Transcript of IMF podcast:

Eswar Prasad on the Future of Money

Eswar Prasad:

So, I think we are moving to a world where we can realize many of the benefits of Central Bank Digital Currencies without having too many risks, but I'll leave you with one final risk, which is an important one.

Bruce Edwards:

Welcome to this podcast produced by the International Monetary Fund. In this episode, how technology is transforming the nature of money and how it's affecting our lives.

Eswar Prasad:

Right now, if we use cash to buy a cup of coffee, there is no digital trace of that transaction. If we move to a world where the only payment options available are private sector-provided digital payments or Central Bank Digital Currencies, we might move to a world where any notion of privacy and confidentiality in financial transactions becomes lost.

Eswar Prasad:

I'm Eswar Prasad, a professor of Economics and Trade Policy at Cornell University and a senior fellow at the Brookings Institution, and also a former IMF staffer.

Bruce Edwards:

In his latest book, The Future of Money, Prasad describes how digital currencies and other financial technologies are reshaping the financial world. Finance and Development's, Chris Wellisz sat down with Eswar Prasad to talk about his book.

Chris Wellisz:

I'm thinking about the title, and I wonder if the future of money hasn't already arrived. Your book describes some innovative methods of payments, such as M-Pesa in Kenya, Alipay in China, Venmo in the US. I can't even remember the last time I used old-fashioned cash to buy myself a cup of coffee. So, is cash destined to simply wither away? And how close are we to the moment when that happens?

Eswar Prasad:

The convenience of digital payments to both consumers and businesses makes it highly unlikely that cash will survive much longer, even in economies where it is still used to a significant

The convenience of digital payments to both consumers and businesses makes it highly unlikely that cash will survive much longer, even in economies where it is still used to a significant extent. In a country like China, there are two private payment providers, Alipay, and WeChat Pay that have blanketed the entire Chinese economy with very low cost digital payments. So you can use those for something as simple as buying say, piece of fruit or a couple of dumplings from a street vendor. And those payments are cost effective enough for both the consumer and the merchant to prefer using those payment technologies. In advanced economies like Sweden, the private sector is doing an equally good job of providing very low cost digital payments. So, the question is why bother with central bank money at all?

Chris Wellisz:

What about cryptocurrencies? We've seen how volatile cryptocurrency can be? Is it likely that cryptocurrencies like Bitcoin will be used in everyday transactions?

Eswar Prasad:

Bitcoin has not worked very well as a medium of exchange that can be used for day to day transactions. One main reason is that Bitcoin is very unstable value. So it, as though you took a Bitcoin in with you to a coffee shop and one day you could buy a whole meal with it and on another day just get a small cup of coffee. So, something that has such volatile values are unlikely to work well as a medium of exchange. But in addition, Bitcoin is somewhat slow, cumbersome to use. So, it's really not worked well in its stated purpose, but Bitcoin is really set off a revolution, I think. And there are other cryptocurrencies that have come along that have improved upon Bitcoin in many respects.

Chris Wellisz:

Is there a solution to the problem of volatility?

Eswar Prasad:

So, there are new cryptocurrencies called stablecoins that get their stable value essentially by being backed up by stores of fiat currencies, such as US dollars or euros. So, they basically become linked to the value of those currencies and they can then be used to make both domestic payments and also payments across national borders more effectively and efficiently.

Chris Wellisz:

You explain in your book how stablecoins may not be as stable as they seen. What risks do they pose?

Eswar Prasad:

Now, stablecoins are new financial products. And it is not clear who exactly would regulate them. There are concerns that we don't really know what sort of collateral these stablecoins will be backed up by, in other words, a stablecoin issuer might say that they are going to hold stocks of liquid securities, but who is going to make sure they do in fact, hold the securities. Even if they did hold the securities, it's possible that if a lot of people try to redeem those stablecoins and convert them back into fiat currencies, all at the same time, many of those securities that are supposed to back up these stablecoins might turn out not to be as liquid, that is, as easy to convert into fiat currencies as one might expect. So, they could become sources of financial instability in themselves.

Chris Wellisz:

Are there other risks?

