CENTRAL BANKING

Book notes: The future of money, by Eswar S Prasad

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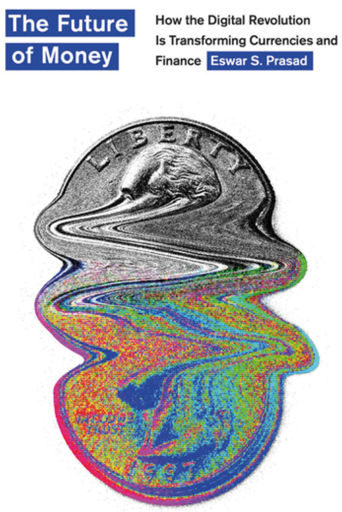

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Eswar S Prasad: **The future of money: how the digital revolution is transforming currencies and finance**, Harvard University Press, 2021, 496 pages

Over the past years, I have read countless blogs, articles and books on the future of money. I found most of them disappointing reads. Experts in technology typically reveal a significant ignorance of the role of money in financial markets and the economy. The contributions written by monetary experts usually lack the necessary expertise in technology and existing payment schemes. Against this background, my hopes were high for Eswar Prasad’s book. Would the experienced and well-versed economics professor from Cornell University be the one who is able to provide the big picture on the future of money? I was not disappointed. Prasad’s book is the best on the topic so far. In particular, it provides the most complete description of issues and factors that will shape the future of money. Everyone with limited time wanting to have a deeper understanding of money in the 21st century, should read this book.

Prasad starts with a detailed description of how the financial system works. Arguably, this is the most important and innovative part of the book. He appropriately refers to these sections as “laying the bedrock”. In a comprehensive way he describes the interplay between public money (issued by central banks; so-called ‘outside money’) and private money (issued by commercial banks; so called ‘inside money’). Private money is denominated in the same unit of account (the currency) as central bank money. This setup is essential for the development of financial markets and the economy. Clearly, the one-to-one peg between private and public money is not something that is given by nature. It is the result of stringent regulatory requirements for commercial banks as well as government orchestrated deposit insurance. While the current design of the monetary system has many advantages, it also has some deficiencies. Inflation may reduce the property of money as a store of value. Insolvencies of commercial banks may lower the value of bank deposits. The description of the main elements of the current global payment system is also accurate, including a timely account on the importance of Swift in financial messaging.

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A prominent part of the book is dedicated to cryptocurrencies, in particular bitcoin. Like others before him, Prasad states that “the blockchain technology that underpins bitcoin … will have a transformative effect”. A particular benefit is that “no single agent in the system has a privileged role in validating or verifying transactions”. But still he concludes that bitcoin “has ultimately faltered when measured against the objectives its creator had set out for it” (page 129). Bitcoin’s volatile value makes it a “crummy medium of exchange”. Bitcoin is “patently ineffective as a medium of exchange”. And, “decentralised unbacked cryptocurrencies are unlikely to serve as viable long-term stores of value”.

The book then moves on to the description of new forms of money that maintain a stable value vis-à-vis fiat currency. When issued by the private sector, the most common form are so-called stablecoins. Stablecoins have many of the same properties as bank deposits. Prasad keeps the discussion on stablecoins relatively short.

The public sector version of stablecoins is usually referred to as central bank digital currencies (CBDCs). An easy way to think about CBDC is that it is a digital version of a banknote or coin. In recent years, central banks have devoted a great deal of effort on questions related to a possible introduction of CBDC. What would be the benefit to society? What would be the impact of CBDC on monetary and financial stability? Would a CBDC support financial inclusion? Would it lead to a disintermediation of banks and credit markets? Again, Prasad lists all the relevant factors to be considered. Implicitly, the reader gets the impression the author is expecting a widespread launch of CBCDs in the coming years, and that he would welcome such a development.

Despite all the praise, the book has, however, one major weakness. It doesn’t devote nearly enough space to the role of regulation in shaping the future of money. What we use as money is not just a combination of technology, economics and policy decisions by central banks. A key factor is how money issuance and the transfer of money are regulated. What societies use as money depends crucially on what the government and legislator allow to be money. As the financial system and its actors are highly regulated, so is the issuance and transfer of money. Blockchain and decentralisation are not going to change this.

An illustrative example is the failed Libra/Diem cryptocurrency scheme that was proposed by Facebook/Meta with big fanfare in June 2019. The original plan was to launch the global currency within less than a year. As we know, the Libra/Diem never went live. The project was wound down in early 2022. Its promoters concluded that it “became clear from our dialogue with federal regulators that the project could not move ahead”.