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## China's digital currency moves

With pilot runs for a digital yuan underway, its monetary system could well become an exemplar for other countries

**Topics**



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[In my column "Translating economic scale into financial heft" \(\*Business Standard\*, December 20, 2019\), I had reported that China was moving towards the launch of a sovereign digital currency based on blockchain technology, although details were still unclear. The launch is now imminent. Known as the Central Bank Digital Currency \(CBDC\), the digital yuan is already in circulation on a pilot basis in the Xiongan New Area in Hebei province, located between Beijing and Tianjin in Shenzhen \(Guangdong\) and in Chengdu \(Sichuan\).](#)

[The English language newspaper \*Global Times\* has reported that the Central Bank in collaboration with private companies "has completed the development of the sovereign digital currency's basic functions and is now drafting relevant laws to pave the way for its circulation."](#)  
[The private companies involved are Alibaba, Tencent, Huawei and China Merchants Bank.](#)

[The CBDC is based on blockchain technology that is also used by crypto currencies like Bitcoin and Tether but the comparison ends there. Crypto currencies are "mined", which reflects their issuance being decentralised. There is a distributed ledger system over which no one has control since it is governed by an algorithm. The value of the crypto currency is determined by demand and supply. The system requires enormous data banks, which are quite energy intensive. It is](#)

interesting to note that though China has banned crypto currency exchanges, 70 per cent of the “mining” takes place in China because of lower costs of operation.

In the case of CBDC, the source of value is the State, which will distribute it through the existing banking and monetary system just like paper currency. While blockchain technology is used as a ledger system, it is controlled by the State. From information filtering out from the pilot centres, each user will have a crypto wallet on his personal digital device into which the digital currency would be transferred. He can use the funds to seed the wallets provided to him by payment apps such as Ant Financial (run by Alibaba) or use them to make payments directly for purchases just like cash. The deposits even carry images of current paper currency notes. In the retail segment, US chains such as McDonald’s, Subway and Starbucks are among those participating in the trials. For most Chinese consumers, the transition will hardly be noticeable since virtually 70 per cent of all transactions in the country are already in the digital mode. The commercial system will also be required to switch to the use of the digital currency for all transactions, enabling the State to monitor transfers and detect tax evasion, money laundering and other illegal activities. It would also enable more accurate and timely data on money in circulation, thereby improving monetary policy and money market operations. For these reasons, over 80 per cent of central banks around the world are reportedly considering following the Chinese example.



*Illustration by Binay Sinha*

The adoption of digital currency is designed to serve other objectives. China views it as an instrument to achieve significant financial autonomy and lessen its exposure to the US dollar. The intention is to create an advanced digital ecosystem in which the Chinese currency can be used in everyday transactions across the world because of its convenience and low transaction costs. It can be used wherever internet is available. Such an ecosystem, once in place, could bypass the US and Western banking system, the SWIFT inter-bank payment mechanism and other pillars of the global financial universe dominated by the West.

Countries and institutions that are threatened by US sanctions and scrutiny would find the Chinese alternative particularly attractive. Over time the digital yuan could graduate to serving as a global unit of account. It is expected that the immediate target for extending the external use of the digital yuan will be partner countries in China's Belt and Road Initiative (BRI) and emerging markets in general. Chinese banks have already lent nearly \$600 billion to 820 projects in BRI countries since 2013. There are 76 Chinese banks operating in these countries. Chinese banks already supply over 60 per cent of all cross-border lending within emerging markets.

The Covid-19 pandemic has given a major push to the adoption of digital technologies and this trend is likely to be sustained even when the crisis is over. The launch of the CBDC affords China a leadership position in this more digitally-oriented new world. The Chinese initiative may well become the exemplar for countries around the world. It would also be aligned with the shift towards more national control and regulation of economic activity. Cao Yan, who is the managing director of China's Digital Renaissance Foundation, has also argued that in crisis situations, such as one confronting us now, the CBDC can be more efficient instrument to deliver stimulus than interest rate manipulation and quantitative easing. Interventions will be based on

real-time data available in the system on financial flows taking place across all segments of the economy. This is indeed a powerful instrument but its efficacy remains to be tested.

One is not aware how closely these significant and potentially game-changing developments are being followed by the Reserve Bank of India and our government. India should seriously consider a sovereign digital currency if that enables a more efficient monetary policy and economic policy in general. The implications for India of a China-led global financial system, which may run parallel to the dominant Western system, must be examined carefully. It has generally been assumed that since China will not give up capital controls, adopt full convertibility and risk currency volatility, it will never be able to serve as an alternative to the US dollar. The digital currency offers a possible route to internationalisation with minimal loss of sovereign control. China is already a major player in the global financial market. Its own financial market is worth \$45 trillion. Its foreign market assets are \$4.2 trillion, which is more than its foreign exchange reserves of \$3 trillion. Its bonds and shares are part of international indices. Being a pioneer in launching a digital currency puts it in a leadership role that may remain uncontested for some time.

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