Eswar Prasad:

There are concerns that stablecoins, unless they are closely regulated, might become conduits for illicit financing of various sorts of activities, both within and across national borders. So, this is a very disconcerting prospect for regulators around the world. And the additional difficulty of

illicit financing of various sorts of activities, both within and across national borders. So, this is a very disconcerting prospect for regulators around the world. And the additional difficulty of course, is that cryptocurrencies including Bitcoin, know no borders. So, for a country by itself to effectively regulate these cryptocurrencies is going to be hard. We'll have to undertake some sort of global coordination in terms of these regulatory policies.

Chris Wellisz:

So, that makes me wonder what all this means for central banks. Some central banks are considering the introduction of so-called Central Bank Digital Currencies. What's the rationale?

Eswar Prasad:

So, it turns out that there are a good set of reasons why central banks are contemplating issuing digital versions of their currencies, essentially Central Bank Digital Currencies, or CBDCs. For some developing countries, the objective is that of broadening financial inclusion. There are many people in those countries who don't have access to digital payments. They don't have access to basic banking products and services. So, a CBDC can be seen as a way of bringing more people into the financial net, being able to give them access to these low cost digital payments and perhaps to use CBDCs as a portal for providing even basic banking products and services, say for savings and credit. In countries like Sweden, where most people do have access to bank accounts, the imperative is a little different. The Swedish Central Bank, the Riksbank, envisions the E-krona or the digital krona, as essentially a backstop to the private payment system.

Chris Wellisz:

How about China?

Eswar Prasad:

So, in a country like China, there is a different set of motivations at play. The Chinese government is very concerned about two payment providers that have come to dominate the payment system that are blocking effectively the entry of new competitors who could provide new innovations and the government is also concerned that these two payment providers are gathering up data on people who use their payment platforms and using it for commercial purposes. So, the Chinese Central Bank views a digital yuan as essentially a compliment to the existing payment systems, but one that could in principle increase the amount of competition.

Chris Wellisz:

So, let's assume that a central bank like the People's Bank of China or the Riksbank in Sweden does adopt a Central Bank Digital Currency. How does that affect their basic functions, namely to control inflation and ensure the economy is running at full employment?

Eswar Prasad:

If you think about each of us being able to have, effectively, an account with our own central banks, let's say all American citizens had an account with the Federal Reserve, then it would become a lot easier the Fed to undertake certain operations, such as stimulus payments. When the coronavirus pandemic hit, the initial coronavirus stimulus bill involved a large amount of money being transferred to American households below a certain income level. Now, many households that had direct deposit information on file with the internal revenue service were able to get direct deposits to their bank accounts, but households that did not have their information on file with the IRS, ended up getting prepaid debit cards, cheques, many of which were lost in the mail, some of which were misappropriated, mutilated.

Chris Wellisz:

And could Central Bank Digital Currencies be used to fight tax evasion and other crimes?

Eswar Prasad:

Eswar Prasad:

So, Central Bank Digital Currencies like most innovations have many benefits, but also some potential disadvantages. The benefits include the fact that any digital form of payment makes it difficult to disguise those payments. So, you would bring a lot more economic activity out of the shadows and into the tax net. In other words, if you cannot use cash to pay your gardener or your babysitter, it's much more likely that those payments will get reported to the government and especially for large value transactions, that will certainly make a difference in terms of tax revenues. Having digital money also reduces the use of cash for illicit transactions, say for fueling drug trafficking or money laundering or activities of that sort, it potentially reduces problems with counterfeiting of paper currency notes, and it could also have a deterrent effect on at least petty corruption.

Chris Wellisz:

Are there risks for private sector banks and payment providers?

Eswar Prasad:

Now, if the government is in effect providing a very low cost digital payment system, that might make it very difficult for private payment providers to continue providing their services because after all, what private corporation can compete with the deep pockets of the government. There is another risk, which is the commercial banks, which are very important in modern economies in terms of providing credits that fuels economic activity. They might find that their deposits are being swept away into central bank accounts. In troubled times, depositors might feel that ultimately their deposits are going to be safer with the central bank or other government institutions compared to a commercial bank even if the commercial banks deposits are insured.

Chris Wellisz:

Is there a solution to that problem?

