# THE MONEY DIALOGUES

**Tommaso Mancini-Griffoli**

Three friends consider the meaning of money, innovation, and stability

JULIAN ELLIOTT PHOTOGRAPHY/GETTY IMAGES

*Imagine three friends meeting in the Roman forum. One is optimistic about technology, one skeptical, and one is after the bigger picture. They start debating the role of money shaped by innovations such as stablecoins, tokenized deposits, central bank digital currency (CBDC), and digital financial infrastructure. In a world laced with uncertainty, dialogue is paramount. Let's listen in.*

*Optimus*: Skeptimus, I just discovered an amazing new way to pay for things. From my phone, I can transfer money to anyone in the world. It's instant, cheap, and easy. To receive funds, just print a QR code or share a number. Even merchants can sign up. It's called a stablecoin.

*Skeptimus*: Oh, Optimus, there you go again. It's just another money-transfer app.

*Optimus:* No, no, no. You can also hold a balance in stablecoins. You don't need a separate bank account. The stablecoin *is* the bank.

*Skeptimus:* It's not a bank! Banks have vaults, they have offices, they insure deposits, they...

*Optimus:* OK, you're right, it's not a bank. But for good reason. Banks offer package deals. They issue money—our deposits. At the front end, they onboard customers and merchants, and build e-banking apps. At the back end, they run databases to track our money, message other banks to transfer funds, and offer services like fraud detection. Full service.

*Skeptimus:* So? I like my bank. I like paying by card. And banks are exploring tokenized deposits.

*Optimus:* Right, millions are like you. Stablecoin companies are a little different. They focus on providing a payment instrument—denominated in dollars, euros, yen, and potentially other currencies. They mostly leave front- and back-end services to others. Stablecoins are recorded and transferred on blockchains. And separate digital wallet providers take on customers and build apps. That frees up each firm in the chain to be more innovative. Of course, banks and asset managers are no bystanders. They too are exploring ways to make their deposits and other assets available on blockchains.

*Skeptimus:* What about fraud detection and ensuring transactions don't fund terrorists?

Previous page: The Temple of Saturn in the Roman Forum.

*Optimus:* That is clearly defined in the laws and regulations of each country. Depending on the specific regulations, various financial companies, including stablecoin providers, are required to "know their customer" and check for money laundering and criminal activity.

*Skeptimus:* OK, but what's in it for users?

*Optimus:* Stablecoin companies have racked up millions of users globally, transacting across borders around the clock at fairly low cost, and they can scale up. That was barely possible even five years ago.

*Skeptimus:* I see the creative energy, the growth potential, the extra competition—it's all good. Still, stablecoins remain small. They're mostly used to buy crypto assets like Bitcoin—they're the payment instruments of the blockchain world.

*Optimus:* True, but they could be used in retail payments if integrated into popular phone apps. They could be used for e-commerce, for cross-border transactions, to buy securities on blockchains. Money market funds and asset managers are starting to offer investment products, like exchange traded funds, on blockchains. And banks are exploring ways to make their deposits transferable on the same infrastructure.

*Skeptimus:* But are stablecoins safe?

*Optimus:* Well, the value of stablecoins fluctuates with the value of the assets held by the issuer as reserves. And that has motivated policymakers to phase in laws and regulations to make stablecoins safer.

## Stability

*Skeptimus:* That's a good start, but just the first step. Is regulation sound? Will supervision be strict? Will enforcement curb dubious activity?

*Optimus:* Why not? Stablecoin companies want to be regulated and trusted.

*Skeptimus:* Not all. Some may try to appeal to bad actors by offering anonymity.

*Optimus:* Those shouldn't even be allowed to issue. They wouldn't meet regulatory requirements.

*Skeptimus:* Ah, but will users be able to distinguish stablecoins targeting a fixed value in, say, dollars or euros from those intended to represent riskier assets? The second type should certainly not be considered money—whether most people would

accept the first as money "no questions asked" is also debatable.

*Optimus:* Skeptimus, you underestimate my ability to tell good from bad!

*Skeptimus:* Sorry, don't take it wrong. Still, even for you, I see a risk. There have always been runs on private money. As you said earlier, the more stable the reserve assets, the more stable the stablecoins. Treasury bills are good backing assets. But even their prices vary as interest rates move. When prices decrease too much, users might run from stablecoins—especially if they question the exact assets being held.

*Optimus:* Even bank deposits are risky, as not all of them are insured. And stablecoin issuers can hold extra capital as a backup. Or what about holding even safer and more liquid assets, like central bank reserves?

*Skeptimus:* Yes, that would be safer. But central banks may not want to be involved, or to immobilize their reserves.

## Currency risks

*Vastus:* Friends, sit down and cast your eyes on the horizon. I see two more risks. Even if stablecoins are safe and convenient—as you say, Optimus—citizens of countries with high inflation, weak currencies, or poor payment systems will jump on them. Finally, an accessible dollar. Individually, people may be better off. Collectively, they could drain deposits from their banks and undermine the ability of their central bank to conduct monetary policy and stabilize the financial system. What's the point of setting interest rates on a currency no one uses? Will stablecoins spell the end of weaker currencies?

*Optimus:* You're right, that is a problem. Then again, countries could require stablecoins to be held in domestically regulated wallets with limits on holdings.

*Skeptimus:* Easier said than done. People can hide their computer's location; enforcement is hard in a borderless market.

*Optimus:* True, but technology is both cat and mouse, Skeptimus. It could help enforce, not just avoid, limits. Of course, stablecoin issuers would need to cooperate with country authorities.

