



THE (POTENTIAL) IMPACT OF DIGITAL FIAT CURRENCY ON THE INTERNATIONAL MONETARY SYSTEM

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POINT OF DEPARTURE

- Imagine a world of DFCs with the following characteristics:
 - Account-based
 - Interest-bearing
 - Denominated in each country's currency
 - No technological barriers
- What impact would the adoption of DFCs have the on International Monetary System (IMS)?
- What are the main implications for the design of standards and policies for DFCs?

MY ARGUMENT IN BRIEF

Early adoption of
DFCs

Increase in the
demand for
currencies of
countries that have
adopted DFCs

Through network
effects an
alternative currency
reserve system may
emerge

Solution to several
problems of the
current IMS, thus
improving its
performance

THE INTERNATIONAL MONETARY SYSTEM

DEFINITIONS

- “set of rules and institutions that facilitate trade, cross-border investment and reallocation of capital across nation-states”
- It refers to countries’ currency/ monetary regimes, rules for intervention if an ER is fixed or managed, for official credits, and capital controls

BRIEF HISTORY

- 1880-1914: classic gold standard
- 1924-1936: interwar gold exchange standard
- 1944-1971: Bretton Woods
- 1971-Present: Managed float

CHARACTERISTICS OF A “GOOD” INTERNATIONAL MONETARY SYSTEM

- Provide for an efficient international payments system, facilitating cross-border trade and investment
- Provide countries with sufficient liquidity (reserve assets) to manage ER and finance temporary balance of payments deficits
- Provide the means by which global imbalances can be corrected
- Generate stability and confidence in exchange rates and cross-border flow of capital
- Allow members to pursue independent monetary policies
- Promote international policy coordination rather than competition (“beggar-thy-neighbour” policies)

POOR PERFORMANCE OF THE IMS SINCE THE 2008-09 GLOBAL FINANCIAL CRISIS

- Scale and volatility of global capital flows; problem of “sudden-stops”
- A dominant country-issued reserve currency (US dollar); problems of “exorbitant privilege” and “exorbitant duty”
- Sharp rise in the demand for reserves and safe assets; problem of “safe-asset scarcity”
- No ready mechanism forcing surplus or reserve-issuing countries to adjust; problem of “global imbalances”
- Lack of international policy coordination

HOW CAN THE ADOPTION OF DFC BE A REMEDY FOR IMS' POOR PERFORMANCE?

- DFC with certain characteristics can serve as a practically costless medium of exchange, secure store of value and unit of account => serve the traditional functions of money better than cash itself => obsolescence of cash
- Scale economies in DFC use can deliver efficiency in international transactions => rise in the demand for DFC both at individual and government level
- Decrease the demand for US dollars (as only reserve currency) => diversification out of dollars
- Network effects could lead to either a mono-currency system or multiple/competing reserve currencies system overtime. => a (partial) solution to problems of current IMS

IMPLICATIONS FOR STANDARDS ON DIGITAL FIAT CURRENCY

- What DFC characteristics can best ensure that DFCs serve the 3 main functions of money: medium of exchange, store of value and unit of account?
- How easy will it be for nationals to hold foreign-currency denominated DFCs?
- Is there are first-mover advantage for countries that adopt DFCs in a more expeditious manner?
- Overcoming excess inertia that currently benefits paper currency may vary across countries. What determines demand for DFCs across countries?