Eswar Prasad:

The experiments with CBDCs that are underway in China and Sweden are suggesting that what might work more efficiently is a dual-tier system of CBDCs. What this basically means is that the central bank would provide the underlying payment infrastructure and provide the CBDCs essentially in the form of digital tokens, but the actual digital wallets in which those CBDCs are maintained, will be maintained by the commercial banks. So, just like commercial banks get cash from the central bank and distributed to their consumers and businesses for their clients, the commercial banks would essentially be distributing CBDCs to their customers.

Eswar Prasad:

So, I think we are moving to a world where we can realize many of the benefits of CBDCs without having too many risks, but I'll leave you with one final risk, which is an important one. Right now, if we use cash to buy a cup of coffee, there is no digital trace of that transaction. If we move to a world where the only payment options we have available are private sector-provided digital payments or Central Bank Digital Currencies, then every transaction ultimately might leave a digital trace. So, we might move to a world where any notion of privacy and confidentiality in financial transactions becomes lost.

Chris Wellisz:

What are the challenges facing emerging market and developing economies, which depend heavily on cross border trade and investment?

Eswar Prasad:

So, international payments are beset by enormous inefficiencies right now. They are very slow to execute. They are quite expensive, and they're difficult to track in real time. And this acts as an impediment for international trade for financial flows. And even if you think about economic migrants sending remittances back to their home countries, and that's a fairly important source of

execute. They are quite expensive, and they're difficult to track in real time. And this acts as an impediment for international trade for financial flows. And even if you think about economic migrants sending remittances back to their home countries, and that's a fairly important source of revenue for many developing countries, then having friction free international payments, could certainly benefit importers and exporters. It could benefit migrants and overall have beneficial effects for emerging market economies that rely on remittance flows, but also other types of financial flows. It could make it easier for them to conduct international trade transactions, but there are some risks as well. The more conduits you have for the international flow of capital, the harder it'll be to manage those capital flows. And that could lead not just to more capital flow volatility, but also to more exchange rate volatility and for small economies, developing economies in particular, capital flow volatility and exchange rate volatility can make the management of domestic economic policies that much more challenging.

Chris Wellisz:

And what are the challenges for central banks in emerging markets?

Eswar Prasad:

We are soon going to be moving to a world where we will have access to digital versions of the dollar, of the Chinese renminbi, and many of the other major currencies. It is also likely that many mega corporations with worldwide reach such as Facebook, Amazon could start issuing their own stablecoins. And these privately issued stablecoins, as well as the large official currencies that are available in digital form, could start being used in other parts of the world as well. So, if you think about small economies or economies that have central banks or currencies that are not very credible, one can very easily see those currencies being swept away by these other currencies, either official or private that citizens of these countries trust a lot more than their own currencies.

Chris Wellisz:

Now, what about the dominant position of the dollar in trade and financial flows across borders? Do you see a digital yuan threatening the dollars as a global currency by virtue of China's status as a fast growing world economy?

Eswar Prasad:

In my view, even if the digitalization of the yuan does marginally increase the renminbi's role as a payment currency, it's not going to have a transformative effect because, after all, virtually all international payments are already digital. It's just that in certain countries that are relatively small, where their domestic currencies are not well trusted, traders and even domestic citizens for their own purposes might find the yuan a useful currency for their day to day transactions, both domestically and in terms of trade with China. So, the dollar's role as a payment currency could be reduced, but I think it will still remain by far the most important currency in that dimension. As a store of value, there is a lot more at play, it's not just the economic size or the size of the financial markets of a country issuing a particular currency, but also the institutional framework in that country that maintains the trust of foreign investors.

Eswar Prasad:

And these elements of trust include the rule of law and independent central bank and an institutionalized system of checks and balances. In all these dimensions, I think the US still retains dominance relative to much of the rest of the world. So, I don't see the dollar being seriously challenged in its role as a store of value, that is as a global reserve currency, although certainly the increasing presence of currencies such as the renminbi on the world stage could marginally increase the relevance of those currencies, even as reserve currencies. So, the dollar's position might become somewhat eroded, but it's still going to remain by far the most important reserve currency.

Chris Wellisz:

Does all that explain why the federal reserve has been so slow off the blocks when it comes to thinking about a Central Bank Digital Currency?

Does all that explain why the federal reserve has been so slow off the blocks when it comes to thinking about a Central Bank Digital Currency?

