Oct 6, 2021, 04:00pm EDT

Eswar Prasad's Embrace Of Economic Fallacy Deprives Him Of A Great Book

John Tamny Contributor
Policy

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A 2018 *Frontline* episode titled *Our Man in Tehran* followed Thomas Erdbrink, who was at the time Tehran bureau chief for the *New York Times*. One of Erdbrink's stops in this most fascinating of documentaries was an outdoor currency exchange.

Paraphrasing the trader whom Erdbrink interviewed, "They hate the Americans, but we don't." "They" was the Iranian leadership. They're not fond of the U.S., but it seems the Iranian people view the U.S. differently. Notable about this currency trader was that he was trading dollars. Yes, the dollar is the currency of exchange in Tehran.

Some reading this will logically ask why the dollar liquefies exchange in an "enemy" country, and more specifically one in which the greenback isn't legal tender. The questions are reasonable, and the answer is that no one buys, sells, lends, or borrows with "money." Underlying all money movements is the movement of products and services.

Which explains why the dollar can so readily be found in Tehran. Precisely because the dollar is trusted the world over, precisely because the dollar commands goods and services in Iran in ways that legal tender like the rial and toman (the replacement for the rial after over *3,500 devaluations* of the rial since 1971) do not, the dollar is the currency of trade on the other side of the world.

It's a reminder that with trade, it's always and everywhere products and services for products and services. Money is just the claim ticket that producers of goods and services take in return for what they've created so that they can get roughly equal value in the marketplace. Which is a long or short way of saying that the dollar's role in Iranian exchange is a statement of the obvious. Where there's production, there's always credible money moving the production.

This and much more came to mind while reading Cornell profess Eswar Prasad's very interesting and very worthwhile new book, *The Future of Money: How the Digital Revolution Is Transforming Currencies and Finance*. "Excellent" would be attached to Prasad's latest, but for his tendency to embrace economic fallacy that is widely accepted in the economics profession, but that his very own book contradicts. Here lies the paradox with Prasad: he writes very informatively, I'll be referencing *The Future of Money* for a long time in much the same way I reference Prasad's previous very excellent book (my review here) on China's yuan (*Gaining Currency*), but it's frustrating to think how much better Prasad's books could be if not pregnant with the fallacy that so relentlessly stalks the economics profession. To read Prasad is to often say to oneself he's so wise, so why does he believe certain things?

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Up front, Prasad's book is about what the title suggests. As he recalls about pre-coronavirus trips to China in recent years, "my habit of carrying actual yuan banknotes in my wallet felt increasingly anachronistic. My Chinese friends would look on with befuddlement as I pulled out my currency notes rather than my phone to pay for a meal or coffee. They could easily beat me to the punch by whipping out their phones and paying before I could even begin counting out yuan notes." As Prasad sees it, the paper money that the Chinese invented in the 7th century is on the verge of being replaced by digital notes. Cash is yesterday. The future of money isn't paper money.

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So what's going to push cash into the proverbial dustbin of history? Prasad imagines crypto-style currencies will write the obituary, along with a rapidly evolving financial sector more broadly. In Prasad's words, the "Fintech revolution has far more disruptive

potential because it is affecting some of the foundational elements of finance.”

In writing about what’s happening now in trade, lending and crypto, this is where Prasad is at his best. He plainly loves the story he’s telling, and provides detailed explanations of various players, big and small, in this new financial world. And it’s a good world. It’s one in which more and more of the unbanked will attain access to credit lines care of the very technological advances that some incorrectly say will render the tired and hungry unemployable.

Let’s start with Muhammad Yunus’s Grameen Bank in Bangladesh. In reading Prasad, I found myself hoping he would eventually write a book on Grameen alone. It’s a very fascinating credit story in that as Prasad describes it, Yunus’s “key insight was that a community’s reputation could serve as a form of collateral.” How? Assuming non-payment of a loan by one member of an underbanked locale, there was an understanding among others that this non-payment could negatively affect the ability of others in the community to attain credit. “Thus, the costs of non-payment by a single household would be magnified and affect the entire community, providing an incentive for the group to make sure its members play by the rules in their financial dealings with those outside the community.”

