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The Future of Money

How the Digital Revolution is Transforming Currencies and Finance

Eswar Prasad
2021, Harvard University Press, 485 pages,
ISBN 9780674258440

Reviewer: Carlo Cocuzzo, Digital Finance Specialist, Italy
Reviewer: Ian Bright, Consultant

Money is a slippery concept. There are many good books that address the philosophy around and the history of money. Offhand, we can think of Eric Lonergan's "**Money**", David Birch's **trilogy** of books, and Kenneth Rogoff's "**The Curse of Cash**". All of these remain relevant and useful. However, the growing presence, relevance and importance of digital approaches to money and finance mean that any one book is likely to date quickly.

There are so many developments happening so quickly, it is difficult to keep up to date. This is one of the gaps that Eswar Prasad's book "The Future of Money" fills. It is encyclopaedic. It gives descriptions and technical details of many developments in digital currencies and digital finance without getting bogged down in detail. However, it is the subtitle of the book that outlines what the author concentrates on. The subtitle is "how the digital revolution is transforming currencies and finance". It is here that the book makes a significant contribution. It addresses many wider issues associated with digital currencies and digital finance. These issues include the potential effects on financial stability, the monetary transmission system, domestic and international payment systems, financial inclusion and inequality. It is impressive that so many topics are covered in an accessible manner.

That said, we have a few quibbles. Should we really think about the changes in finance under digital approaches as a revolution or an evolution? Finance has been changing for centuries and it is possible to think of digital approaches as another development, rather than "the overthrow of a social order in favour of a new system" as a revolution can be defined.

Part of the evolution of finance since the liberalisation of banking and finance from around the 1970s has been disintermediation. It is possible to consider developments in digital finance as an extension of this. New digital payments systems at the national level, such as Venmo or Paym, are examples of disintermediation and present, by now, well-known challenges to old style bank-to-bank payment systems. At the international level, settlement and reconciliation using blockchain approaches are challenging and changing the SWIFT system. Whether the challenges made by these new settlement systems will be sufficient to set up alternatives is discussed at length in the book. Further, will these alternative international payment systems challenge the dominance of the US dollar in international payments? Nobody knows but the issue cannot be ignored, especially for emerging market economies where national currencies may suffer from the development of private stablecoins and other CBDCs. Indeed, the book addresses these issues with clarity.

Some are concerned that digital payment systems are revolutionary because they may challenge the ability of central banks to control some aspects of the financial system. This has clearly become a major concern in China where the dominance of Alipay and WeChat has "created a parallel system that undercuts traditional banks' lucrative retail payment clearance systems."(p.86). Alipay then expanded and became Ant Group, a fully–fledged financial services company in 2014. However, the dominance of the group has concerned government and party officials and seems to be the main reason Ant Group's IPO was pulled late in 2021. The book touches only briefly this, we suspect largely because it was being written as the developments in China were taking place. Given the dominance of these companies it is not surprising that the Chinese central bank is experimenting with a Central Bank Digital Currency (CBDC) – the e-CNY – to maintain the relevance of the central bank in payment systems.

When it comes to CBDC's, it is possible that these may allow cashless societies to become more entrenched everywhere. This opens the possibility of more flexibility in monetary policy by making it easier, if necessary, to have negative interest rates and run helicopter money drops. To demonstrate the limitations that exist with sending money to people in the current US monetary system, it is noted that in the US about thirty million eligible Americans had not received their stimulus money of up to $1200 per individual from Economic Impact Payment by early June 2020 during the Covid pandemic. “Low-income households, especially those whose incomes were below tax-filing thresholds in the previous two years, suffered the most.” (p. 208)

It is for these and other reasons that Prasad writes “Some central banks seem to view the introduction of a retail CBDC as an important tool for maintaining control over financial markets by retaining a role for themselves in the creation of money. Indeed, if central bank retail money is to preserve its relevance, the need to switch to a CBDC seems like a foregone conclusion.” The case, and perhaps need, for retail CBDCs may be more in some emerging market economies. Prasad continues “In many emerging market economies, the challenges associated with keeping cash available come not just from electronic payment systems but also from foreign currencies that compete directly with their own currency – the availability of foreign currencies in digital form could hasten the switch away from the use of domestic cash”. (p. 274). But Prasad also later notes that such a move is not a silver bullet. “Merely switching to a digital version of a fiat currency with no changes in underlying policies will scarcely increase that currency’s traction as a form of payment and store of value. A CBDC, if designed and managed well, can improve economic and financial outcomes but is hardly a panacea for a nation’s deep-seated economic ills.” (p. 353).

Prasad is aware of and writes eloquently about the legal, privacy and societal issues that CBDCs present. Arguably these issues are underplayed. There is little discussion of how society should be asked to address these issues. Here, we are likely being too picky. However, when it comes to the implications of CBDCs for the deposit-taking operations and profitability of retail banks, Prasad is probably too accepting that procedures could be defined so that this was not threatened. The joint reviewers of this book have differing opinions on the extent of the threat. One considers the threat almost existential for standard retail banking operations. After all, why would many people need or want a private sector bank account for transactions purposes if a government backed system that did a similar job was available? The other argues that central banks would not want to introduce CBDCs in a way that threatened financial stability or which dragged them into becoming a key part of the payments system. These are outside the mandates of central banks. That reviewer argues the threat from private (single and multi-currency) stablecoins from large groups such as Facebook/potentially Amazon is much more real, especially in emerging market economies where the payment system is still underdeveloped and less efficient. These big tech platforms have finely-tuned, customer interfaces and a massive amount of data. As a result, all the key ingredients to potentially disrupt the banks' business model in the digital age are available. However, it is easy to imagine that if big-tech firms were to start doing semi-banking activity then policymakers and regulators will eventually require these firms to comply with banking regulation. No matter which way the threat is assessed, no bank can afford to turn a blind eye to the developments around them.

There are many other topics covered in this excellent book that could be covered in this review. We have deliberately been selective in our comments. Prasad is clearly sceptical of the more ebullient claims of crypto promoters, pointing to many times where fraud has happened, privacy has been broken, chains broken in authentication and capacity of the digital payment systems have been overwhelmed. The author goes even further and argues that decentralised finance will not eliminate the need for government, which will retain the role of ensuring property rights and financial stability.

Prasad is also a realist. He recognises that digital currencies and digital approaches to finance cannot be ignored. They will be developed and central banks will play a critical role. For an overview of the current discussion of CBDC's in the UK (popularly dubbed "Britcoin"), this Bank of England page is worth bookmarking. We recommend buying this book. You will use it.

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