

The use of cash will disappear very fast: Author Eswar Prasad

Synopsis

The rise of these central bank digital currencies, or CBDCs, essentially virtual versions of currencies backed by the state, will be a major push towards hastening the demise of cash, says Eswar S Prasad, the Tolani senior professor of trade policy and professor of economics at Cornell University. It's one of the several revolutionary changes under way that Prasad delves into lucidly in his new book, *The Future of Money: How the Digital Revolution is Transforming Currencies and Finance*.



Author Prasad, who previously headed the China division of IMF talks about the changes sweeping through the world of finance, and his deadline for the death of cash.

By the end of 2021, the **Reserve Bank of India** is likely to launch trials for its digital currency, following the example of several other countries, from China to the Bahamas, which last year launched its **Sand Dollar**.

The rise of these central bank **digital currencies**, or CBDCs, essentially virtual versions of currencies backed by the state, will be a major push towards hastening the demise of cash, says Eswar S Prasad, the Tolani senior professor of trade policy and professor of economics at Cornell University. It's one of the several revolutionary changes under way that Prasad delves into lucidly in his new book, *The Future of Money: How the Digital Revolution is Transforming Currencies and Finance* (Harvard University Press and HarperCollins India).

Author Prasad, who previously headed the China division of IMF, spoke to Indulekha Aravind on Zoom about the changes sweeping through the world of finance, and his deadline for the death of cash. Edited excerpts:

As someone who has written about the end of the use of cash, how much of it do you use?

You know, I actually still like cash – its tangibility, the personal connection it creates. Very often, I still tip my Uber drivers and food delivery people with cash. But I think even I am beginning to come to terms with the reality that sooner or later, I'm going to have to have an app on my phone to make payments.

In your book, you say it's only a matter of time before we stop using cash. What's driving this?

It's become clear that it's possible to provide very low-cost and efficient digital payments, even to people who are relatively poor, who may be unbanked. Countries like China, India and Kenya are leading the way in this. So the technology is there, it is easily scalable and that makes it harder to assume cash is going to remain viable. The other important development is that the new financial technologies, especially those underlying cryptocurrencies, have lit a fire under central banks to start issuing their own digital currencies or at least experimenting with them.

I know that India has announced it may start trials towards the end of this year. So if you have digital versions of central bank money available, in addition to low cost **private payment systems**, I think cash will organically start disappearing simply because people will find the convenience of digital forms of payment substantially override any of the benefits of cash.

RBI deputy governor **T Rabi Sankar** had said CBDC is something that is likely to be in the arsenal of every central bank. Would you agree?

From the point of view of a government or a central bank, a CBDC has many advantages. First, it brings a lot of economic activity out of the shadows and into the tax net because any transaction that leaves a digital trail is going to be harder to conceal from the authorities. A digital trail also means there is less likelihood that central bank money will be used for nefarious purposes. In addition, it is likely to deter at least cash-fuelled corruption.

There are also certain broader advantages. There are some countries that experimented with the CBDC which view it as a way to increase financial inclusion, the idea being that if the central bank can provide very low cost digital payments, with no barriers to access, then you can bring many more people into the financial system not just by providing easy access to digital payments, but also by using that perhaps as a portal for basic banking services.

In terms of monetary policy, a central bank might find a CBDC attractive during times of major economic or financial crisis. If the CBDC took the form of each household or each individual having effectively an account with a central bank or a digital wallet, that makes certain monetary policy operations easier. For instance, if I wanted to make cash transfers to the population at a time of a very deep recession, you can do it very easily using a CBDC account.

You've talked about the advantages of a CBDC. What are some of the risks?

One of the major risks is that a CBDC ends up disintermediating the banking system. What that means is, if people in a country have access to a central bank account, if that's the form the CBDC takes, they might prefer that to a commercial bank account, even if that CBDC account pays no interest, because they view it as safer.