Thinking about Grameen, its lessons would vastly improve the terms of the credit discussion in the first world; a discussion that becomes more ridiculous by the day. Grameen reminds us that credit is reputation, and no amount of central bank “zero bound” nonsense can alter this truth. Too many in the U.S. are gulled by the nonsensical view that in going to “zero,” the Fed is making money “easy.” Oh please. There’s no such thing as “easy money,” and the surest sign it’s not easy is when rates of interest are really low. To quote Prasad quoting Ogden Nash in the opening of Chapter 3, “you must never lend any money to anybody unless they don’t need it.” Translated, U.S. banks are surely lending right now at low rates; albeit to sure things that don’t need it. In the real world, bank credit is generally hard to come by for all but the bluest of blue chips. Banks once again lend to those who don’t need it. This isn’t an attack on gun-shy banks as much as it’s another statement of the obvious, and a loud reminder that the Fed’s vain rate machinations vis-à-vis banks are of little consequence to the U.S. economy. Prasad will never write it given his close ties to the central banking crowd, but *The Future of Money* (going forward, *The Future*) is an implicit or unwitting acknowledgment that the Fed and other central banks are rushing toward irrelevance. Some, including yours truly, would say they’ve never been relevant.

The main thing is that market forces are rapidly bringing us to a time when even the

mildly sapient will look back on the days of breathlessly following central-bank utterances, only to laugh. Think peer-to-peer lender Prosper. Prasad writes that "interest rates on its loans vary based on a borrower's credit profile, which is visible to potential lenders registered on the site." So while economists and their media enablers will continue to focus on the Fed's rate fiddling, and charitably silly view that it robs savers of interest on savings, the Prospers of the world will multiply, at which point "Individuals and institutions can invest in specific loans, construct a portfolio of loans, or use automatic investment options" to achieve the interest rate on savings they're looking for, and that risk-averse banks no longer pursue. Where it gets even more interesting is Prasad's report that banks themselves increasingly expose their own holdings to these innovative, higher-yielding sources of credit.

Why are stodgy banks so comfortable exposing some of their holdings to *those who do need it*? Prasad points to technological advance. Jack Ma's Ant Group, U.S.-based LendingClub, and India-based Lufax (Prasad indicates that it passed LendingClub in 2019 as the world's largest peer-to-peer lender) are information-processing marvels. Their access to voluminous data, and their ability to process that data in seconds, renders them very capable when it comes to picking the right individuals and businesses to lend to. Along these lines, Prasad writes of Ant Group's MYbank which, by the end of 2020, "had served thirty-five million businesses and originated loans amounting to more than $300 billion." What's game-changing here is that while MYbank's "loan approval rate is four times higher than that of traditional lenders" to small and medium-sized enterprises (SMEs), "its reported nonperforming loan ratio (relative to total loans outstanding) at the end of 2020 was only 1.5 percent." Don't worry, it gets more interesting. Prasad adds that "MYbank pioneered the 3-1-0 model for providing collateral-free business loans to SMEs. The model intimates that borrowers can complete their online loan application in three minutes and obtain approval in one second, with the entire process requiring zero human intervention." Quoting Prasad quoting Bill Gates, "banking is necessary, banks are not." Yes. Is it any wonder China's ruling class looks a bit askance at Ma and his lending innovations? Central banks continue to project their well-overstated influence through an antiquated banking system that modern technology is plainly positioned to disrupt. It's for analysis, reporting or both like this that one is never disappointed after having read Prasad. He informs. Readers learn.

