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Can We Trust What's Happening to Money?

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I felt two unexpected emotions — pity and guilt — one day recently while I was packing loose pennies, nickels, dimes and quarters into paper rolls to take to the bank. Coins, which were a big part of my childhood, have come to seem like inconvenient relics, as anachronistic as my grandfather's stamp collection.

All over the world, people are abandoning old forms of money and adopting new ones, like cryptocurrency, faster than our brains and customs can process.

"We are at an interesting juncture," Eswar Prasad, a Cornell University economist, told me. "It is a period of a great degree of concern about what happens to traditional forms of money and whether these technological developments we see around us are going to benefit us in some way or just create more disruption and turmoil."

In much of Europe and East Asia you can go for weeks without touching paper money or coins. In 2013, a bank robber in Sweden was thwarted because the bank he targeted didn't have any money to steal — the branch was a "cashless" location. Five years later, Cecilia Skingsley, then deputy governor of the Sveriges Riksbank, the central bank of Sweden, told The Financial Times, "If you extrapolate current trends, the last note will have been handed back to the Riksbank by 2030."

The trend is the same, though not as advanced, in the United States. The share of Americans preferring to pay with cash fell to 18 percent in 2020 from 27 percent in 2016, according to a Federal Reserve survey, a trend accelerated by the pandemic. Americans aged 25 to 34 are less than half as likely to use cash as those 65 and older.

Last year, the New York City Council had to pass a bill requiring that food and retail establishments accept cash or face a $1,000 fine, in order to make sure people who don't have credit or debit cards — people who are more likely to be poor, elderly or homeless — could continue to shop. There are similar rules in Philadelphia, San Francisco, Massachusetts and New Jersey. It's a bad sign for a means of payment when the government has to force people to accept it.

Dollar bills remain in favor mainly in countries with underdeveloped financial systems and shaky currencies, where American cash is a store of value. There are now more dollars circulating outside the United States than in it. Criminal enterprises also like to do business in large-denomination bills because they're harder to trace than money in, say, checking accounts.

According to the Federal Reserve Bank of San Francisco, there have been more $100 bills than $1 bills in circulation worldwide since 2017.

The demise of cash isn't the only development causing concern among economists. Most of the money we use today is issued by banks, not the government. When you pay with a credit card, a debit card or electronic funds transfer, the institution standing behind the transaction is a bank. In that sense, a virtual dollar in a checking account at your bank is fundamentally different from a dollar bill or four quarters in your fist.

The next stage in the evolution of money will be the rise of non-bank money, including cryptocurrencies, which are encrypted virtual currencies that exist in online ledgers. But the evolution could be rocky. In the United States, credit and debit cards are deeply entrenched. Bitcoin and other volatile cryptocurrencies, while popular as speculative investments, by and large aren't useful for everyday transactions, making them more akin to financial assets than to money.

Some economists believe there is a risk that we'll some day find ourselves with nothing that is universally accepted as a medium of exchange. Even government-issued money, they fear, could someday fall under suspicion. Monetary systems depend on "a leap of faith," the economist and law professor Neil Buchanan wrote in a 2013 blog post. People accept it because others accept it, making money one big "group delusion," he wrote.

"Delusion" is a strong word, but Professor Buchanan is right that money is useful because other people find it useful. What frightens him is that something could make ordinary Americans start focusing on this inherent fragility. He's worried about an idea that has been kicking around on the internet for a decade: that a U.S. president could try to evade Congress's ceiling on the size of the national debt by minting a single platinum coin with a face value of $1 trillion and depositing the would-be money at the Federal Reserve. Professor Buchanan wrote in 2013 that issuing such a coin would expose "the entirely ephemeral nature of money and finance itself."

The trillion-dollar coin gimmick is popular among adherents of Modern Monetary Theory, which says that government budget deficits don't matter unless they cause the economy to overheat from excessive demand, producing inflation. M.M.T. is quietly gaining currency in Washington. Stephanie Kelton, an economist at Stony Brook University who's a leading expositor of the theory, compares the government to the banker in a game of Monopoly: It can never run out of money because it's allowed to make as much as it needs. A problem with Professor Kelton's catchy metaphor is that even if comparisons between dollars and Monopoly money are technically defensible, they tend to rattle the public.

Socrates originated the concept of a noble lie, which is a myth that elites propagate for what they view as the good of the public. To Michael Dorf, a frequent collaborator of Professor Buchanan who teaches at Cornell Law School, the solidity of money is one such myth. Professor Dorf told me he's sympathetic with the idea that governments shouldn't depend on noble lies, but said they serve a purpose. Especially in a crisis, he said, the public's reaction "is unpredictable and potentially very dangerous."

What makes money, money? Not a government decree, a blockchain innovation or some inherent value. Cowrie shells, company scrip, tobacco and feathers of exotic birds have all served as money at various times. The only requirement is that the instrument has to function as

a medium of exchange, and that role is socially determined. I will accept just about anything from you as payment if I trust that the next person in the chain will accept it from me.

"Money is a social institution," George Selgin, a senior fellow at the Cato Institute, told me recently. "It's like language. Its value depends on how many people agree to use it."

Some people argue that money lost its tether to reality in August 1971, when President Richard Nixon took the United States off the gold exchange standard and made the dollar a "fiat" currency, which means it has value simply because the government says it does. But that overstates what Nixon did. Fiat money had existed on and off for centuries, including the early Song dynasty in China (960-1279), as recounted by David Graeber in his 2011 book, "Debt: The First 5,000 Years." Money, Dr. Graeber wrote, "is almost always something hovering between a commodity and a debt token."

