



Central Bank Digital Currency

Why in News

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

▪ 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 (Bitcoin).
 - 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

- 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](#)

PDF Refernece URL: <https://www.drishtias.com/printpdf/central-bank-digital-currency>

