



A game of catch-up on digital currency

China's rapid advances in developing a digital currency have spurred the world into action. India should not be left behind

In the account of his travel to China in the 13th century, Italian traveller Marco Polo referred to the use of paper money in that country but this was regarded as fantasy back then in Europe. The Chinese had started using paper money in the form of promissory notes, as early as the 9th century during the Tang dynasty. It was several centuries later that paper money became ubiquitous in Europe. There is no fantasy attached to Chinese advances in introducing the world's first sovereign digital currency or the Central Bank Digital Currency (CBDC). It is already undergoing trials in several Chinese cities.

The People's Bank of China (PBoC) reported that as part of these trials, 113,300 personal digital wallets and 9,000 corporate wallets for what it calls eCNY (Chinese yuan) have been created and over \$160 million in transactions had been processed. The digital currency will work through a two-tier system. Commercial banks would serve as gateways for the distribution of eCNY, much like cash is currently distributed to consumers. There will be ceilings on how much eCNY may be held in wallets so as not to threaten the role of the banking system in financial intermediation.

The experimental use of eCNY has been tested in bill payments, catering services, transportation, shopping and government services. PBoC also plans to extend digital currency usage in cross-border payments. Its deputy governor, Fan Yifei, said that in cross-border payments, "we would achieve interoperability and address the trilemma (low costs, low risks, high efficiencies) by using digital fiat currency collaborating with private sectors and adapting to

long-term technology evolution continuously and establish a fiat digital currency alliance that observes regulations across the jurisdictions and complies with international standards...."

Clearly, the "global alliance" Mr Fan is referring to could include the Belt and Road Initiative (BRI) partner countries. Financial integration is one of the important objectives of BRI and what better way of achieving that than through the use of a eCNY-based digital payments system? China has established an early mover advantage for itself and may well take the lead in the setting of international standards in this area.

According to financial experts and international bankers, CBDC "is beginning to look inevitable.... the CBDC train has left the station and is gathering pace. Anyone who fails to board will be left well and truly behind in one of the potentially most significant geopolitical and macro-economic advances of our age."

Early this year, six central banks decided to collaborate on CBDC by setting up a working group to study its possible design, architecture, regulatory and legal issues and how it would connect with the existing banking and payments systems. Participants included the central banks of Canada, the UK, Japan, Sweden, Switzerland, European Central Bank and the Bank of International Settlements (BIS). The US Fed joined later. The report of the group has just been released and is worth a closer look. BIS has a useful definition of CBDC:

"A CBDC must be convertible, convenient, accessible and low-cost. The underlying system should be resilient, available 24x7, flexible, interoperable, private

and secure for the general public. At the same time, the payment system upon which a CBDC exists and is transferred must involve the private sector to benefit from innovation and competition and support adoption and use."

The aim is to establish a risk-free central bank currency that will complement and not replace cash. It will also consider the risk involved if a foreign CBDC (read the eCNY) or private digital currency (such as the Facebook sponsored Libra) started to be widely used in western economies. Decisions may have to be taken on limits on private and foreign holdings of CBDC.

As is apparent, privacy is an important consideration. The Chinese system has less concern over this and it bills its system as ensuring "controlled autonomy." The Chinese eCNY does not aim at convertibility but "interoperability." But in the Western conception as in the Chinese, there is a strong intent not to undermine the role of commercial banks and financial institutions. The participating central banks have decided to proceed with the drawing up of two proof of concept (POC) steps before the trial stage. The phase-1 POC commences in March 2021.

These major central banks have been spurred into taking action on adopting CBDC as a result of the advances already made by China. Their reaction is fortunately faster than the centuries it took to adopt paper money invented in China. They are also responding to the possibility that private crypto-currencies like Libra could well undermine sovereign functions of central banks.

Around the world, 80 central banks are exploring the creation, development and implementation of their own CBDC. These include Singapore and Thailand in Asia. The Reserve Bank of India (RBI) has proved to be a laggard and this may prove detrimental in the long run. In 2017, there were reports that the RBI was indeed considering a CBDC, which was rumoured to have the name, appropriately, Laxmi. A working group was set up to explore the potential for introducing a rupee-backed digital currency. Later, in 2018, an inter-ministerial committee of the Department of Economic Affairs was mandated to draw up legislation to regulate private crypto-currencies. In its report, the committee also touched upon sovereign digital currency stating that "it would be advisable to have an open mind regarding the introduction of an official digital currency in India."

However, the RBI governor considers it to be "very early to speak on a central bank issuing digital currencies." He added that the technology had not fully evolved and that it was still in "a very incipient stage."

The technology has already evolved and all major economies, led by China, are on the threshold of adopting digital sovereign currencies. India should not be left behind. It should join the seven central banks which are already engaged in studying their feasibility and safeguards necessary to eliminate risks, particularly from hacking. The prime minister has promoted a digital India and the country has a rapidly expanding digital banking and payments sector. These should be leveraged to stay ahead of the game. Falling behind may prove to be costly.

The writer is a former foreign secretary and senior fellow, CPR



SHYAM SARAN