Which brings us to cryptocurrencies. Prasad addresses the elephant in the room with respect to Bitcoin in the *The Future's* opening pages. The price of a coin was less than $500 in 2015, almost made it to $20,000 in December of 2017, then traded between $4,000 and $15,000 during the ensuing three years. Then it jumped past $60,000 in March of 2021. This, for those who don't know any better, is not a currency. Further in

the book, Prasad acknowledges the previous truth. Once again, no one buys, sells, lends or borrows with "money." Money movements signal the movement of products and services for products and services, so if the exchange medium is all over the map from a value standpoint, trade that by its name is mutually enhancing suddenly is not. Suddenly there are winners and losers made by currencies that have no stable or fixed value. In Prasad's words, "Such volatile values mean cryptocurrencies like Bitcoin are not reliable mediums of exchange, a key attribute of any workable currency."

Despite this, Prasad sees the potential. For one, these modern monies are plainly billed as a way for individuals to move money around seamlessly, and increasingly without cost. This is of crucial importance to the many Indians, Haitians, Philippinos, and Salvadorans who don't work in India, Haiti, the Philippines, or El Salvador, but who have relatives who live in those countries. Prasad notes that Haitian workers "laboring in nearby countries such as the Dominican Republic and in faraway countries such as France face fees of 8 percent on money sent back to their families." 8 percent is usurious, at which point Prasad sees "a huge opportunity for improvement in the area of cross-border transfers, especially in the context of remittances."

Which is where crypto looms large. Indeed, while Prasad veers into econo-speak when he expresses worries about Diem, Facebook's crypto concept (initially rolled out as Libra), given that "Facebook is a profit-driven, commercial organization that will ultimately seek to monetize the cryptocurrency in some form," he acknowledges that a more trusted "stablecoin" like Diem could protect the world's vulnerable from devaluation while enabling ease of remittance. As for the econo-speak, surely Prasad knows better. Precisely because Facebook is a "profit-driven, commercial organization," it can't devalue the Diem in the way that Treasury has routinely devalued the dollar, Iran the rial, Venezuela the bolivar, etc. etc. And just to confirm for readers and to Prasad that he surely knows better, he writes on pages 34-35 that money is "an important device for saving for the future." Yes it is. Which is why "profit-driven" organizations like Facebook could have such a remarkably positive impact on the quality of money. What's profit-motivated cannot devalue, which means the fruit of our work has the potential to be protected in the future.

Notable about crypto more broadly is that more than a few libertarians have asserted that exchanges with private money would actually be kept private from government types. Prasad rejects this. He claims that anyone who using monies like Bitcoin and Ethereum "leaves a digital trail that, through their interactions with the real world in the form of purchases or sales of physical goods and services, makes it possible to link physical and digital identities." Libertarians have also said both optimistically and pessimistically that

crime will be easier with crypto (they want drug legalization, so the ease of anonymous, cashless exchange would be a positive), but Prasad views paper money as a much easier way to move substances politicians don't like, plus cash enables the movement of stolen goods in a bigger sense. Maybe so. Maybe not. Prasad seems to think digital trails left by crypto exchange will crack down on crime, but that doesn't seem realistic to this reader. Alas, Prasad finally acknowledges same with his proper assertion that "Corrupt activities will flourish so long as the benefits outweigh the costs." Yes, they will. And it's worth adding that way too much is illegal in the modern world, which is its own form of corruption.....

Prasad also finally brought clarity to the "mining" of Bitcoin. It's always caused confusion here. The "mining" is real. With supply of the coin limited to 21 million, miners can attain what's theoretically precious and limited by solving increasingly complex mathematical problems. Don't worry, you can't do this with your home computer. Which is why it's increasingly an industry in the way that gold mining is. And it's lucrative if you're skillful. Still, success is rare. In Prasad's words, "your odds of mining a bitcoin are no better than those of winning a major lottery jackpot after buying a single ticket."

