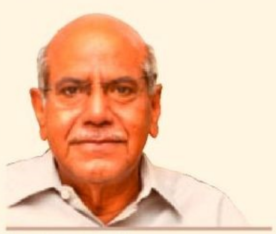
ILLUSTRATION: BINAY SINHA

Understanding the e-yuan initiative

There is merit in carefully examining the recent developments in China's sovereign digital currency space and participating in it if India's interests are served

China launched its digital currency, the e-yuan, at the Beijing Winter Olympics in February this year, after running a series of pilot projects in major cities. The e-yuan operates through digital wallets, much like the Chinese digital payment platforms of Alipay and WeChat, but it is issued and managed by the People's Bank of China (PBOC), the central bank.

It is reported that currently there may be over 140 million e-yuan wallets in use by individuals and 10 million by businesses. The transaction value achieved is about 10 per cent of the total, compared to the 90 per cent still conducted through Alipay and WeChat. There is interoperability among the platforms. Alipay handles 544,000 transactions per second (TPS) against a mere 10,000 TPS for the e-yuan. The digital sovereign currency still has a long way to go. The PBOC has also let it be known that the e-yuan will be developed without impacting on financial intermediation by banks, which will continue to receive deposits and pay interest on savings. The e-yuan does not offer any interest. There has been a deep concern over the prospect of the traditional banking system being rendered obsolete by digital finance, since virtually all the services offered by banks could be incorporated in the new system. This may eventually be unavoidable.



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The current debate in China is focused on two key issues. One is concerning the collection, scrutiny and protection of data generated through the use of e-yuan wallets. In theory, the state would have access to the spending behaviour of all e-wallet users and this would enable even more pervasive surveillance of wallet users. The issue of privacy is being raised both with respect to the private payment platforms and the state-run platform. However, there is greater concern over the state's access to data and this may be slowing the adoption of the e-yuan. There appears to be greater trust in private platforms, but then the state has legal right to all the data gathered by them.

Second, the digitisation of the Chinese currency has been seen as a relatively safer route to its internationalisation. China is averse to adopting a fully convertible currency with no controls over capital flows. It wants to achieve internationalisation without risking volatility and capital flight. A cross-border payment system is currently being tested in a pilot involving China, Hong Kong, Thailand and the UAE. It is known as the Multiple Central Bank Digital Currency or the M-CBDC. The objective is to permit real time foreign exchange transfer on a 24X7 basis. The system ought to permit no disruption, interoperability and compliance with local laws and regulations relating to financial transactions. Once it has been made operational among these partners, it could then invite other central banks to participate. In effect an alternative cross-border payment system would be established bypassing the US dollar-based system. It would also permit the bypassing of unilateral sanctions of the kind that have been imposed on Russia in the wake of the Ukraine War. It is surprising that Russia has not been invited to take part in this pilot but perhaps its participation is taking place in a discreet manner. China looks to countries which are part of its ambitious Belt and Road Initiative to join in the M-CBDC project. Before that a whole host of issues will need to be resolved, including the security of national financial data and interoperability procedures. This is still a work in progress but China is way ahead of other major economies, including the US.

China has been alarmed by the imposition of sweeping economic and financial sanctions against Russia in the wake of the latter's aggression against Ukraine. There is fear that it could be the next target. This has given a serious impetus to the e-yuan project, in particular its possible role in the internationalisation of the Chinese currency and the establishment of an alternative international payment system free of the US and Western domination. Many other countries would be attracted to this initiative because there is a general unhappiness over the American unilateral resort to economic sanctions in pursuit of its geopolitical aims. Even the west European countries are resentful of this American power to impose punitive sanctions on adversaries and friends alike. India, too, would welcome a financial order that does not give any particular country an inordinate influence and ability to inflict unilateral economic pain on others.

There is merit in studying the Chinese initiative carefully and participating in it if our interests are served. It would also enable India to shape the contours of the new financial architecture in line with its interests, much as we had been able to do in the establishment of the Asia Infrastructure Investment Bank and the BRICS Development Bank. India has already announced its intention to create its own digital rupee. This project should also take into account the possibilities of its participation in an international digital payments system, which may reduce transaction costs but also provide a rule-based digital global financial system. One should not pursue a digital sovereign currency merely because other countries are racing to adopt it. There needs to be a careful examination of the pros and cons from India's perspective. Having followed the debate in China on the subject, it appears to me that the idea of a digital sovereign currency is here to stay. It is also apparent that the contours of an alternative international payments system based on digital sovereign currencies are also being worked out under Chinese lead but with the participation of some other developing countries. Our cordial relations with the UAE and Thailand should enable us to get a sense of how this initiative is unfolding even if it is premature to seek active participation in it. We should not merely watch from the sidelines.

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