes, especially after Covid**.
- Unlike perfectly anonymous cash, most CBDCs will be designed in such a way that the **central banks will be able to trace the spending**.
 - However, transactions conducted with them may not be visible to payment apps, and fintech firms may lose access to some data being mined for cheap loans to those who don't have collateral.

Where do the Other Countries Stand about Digital Currency?

- Some countries have already introduced CBDCs in some form or the other. In 2020, the central bank of **Bahamas issued a digital currency**.
 - More and more central banks across the world are beginning to explore the viability, usefulness and value of digital currencies.
- The only large economy where a **CBDC is being experimented on a national scale is China**, which had the compulsion to go for a CBDC in view of absence of competition to two large players in digital payments.
- Banknotes in **Sweden** account for 1% of the money supply. Yet, the Riksbank (Swedish Central Bank) is in **no hurry to embrace a CBDC**.
 - After five years of weighing options, the Swedish monetary authority is still to take a final decision on whether to issue an e-krona.
- The **US Fed is seeking the public's views** on whether to provide an official tender to compete against private stablecoins riding on the dollar as the world's most popular unit of account.
- A **digital euro is in a 24-month investigation**. If all goes well, the European Central Bank may offer it by 2025.
 - **Japan may delay the introduction** of its digital currency **by 2026**.

Why the Rush for Digital Rupee?

- India's rushed deadline seems to be **at least partly a response to cryptocurrencies**, though it's hard to see how an e-rupee can discourage the public from the **'get-rich-quick' lure** of the former.
- Another reason for hurry may be **a desire to head off China** which is also **set to launch its e-CNY (Chinese Yuan Renminbi)**.
 - China intends to promote a rival to the dollar in cross-border trade and finance.

What is the Way Forward?

- A **Well-Evaluated Implementation**: With depleting usage of paper currency, there is a need to popularize electronic platforms of currency. This becomes **more efficient in high physical cash usage economies like India**.
 - However, a properly planned and well-evaluated implementation of such a crucial decision is important as **hasty implementation may result in more losses than gains**.
- **Strict KYC Norms**: A digital rupee may well be a boon. For one thing, it may not be a bad idea for

the monetary authority to use technology to put bank managements on notice that they need to stop taking depositors for granted.

- There is a need to **enforce strict compliance of Know Your Customer (KYC) norms** to prevent the currency's use for **terror financing** or **money laundering**.
- **Role for RBI:** RBI must do its homework. The blockchain technology or whatever will be used to run the digital currency, will need to **balance the often-conflicting goals** of speed, scalability, auditability, security and privacy.
 - Given India's still-vast digital divide, **a protocol for offline use** has to be worked out. Rushing the implementation of what should **ideally be a multi-year project** may be fraught with unnecessary risks.

Drishti Mains Question

"The RBI must carefully weigh the pros and cons before launching the digital rupee remaining mindful of the various issues". Comment.