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China Will Launch Digital Currency: the Nature And Prospection

By Xun Yang

A series of news reports have recently been released, suggesting that China is going to launch the first digital currency (the "Digital Currency") in the world. On 14 April 2020, it was reported that Digital Currency will be launched in Shenzhen, Xiong'an, Chengdu, and Suzhou on provisional basis. Three days later, a picture about testing Digital Currency at the Bank of Agriculture appeared on media. On 22 April 2020, Xiong'an government announced that Digital Currency will initially be introduced for using in food and beverage services, retails, and entertainment business. All these news suggested that the launching of Digital Currency is not a faraway dream. The question is what the Digital Currency is and how it will affect the business?

How is the Digital Currency different from virtual currency?

There used to be a misunderstanding that the Digital Currency is a virtual currency, like Bitcoins and Libra. Actually, it is not the case. The Digital Currency is a digitalized real currency and and not virtual currencies. It is different from virtual currencies from the following aspects:

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Firstly, the Digital Currency is to be issued by the People' Bank of China and backed by China's sovereignty credit. It will be a type of legal currency in China for being used to purchase goods and services in China. No one is allowed to reject it. In other words, it will share the same legal status as cash, including RMB notes and coins. This is fundamentally different from virtual currencies, which are only intermediates for exchange of value and do not have any independent value.

Secondly, according to patent application records maintain by the State Intellectual Property Office, the Digital Currency Research Institution affiliate to PBOC appears to have applied for patents in relation to the issuance and circulation of the Digital Currency. These patents applications suggest that the issuance and circulation of the Digital Currency will likely partially use blockchain technology but they are not refrained to the blockchain technology. This may be an obvious selection because the energy consumed in a transaction on blockchain is hundreds of times of that in a normal e-payment transaction (such as a transaction via Alipay). In particular, the Digital Currency will not adopt a distributed ledger; rather, it will still have a general ledger maintained by PBOC. Additionally, PBOC has no plan to construct a blockchain (which, if it does, will be too vast to be realistic) for the circulation of the Digital Currency; rather, it will select to use simpler and lighter networks.

Thirdly, the Digital Currency will not be circulated in a completely anonymous way. Rather, PBOC decides to retain certain level of traceability to protect financial accountabilities. In other words, from PBOC's point of view, although specific transactions are anonymous to general public, PBOC will maintain a record of circulation of the Digital Currency to prevent money laundries and to help suppress corruptions.

How is the Digital Currency different from e-payment?

There are also speculations that the Digital Currency will replace online payment settlement platforms such as Alipay and WeChat Pay. These speculations are not true either.

Firstly, the Digital Currency is the fundamental currency issued by PBOC for circulation in the market and is often referred to as M0. These moneys settled via Alipay, WeChat Pay, or other online channels are those moneys deposited at bank accounts, which are referred to as M1. In other words, they are different layers of currencies.

Secondly, according to the news reports, PBOC will issue the Digital Currency through commercial banks. In other words, despite of the technical possibilities, PBOC has no intention to bypass commercial banks to issue currencies. Since online payment settlement platforms functions to provide channels for settlement among different commercial banks, the fact that PBOC issues the Digital Currency via commercial banks suggest that these platforms will still a role to play even after the Digital Currency is introduced to the market.

Thirdly, different from Alipay and Wechat Pay by which the settlement needs the use of networks and requires that both payers and payees maintain accounts with Alipay or WeChat Pay, the exchange of Digital Currency does not need to use any network nor does it need any intermediate accounts. In other words, Digital Currency can be exchanged just like cash.

What are legal issues associated with Digital Currency?

A number of legal issues may worth considering for smooth operations of the Digital Currency.

Firstly, some pieces of legislation must be amended to enable the Digital Currency to have the same legal nature as cash. For example, in the Renminbi Administrative Regulation, Digital Currency needs to be included in the definition of legal currency in China, in addition to notes and coins, so that acceptance of the Digital Currency as payments becomes mandatory.

The second issue is about the balance between the privacy protection and the traceability of the Digital Currency. In other words, it is worth considering the extent to which an exchange of the Digital Currency is traceable. Which person or organization ought to be granted the access to transactional details? Do payers, payees, or relevant banks have the right to view the transaction records? What information may be viewed by the banks? Moreover, in what circumstance, the court, the government or other agencies are allowed to view transaction details? Does it require a court order or a government instruction is sufficient?

Thirdly, the use of the Digital Currency may require additional and enhanced IT infrastructure, which needs to meet a certain cyber security requirements. Financial regulators have imposed many cyber security requirements on online financial business. With the use of the Digital Currency, will these requirements be extended to apply to all transactions using Digital Currency? What are the cyber security standard applicable to the system used to process transactions involving Digital Currency?

Fourthly, the IP protection is also an issue to be considered. Up till now, from the public record, Digital Currency Research Institute has applied for at least six patents in relation to operations of the Digital Currency, covering account registrations, account and transaction enquiries, currency conversions, account synchronizations, and account deregistrations. Applications for patent protections not only reflect China’s confidence in the innovativeness of the Digital Currency but also suggest China’s ambition to lead the revolution about digitalized currencies.

What will Digital Currency bring to the public?

The introduction of the Digital Currency will likely facilitate payments, both online and offline. The Digital Currency not only enables cashless payments but also allows payments settled between payees and payers who use accounts with different banks and with different payment platforms. Additionally, the Digital Currency allows payments take place without wifi or mobile networks, which payments can be recorded and synchronized at a later stage when network connections are available. As such, the Digital Currency appears to introduce a possibly more convenient direct settlement method.

However, there will be a long way for the general public to accept Digital Currency psychologically. When Alipay and WeChat Pay were introduced to the market, a huge amount of subsidies were granted to attract both merchants and individual users and to build up their habits. It remains questionable whether PBOC or the merchants which accepts the Digital Currency will be able to attract users in the same way.

What will Digital Currency bring to the business?

The launch of Digital Currency will first affect the banking and financing business. Banks would need to manage Digital Currency accounts and to provide conversions between the Digital Currency and cashes. Banks and other financial institutions would need to construct IT infrastructure to allow acceptance, process, and settlement of the Digital Currency in addition to and in conjunction with the acceptance, process, and settlement of other type of funds.

The launch of the Digital Currency will likely benefit small merchants. Cashless payments will no longer require the installation of terminal sets specific to single settlement channels, such as Alipay, Wechat Pay, etc. Rather, with the introduction of the Digital Currency, a uniformed terminal set will likely work for settlement via all payment channels.

The launch of the Digital Currency will surely bring a tremendous amount of business opportunities for IT companies, including both hardware, software and service providers. Electronic purses (if not mobiles), virtual purses (if stalled into mobiles), and terminal sets are necessary for the Digital Currency to be widely used. A large-scale complicated infrastructure would also need to be constructed to allow Digital Currency to be circulated and processed.

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