Of course it's in his discussion of money that the highly interesting and informative Prasad veers most unfortunately into economic fallacy; fallacy that his own analysis rejects. Prasad would likely never do it, but he would be a much more persuasive economist if he were to shed his way-up-high buddies in the field. Sadly, it starts early. He writes on page 7 of a middle-income country like China "sending large quantities of its domestic savings to the United States and in effect helping to finance the trade deficits of a much richer economy." Oh come on! It's not as though there are marketable securities called "U.S. trade deficits" that savers around the world can buy. More realistically, the U.S. is a magnet for the world's savings, and for obvious reasons. Not only is it populated by some of the most enterprising people on earth (including countless people with Chinese origins) such that its corporations are attractive places to park one's cash, the U.S. is in many ways a 50-state wealth haven of sorts for the rest of the world. Countries don't trade. Prasad has to know this. The U.S. has "trade deficits" because it's an ideal locale for non-Americans to keep their wealth parked safely. The trade deficit line is so trite, and dare one say it given Prasad's presumed Lefty political leanings, *so Trumpian*.

As seemingly all economists claim, Prasad falls in line with the silly observation that "the gold standard limited the Fed's ability to print money that the US economy and banking system sorely needed in the 1930s, contributing to the severity of the Great Depression." That's just not serious, and you don't need to be a gold-standard proponent to scoff at what vandalizes reason. It's silly because money and credit always, always, *always* flow to

their highest use, and without regard to border. As Prasad notes in *Gaining Currency*, banking and credit limits imposed by the Chinese resulted in non-Chinese banks literally parking offshore in ships in order to liquefy Chinese economic activity. Applied to the U.S., even if it had been true that the Fed had limited so-called "money supply," the limits would have been made up for by global sources of money in rapid fashion. Still not convinced? Just read Prasad himself. Four pages after he contends that maintenance of dollar-price stability constrained the Fed in the 1930s, he writes that "Recent estimates suggest, for instance, that more than half of all US currency is held abroad." Which directly contradicts the nonsensically monolithic claims by economists that the Fed was a major player in the 1930s downturn. Actual dollar scarcity would have existed as a market summons for other currencies. The view about the 1930s misunderstands money and credit. Money and credit don't instigate as economists assume. They're in truth a consequence. Where there's intriguing economic activity, there's always money and credit. Prasad intuitively knows this from *Gaining Currency*. If economic activity in China had been un-interesting, there's no way that credit sources would have docked offshore to lend.

Conversely, there's no way to push money and credit into an economy that isn't growing. Despite this truth, in making his case for central bank digital currencies (CBDCs), Prasad writes that the proverbial "Helicopter drops" of money "would be easy to implement if all citizens in an economy had electronic wallets linked to the central bank." No, that's not true. To see why, Prasad need only consider a digital drop from the Fed into the perpetually impoverished western part of Baltimore. Prasad is surely familiar. Assuming the Fed drops millions or billions, and assuming the more unlikely scenario that the suddenly "stimulated" spend the funds with abandon where they live, it's not as though the funds would stay there. Think about it. No business is going to expand based on a helicopter drop, at which point millions or billions spent at businesses in west Baltimore, and banked by those same businesses, will exit west Baltimore with great rapidity. Money and credit go where they're treated well, and exit where they're not. Prasad knows this. Central banks cannot stimulate any more than politicians can. Investment is what stimulates, and governments cannot play investor.

Despite this, Prasad also pays lip service to central banks going negative, and that doing so "should prod consumers to spend rather than save and businesses to invest rather than conserve money." The problem here is that unspent wealth is what feeds businesses eager to expand. Consumption is the easy part. What grows an economy is savings. Entrepreneurs can't be entrepreneurs without savings, yet when access to capital is most crucial, Prasad is oddly calling for central banks to discourage capital formation.