This becomes a particular problem when there are concerns about the stability of the banking system -- you could have a flight of deposits out of the banking system into CBDC accounts, which could precipitate the exact financial instability a CBDC is trying to avoid. Now, in modern economies, commercial banks still play a very important role in creating money, such as by providing loans.

In a country like India, only about 15 to 20% of money that fuels economic activity is created by the central bank. So if commercial banks start facing threats to their existence, then we have to think very hard about who does the job of money creation or credit allocation equally. The second risk is that a CBDC because it is a digital payment system might end up outcompeting with private payment systems, which would squelch private sector innovation. But there are ways around these risks. With the first risk for instance, one could set up a CBDC account with limits on the amount that can be kept in those accounts.

There's one final, very significant risk, which is to society as a whole. One can think about digital currencies, both private and central bank issued, as being very efficient and making life better in many ways. But the reality is that anything digital is going to leave a trail. So the sort of privacy and confidentiality that cash gives us is going to be difficult to maintain with a CBDC. Whether we want to live in that world is something we all need to think about not just from economic or technocratic terms, but also at the societal level

What are your thoughts on that -- I mean, from a societal point of view?

I worry about that a great deal. We need to give this some serious thought rather than getting caught up in the technological razzle dazzle of digital currencies. If we give away the last vestige of privacy afforded through cash transactions, I worry that that could be a world that provides a lot of possibilities, especially for more authoritarian governments, as part of their surveillance of citizens. Most central banks that are talking about CBDC have tried to

portray it as a relatively neutral thing, that it will just be a digital replacement for cash, that it will not bear any interest rate, that you could still maintain some degree of privacy. But again, the technology is here for CBDCs to be turned into some form of smart money.

At certain times, this might be useful for economic policies. For instance, if an economy is in a deep recession and you give people money, some might save that money, and then it doesn't have the sort of effect you would want it to have on economic demand. So you could set up smart money with expiration dates, saying that you either spend this within the next year and that's going to help the economy or it expires. That might seem like a good thing, but (then) you have different units of central bank money with different purposes and that's a potential concern.

You could also think of a government, even a seemingly benevolent one, saying it doesn't want its money used for certain nefarious purposes, such as buying ammunition. So you can very quickly see how we might end up in a situation where you could have central bank money being used not just for economic, but social objectives. This is a very dystopian future I'm painting. But all of these become real possibilities once you have digital money, which is why I think there needs to be a lot of debate and discussion in society before we move forward with CBDCs, and there needs to be appropriate safeguards in place.

What do you make of India's approach to fintech and how would you contrast it with China's?

Fintech has a lot of promise in terms of directly connecting savers and borrowers, broadening financial inclusion, giving the masses easy access to digital payments and also as a portal for basic financial services such as edit, savings products and so on. But technology can cut both ways. Network effects, that is, some companies becoming very big and dominating the market, can bite with a vengeance, especially in any sector that uses technology.

So while technology might make it easier for newer operators and small companies to start innovating, one should also be aware of the risks that you could have of the entire system being captured by a handful of major players. There is an interesting contrast between China and India. In China's case, the government stepped back and let the private sector provide digital payments, which it did very effectively but it's come at a cost -- competition has been deterred and the two dominant companies -- WeChat Pay and Alipay -- have become economically and politically quite powerful, which is why the government has recently taken steps to cut them down to size.

India's approach of the government creating a public infrastructure that all entrants have easy access to, so that the big players are not privileged, is a much better way for a government to proceed. But it also shows that the government really has a role to play. You cannot leave these things entirely to the private sector. So long as the government does not intrude as a direct competitor but provides the technical infrastructure and then create some guardrails, in terms of the use of data and promoting competition and entry, I think that's a really constructive role the government can play.

Coming to cryptocurrency, how do you view the frenzy around Bitcoin?