Even under the gold standard, money wasn't purely a commodity. True, you can use gold for jewelry, dentistry or as a coating on space telescopes. But that explains only a fraction of its price. You can't eat gold or shelter yourself from the rain with it. The only reason you would ever accept gold as payment for, say, a truckload of potatoes is that you can use the gold to buy something else. That makes gold-backed money not so different from fiat money.

Modern Monetary Theory says money is not just a social institution — it's valuable because national governments require it for payment of taxes and fees. Professor Buchanan acknowledges that the requirement to pay taxes with money gives it some "real" value but he believes that's not enough to induce members of the public to use it to transact with one another.

The social nature of money is both a strength and a weakness. It's a strength in ordinary times because money's usefulness grows with each new person who embraces it.

But that dynamic works both ways. The trust that sustains money can disappear in a flash. "There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency," John Maynard Keynes wrote in 1919 in "The Economic Consequences of the Peace."

History shows that when a society loses faith in its money, bad things happen. Take bank customers' deposits in the 1930s. A bank deposit is money in the sense that you can write checks against it to pay for things. But unlike bills and coins, it's an obligation of the bank rather than the federal government. Banks failed when people lost faith in the banks' promises: They wanted government money, not bank money. The cascading failure of banks helped turn a routine economic downturn into the Great Depression.

Since the 1930s, federal insurance of deposits has by and large prevented runs on banks, but we have seen more recent crises of confidence in the "shadow" banking system, where non-banks borrow and lend. Shadow banking is a vast arena that includes money market funds, hedge funds, private equity, non-bank mortgage lenders and investment banks.

Consider what happened in the global financial crisis of 2008-9. Asset-backed securities such as mortgage bonds had become a form of money, Wall Street's equivalent of cash. Big players posted them as collateral for short-term loans in what's known as the "repo" market, short for repurchase agreement. When foreclosures spiked, people lost faith in the value of those mortgage bonds and the borrowers who had used them as collateral were suddenly cut off from credit. In

2010, the economist Gary Gorton compared it to an E. coli outbreak: It took only a few bad bonds to scare people away from the whole class. Something that had functioned as money abruptly ceased to do so.

Governments worldwide have an obvious interest in maintaining the public's confidence that their money is not, in Professor Buchanan's words, "entirely ephemeral." That goes for both government-issued money, which consists of paper bills, coins and reserves at the central bank, and privately issued money, which includes bank accounts, repo and new products like cryptocurrencies. In the United States, there is not an urgent crisis of trust when it comes to government-issued money. The country is in no real danger of runaway budget deficits or hyperinflation or a modern-day equivalent of Depression bank runs.

But cash is different. It is becoming technologically obsolete before replacements have gained the trust of the public and the backing, or at least acceptance, of governments.

The two new kinds of money that are rising as cash falls are stablecoins and central bank digital currencies. Stablecoins, which like Bitcoin exist in virtual ledgers, are issued by private entities that promise to convert them on demand into government money or some other asset at a fixed exchange rate. "The irony here is that cryptocurrencies were supposed to get us away from official money, whereas the ones that seem to work as a medium of exchange are backed by official money," said Dr. Prasad, the Cornell professor, who is the author of a new book, "The Future of Money: How the Digital Revolution Is Transforming Currencies and Finance."

The problem for stablecoin issuers is that to make their promise of convertibility rock-solid, they would need to hold $1 in cash in reserve for every dollar stablecoin they put into circulation. That's a lot of money for them to have tied up earning no return. The temptation is to invest the reserves to earn some kind of return. But that makes the reserves less than perfectly safe.

The potential instability of stablecoins is one reason there's growing demand for digital currencies issued by central banks. Central bank digital currencies are obligations of the government, like cash, but they're virtual, like a check or an entry in PayPal or a bank's reserve account at the Fed. China, South Africa, South Korea and Sweden are among the nations that have piloted central bank digital currencies, and the Bahamas and Nigeria have officially launched ones, according to the Atlantic Council's Central Bank Digital Currency Tracker. The Federal Reserve has been more skeptical. Randal Quarles, who was vice chair for supervision until October, hinted in a June speech that they were a fad akin to parachute pants of the 1980s.

Central bank digital currency is less anonymous than cash, which makes it less useful to criminals but likewise more of a threat to the privacy of law-abiding citizens. It could also be programmed to be used for only certain purposes, which many people would regard as an infringement on their liberty. To combat a slump in spending, the central bank could even program it to gradually lose buying power, which would induce people to spend it quickly if grudgingly.

A separate risk is that because central bank digital currency would be viewed as more reliable than bank money, bank depositors would switch their funds to it in a financial crisis. That would starve the banks of deposits, which would force them to call in loans, deepening the crisis.

All these developments make for uncertainty and risk. "We're in a state of innovative flux," said Mr. Selgin, the Cato senior fellow. "This has people confused, naturally enough, because it's not

clear whether some of these things should be considered money, whether they should be allowed to be money, whether they should be regulated, who should regulate them."

If all goes well, the innovative flux will leave us with means of payment that are better fit for modern purpose. But the transition will be turbulent. I, for one, will miss those shiny pennies.