*Vastus:* Another risk is fragmentation—the difficulty of exchanging one stablecoin for another form of money or with another stablecoin. Say you hold Stablecoin A, Optimus, and Skeptimus holds Stablecoin B. Optimus, how do you pay Skeptimus?

*Optimus:* Click and go...

*Vastus:* Not so easy. Skeptimus doesn't trust coin A. He only wants B. And you can't just convert A to B, as A may be backed by a different pool of assets—perhaps because it's regulated differently in another country. Or suppose A is recorded on one blockchain and B on another, and the two are not compatible. There are solutions, but they're clunky and costly. Or perhaps you convince Skeptimus to hold coin A after all. But then you have an antitrust problem—everyone holding the same coin.

## Central bank reserves

*Optimus:* Banks solved this problem long ago. Each holds some central bank reserves—a common, safe asset—and when one pays the other it transfers reserves over the central bank's payment system. Why can't stablecoins do the same?

*Vastus:* In that case, we're coming back full circle to central bank digital currency. If central bank reserves were available to stablecoin issuers within the day, just for payments, they could ensure interoperability, as Optimus says. Maybe in exchange for some additional oversight by the central bank. Fully backing stablecoins with reserves is a different possibility. It's but a small step away from fully exchanging stablecoins for CBDC.

*Optimus:* What? You'd do away with all the innovation and customer connections that stablecoin companies have built?

*Vastus:* Not quite. Keep the talent, the innovation, the new services. Just do away with the creation of money. Leave that to central banks, which know how to do it safely. But allow private firms to invent ways to distribute the money, to transact efficiently, to build financial services. Instead of obsessing about *the* killer application for CBDC, and putting that on the shoulders of central banks, give wings to the private sector to innovate—safely and passionately. It's a different approach—CBDC built for integration and innovation.

*Optimus:* That's my kind of optimism!

*Skeptimus:* It won't work. Without a balance sheet, or revenue from holding assets like Treasuries, stablecoin companies will close.

*Optimus:* Not necessarily. They're already rebating most of their revenue to users through incentives, and competition will augment that. Plus, they'd need to find other revenue sources when Treasury yields approach zero in downturns. They'll figure it out. And central banks could provide incentives to foster innovation.

*Skeptimus:* To grease the wheels of private firms, you mean...

## The money road

*Vastus:* Now, now—we're just speculating. Money doesn't exist in a vacuum; except for cash, it is recorded on ledgers, the roads on which money travels. Roads have held together empires! Infrastructure matters.

*Optimus:* Blockchains are the new roads, Vastus. They are the ledgers on which stablecoins are recorded and transacted. And they can also record securities—any asset, really. When money and securities are on the same blockchain, you can pay for a security at exactly the time you receive it, lowering risks of remaining without either. It's also easier to automate, you can trade around the clock and across borders, and you don't need so many costly intermediaries.

*Vastus:* That assumes proper legal and regulatory foundations, which are still being hashed out. Hopefully these will be consistent across countries.

*Skeptimus:* The real risk is concentration. If a single blockchain offers so many advantages, will we end up with a massive national or regional blockchain recording all assets? Would a dominant stablecoin favor one blockchain, then impose its standards on everyone else?

*Optimus:* Stablecoins are independent of infrastructure. But plans may change. The same stablecoin can be reissued on different blockchains.

*Skeptimus:* That may be the future, though jumping chains is expensive and risky. That's where cybercriminals lurk. Then again, stablecoins aside, competition among blockchains is healthy, and diversity helps. One chain may be better for privacy, another for programmability, and a third for speed.

*Vastus:* The trick is compatibility. Code written for one chain—to establish ownership, swap assets, or check identities—should run on another chain. Compatibility alleviates the problems of concentration and fragmentation.

*Skeptimus:* Maybe there's a role for the public sector: to vet the stability and compatibility of blockchains and contracts written for them?

*Optimus:* Actually, I'd go one step further. If central bank money is needed on-chain to settle transactions for everyone's peace of mind, then central banks can be a catalyst for one blockchain standard over another. Everyone will want to be compatible with the central bank. Meanwhile, innovation can still happen on external, yet compatible, chains.

*Skeptimus:* Easier said than done. But that's the direction some central banks are exploring. Things are moving fast.

*Optimus:* Here's another idea, perhaps far-fetched, to avoid the downsides of concentration but still have a single, or few, blockchains and sufficient innovation: open-source code and decentralized ownership. Thousands of programmers innovating and proposing new features, and thousands of computers running the blockchain. No single entity in control but still seamless exchange of assets. And no one has to pay billions to develop their own blockchain.

*Skeptimus:* I would never hold an asset on a blockchain without a customer service number to call. Forget it. And what arrangements govern a decentralized community, even if well intentioned?

*Optimus:* Governance is an issue, so is privacy, but solutions are emerging. We must think differently. The phone number will be that of your wallet, of your broker, or the asset issuer. They could control the assets and take responsibility. Transaction rules could be hard-coded into the asset itself and automatically enforced. That way everyone could potentially transact; whether they're allowed to is another story.

*Vastus:* Optimus, you force us to look ahead. But perhaps too far, or too fast. We're talking about personal wealth, financial stability, institutional credibility. We may eventually get to where you gaze, or elsewhere. Do me a favor, walk hand in hand with Skeptimus. Together, you'll find the right pace and course of change.

*Skeptimus:* Wise words, Vastus.

*Optimus:* And yet, we must move... F&D

**TOMMASO MANCINI-GRIFFOLI** *is a division chief in the IMF's Monetary and Capital Markets Department.*