Furthermore, his presumptions are contradicted by his good reporting elsewhere. Indeed, while he lauds the ability of central banks to allegedly "implement negative nominal interest rates simply by announcing that balances in central bank accounts will shrink at a certain rate," he makes this presumption while seemingly forgetting Prosper, LendingClub, MYbank, Lufax and countless others that operate in reality. Assuming central banks decree what market forces never would (a negative cost of capital), actual market actors will hoover up more and more of the savings repelled by central banks in a sense begging to be put out to pasture.

Basically Prasad's very informative commentary about crypto and Fintech set the stage for him to also showcase how he's spent way too much time at nice hotels with people like Barry Eichengreen and their mythical "golden fetters," and way too little time with actual people moving resources (credit) to its highest use. And this causes the author to err.

The examples of error are many as the back of this review makes plain, but the one committed most consistently throughout *The Future* is Prasad's belief that "an unbacked privately issued currency could not be assured of maintaining a stable value." Prasad can't mean this, can he? Has he seen what governments have done to money century after century? The answer is yes. Prasad is extraordinarily well informed, which means he knows the history of governments devaluing money. Despite this, he quite literally lists the private and profit-motivated as risks to stable money. The view is backwards. Completely backwards. Precisely because private money likely has a profit motivation, that's what makes it so much more ideal than what the world has today. Government money has broadly failed. Prasad knows this.

Where it grows frustrating is that in listing an alleged demerit of private issuers (their supposed inability to maintain currency stability), Prasad is properly acknowledging that the best money is money that holds its value throughout time. Looked at through the prism of gold, it didn't become money thanks to sun spots, or because the sky is blue, or randomly. More realistically, gold-defined money became the norm because money defined in terms of gold is stable. Which is what Prasad wants. Rather than acknowledge this, he claims that Bretton Woods constrained "the creation of money." Except that it didn't for many reasons, including that it's not designed to. Goodness, dollars in circulation soared 63x from the late 1700s to the early 1900s. Prasad knows all this, but to say it would get him kicked out of the economist fraternity that he's a member of. Gold as a definer of money can't and did not restrain the supply of money given the simple truth that if it did constrain supply, the value of gold-defined money money would be volatile. Except that gold-defined money is the opposite of volatile precisely because there's nothing about a gold exchange standard that limits supply.

Compare this to Bitcoin. Prasad is clear that the 21 million coin limit foretells BTC instability. Which is his unwitting way of saying that Bitcoin is what limits currency supply, not gold. Gold merely defines. Nothing else. Prasad's analysis of Bitcoin's volatility is an unwitting endorsement of gold as the money measure par excellence (Karl Marx), but for Prasad to go public with what is rather obvious would be for him to once again be tossed from the economist fraternity that he's an elite member of. Too bad.

It's too bad in many ways, but one of the biggest is that Prasad could, if he wanted to, really expand the currency discussion. He could talk about why gold was used so long. He could reject all the falsehoods that he instead furthers in his book. Rather than expand on why stable money is true money, Prasad makes a case for central bank digital currencies. Yet even here, he contradicts himself. More important, he reveals one of many reasons why central banks relentlessly in search of a purpose will fail at CBDCs. In Prasad's words, central banks could "implement negative nominal interest rates simply by announcing that balances in central bank accounts will shrink at a certain rate." Yes, they could. But private issuers couldn't. Thankfully. Which currencies will the people choose? The question answers itself.

Once again, *The Future* is a very interesting, very informative book that could be an excellent one if Prasad weren't weighed down by so much econo-speak. Alas he is. And this limits his obvious skill as a thinker.

Early in *The Future of Money*, Prasad writes that "the concept of money is complex and, in some ways, even mysterious." No it isn't. Money is simple. Producers want equal value for their production, plus they want to delay consumption (save) of some of their production. Good, stable money facilitates both. Amazon, Walmart, and yes, Facebook, could design credible, widely circulated currencies between breakfast and lunch. The good ones might – gasp – be defined in terms of gold. Prasad will obviously be a player in the future of money, but the money will only be great if he's willing to anger his fellow economists.

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