

Opinion Digital currencies**Stablecoins will force finance to modernise**

Instead of trying to limit their use, foreign governments should focus on improving confidence in their own currencies

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Speedy transactions can reduce both cost and risk of exchanging one currency for another © Shutterstock/Skorzewiak

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The passage of US stablecoin legislation has set off tremors around the world. Many countries are shaken at the prospect of dollar-backed stablecoins reinforcing the dollar's dominance in international payments and perhaps even supplanting their domestic payment systems. The European Central Bank [has warned](#) of loss of monetary autonomy and greater geopolitical dependency on the US.

A number of countries have rushed to update or issue regulation in the hopes of [spurring private issuance of stablecoins](#) pegged to their own currencies, limiting the use of foreign currency-backed versions.

This knee-jerk defensive response is understandable but misguided. What stablecoins are really doing is shining a harsh light on pervasive inefficiencies in modern financial systems and showing how new technologies can fix them by creating efficient, cheap and broadly accessible means of domestic and cross-border payments. They are also exposing lack of confidence in many countries' central banks and currencies. Fixing those underlying problems, and doing so quickly, should be the priority for governments, regulators and central banks.

Take the Eurozone, which has a common currency and tightly regulated financial markets, but which lacks a unified payment system. The ECB is in the process of creating a digital euro, which will certainly mitigate this problem. But the lack of private sector alternatives highlights the fragmentation of Europe's banking systems and financial markets, not to mention the centrifugal political forces that pull it apart and limit the euro's role as a global reserve currency.

Countries that lack economic and financial heft, and whose currencies are not trusted by their own citizens, have even greater fears of being overrun by dollar-backed stablecoins. China and India have excellent domestic payment systems that set the global standard. Yet both countries suffer from occasional bouts of weakening foreign investor confidence in their currencies and central banks, and both still maintain capital controls. They are legitimately concerned that dollar-backed stablecoins could limit the rise of the renminbi and rupee as global payment currencies, even for their own imports and exports.

Another concern is that stablecoins could displace bank deposits and undermine commercial banks. Many banks are taking steps to ["tokenise" their deposits](#), allowing them to be used easily for blockchain-based transactions. And they are reducing their fat fees on cross-border payments. In other words, faced with new competition, they are cutting costs and increasing efficiency. This is as it should be.

The best response to the rise of dollar-backed stablecoins is not to encourage the use of domestic currency private versions or even issuing retail central bank digital currencies. These approaches are Band-Aids that won't fix the deeper problems that bedevil countries' financial systems and enfeeble their currencies.

Instead, the priority should be to develop more robust and inclusive domestic payment systems. Let a thousand payment systems bloom, with suitable regulation to maintain payment system integrity and minimise counterparty risk. Stablecoins, tokenised bank deposits and third party payment providers all have a role to play. Retail central bank digital currencies might fill in gaps in some countries.

It is essential to mitigate frictions in cross-border payments. This involves reducing controls on a broad range of transactions while using wholesale central bank digital currencies and perhaps blockchain-based clearing and settlement mechanisms that allow money to move seamlessly. Exchanging one currency for another is never trivial but speedy transactions can reduce both cost and risk.

The greatest need is to enhance confidence in domestic central banks and the currencies they stand behind. This is about better monetary, fiscal and regulatory policies as well as credible and independent central banks rather than just currency digitalisation.

Commercial banks will find it difficult to survive if they cede their role in intermediating payments. They must find ways, through the adoption of new technologies but also by offering better products and service, to compete.

Stablecoins are playing a valuable role in catalysing improvements in financial markets and forcing commercial and central banks to up their game. This will be their true legacy.

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