Bitcoin, of course, was created with a very interesting objective in mind, which was to allow parties to undertake transactions without the use of a trusted intermediary, such as a central bank. And the fact that Bitcoin came up in 2009, right after the global financial crisis, when trust in central banks and commercial banks was at a real nadir, I think allowed it to gain traction.

Now, the reality is that Bitcoin has proven to be a rather ineffective medium of exchange. Its promise of digital anonymity has proved to be something of a mirage and it also turns out that Bitcoin is very cumbersome and expensive to use. Most importantly, it has very unstable value -- it's as if you took Rs 1000 into a coffee shop and you could buy a

small cup of coffee one day and a whole meal another day.

But cryptocurrencies have had a real impact on the financial ecosystem. First, the technology is really a marvel. The benefits of that technology are becoming apparent in some of the newer innovations we are seeing, largely under the rubric of decentralized finance that will allow for a democratization of finance, by giving people much easier access to a broad range of financial products and services, by making it easy for developers to create those products and services. And largely by reducing the cost and increasing the efficiency of those. So I think the legacy of the Bitcoin revolution is going to be with us in different forms, even if cryptocurrencies don't exist.

Now the irony of Bitcoin and other such private cryptocurrencies is that instead of becoming an effective medium of exchange, they have become speculative assets. People who hold Bitcoin right now seem to hold it in the belief that its value can go only one way, up. To an economist, that seems like one massive speculative bubble because there is no intrinsic value to Bitcoin. Bitcoin adherents will tell you that the reason it has value is because of scarcity, that ultimately there are going to be only 21 million Bitcoins. But to me, scarcity alone doesn't seem like a durable foundation of value. So we're going to see some turmoil in the Bitcoin market, as far as investors are concerned.

Would this turmoil reflect in other cryptocurrencies?

There are some who talk about diversifying their holdings of crypto currencies by holding a basket of cryptocurrencies, rather than one. But the evidence indicates that cryptocurrency prices move very closely together. I suspect that if it turns out there are either technological vulnerabilities or a crisis of faith that hits the cryptocurrency investing community, it will quickly spread through the entire cryptocurrency world.

Facebook is planning to launch a digital currency, now called Diem (earlier, Libra). Do you see more MNCs following suit? It will almost certainly happen. The notion of using your own digital tokens that can work effectively on your platform but can also be extended to other platforms is a temptation that few major corporations are going to be able to resist. There are already Amazon Coins that can be used on the platform and it's not hard to see that it can be used on other platforms.

But you have concerns...

When Facebook proposed its crypto currency or stable coin, initially called Libra, it professed very noble objectives because the access to digital payments is still very limited in many economies and cross-border payments in particular are fraught with frictions. But the reality is that you would have a major corporation with very substantial financial resources and a worldwide reach that would effectively be managing a currency.

It would hardly be inconceivable that this currency would quickly gain traction and could lead to a situation where Facebook would no longer have its cryptocurrency, backed up by reserves of hard currencies, it would basically become a monetary authority of its own, even though they have indicated they have no plans to do so.

There are also concerns about whether Facebook would sufficiently closely monitor the activity on the payment network so that it could convince regulators that Diem would not be used for illicit money transfers. And it's not just the financial risk - it would be one more way for FB to get access to our financial and social lives and that is a very disturbing prospect.

My final question -- what's your timeline for the demise of cash?

That depends on how quickly two things happen: the maturing of the technology underlying cryptocurrency so that it can actually provide more efficient payments, and when central banks start rolling out their digital currencies. My sense

is that we are going to see very substantial changes in the next three to five years.

Like I said, no central bank is going to eliminate cash but we'll organically see the use of cash disappearing very fast. Even in economies where cash is very widely used right now, in the next 10 years or so, the use of cash for legitimate financial transactions is going to be at a minimal level.

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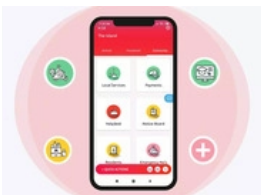
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