Eswar Prasad:

The Fed like many other central banks is very conservative and cautious. And in the US, there is a sense that there is a less compelling case to be made for a CBDC. So, as one goes country by country, one needs to think about what the user case really is for a CBDC in each country and in the US, certainly we have certain issues with our payment systems. A lot of payments are intermediated through credit cards, which are actually quite expensive for merchants to use because of the very high interchange fees. And many of those costs are passed on to customers. About 5% of households in the US are still unbanked or underbanked. So, you and I can use Apple Pay, but to use Apple Pay, we need to have that linked to a bank account or a credit card and many households simply don't have access to that.

Eswar Prasad:

So, a CBDC might at the margin increase financial inclusion, but the Fed already has a major project underway called FedNow to increase the efficiency of both retail payments, as well as wholesale payments, that is payments among businesses and financial institutions. So, those increases in efficiency might reduce the need for a CBDC. Besides the Fed seems to have realized that there is no real first mover advantage here. I spoke about China, Japan and Sweden moving forward more aggressively with CBDC experiments, and perhaps they'll be able to issue nationwide CBDCs more quickly. But I don't think being a late mover is going to be a huge disadvantage. In fact, there might be many advantages to learning lessons from the experiments being conducted by other countries about how best to undertake both the technical and conceptual design of a CBDC. So, you can garner many of the benefits while tamping down the risks.

Chris Wellisz:

Now, the Fed jealously reserves its independence, and that's completely understandable because it wants to conduct an independent foreign policy without interference from the day to day concerns of politicians who seek to get elected every couple of years. Is there a risk there for the Federal Reserve in particular and even other central banks that adopting a Central Bank Digital Currency could somehow inject them into the realm of fiscal policy and open up to interference from the political power structure?

Eswar Prasad:

A central bank, even an independent central bank, has its autonomy hanging by a threat. And ultimately when a central bank starts losing legitimacy, it stops being seen as credible or effective. And that can happen not just if the central bank undertakes policies that are not helpful to the economy or to nations people, but also if it is seen as an arm of the government, the independence of central banks in terms of their ability to manage monetary policy has really been at the heart of their effectiveness. So, if a central bank feels that by providing a digital form of its currency, it can maintain its ability to provide a safe and reliable payment instrument, it's one thing. But digital money opens up a range of other possibilities certainly if we start seeing CBDC accounts being used to undertake what is essentially fiscal policy that is providing direct cash transfers to households in an economy, then the central bank might be seen as losing some of its independence.

Eswar Prasad:

But more importantly, there are other elements of digital money that could come into play. There was some talk when the coronavirus stimulus payments were being sent out in the US that it would be useful to have expiry dates on that money. Because otherwise, people rather than going out and spending that money and thereby stimulating the economy, might end up saving that money. If they had digital money, especially money that had certain programmable aspects to it, which is certainly quite feasible given existing technologies, you could have central bank money that had expiry dates. More broadly and in a somewhat more dystopian world, you could see an

which is certainly quite feasible given existing technologies, you could have central bank money that had expiry dates. More broadly and in a somewhat more dystopian world, you could see an authoritarian government using a digital version of its central bank money, essentially to surveil its population in a much more intrusive way. And even a benevolent government might decide that it wants to make sure that the money that it's central bank issues is not only not used for illicit purposes, but it's also not used for purposes that it might regard as not necessarily socially beneficial.

Eswar Prasad:

So, you might very well start seeing money being used as an instrument, not just of economic policy, but potentially even social policy. That would be really dangerous for the credibility of central bank money and for central banks themselves.

Chris Wellisz:

Well, thank you, Eswar. That was a fascinating conversation and it was great to talk to you. And I really enjoyed reading your book.

Eswar Prasad:

It's been my pleasure, Chris. I really enjoyed a conversation as well. Thank you.

Bruce Edwards:

That was Cornell University professor, Eswar Prasad talking about his new book, The Future of Money with F&D's, Chris Wellisz. You can find all kinds of exclusive F&D articles and interviews like this one at imf.org/fandd and look for other IMF podcasts, wherever you get your podcasts. You can also follow us on Twitter, @imf_podcast. I'm Bruce Edwards. Thanks for listening.

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