



Policy Brief

DIGITAL PAYMENTS AND CROSS-BORDER CAPITAL FLOWS: POLICY ACTIONS TO SAFEGUARD MACROFINANCIAL STABILITY

Task Force 7

International Finance and
Economic Recovery

**DIGITAL PAYMENTS AND CROSS-BORDER
CAPITAL FLOWS:
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John Beirne (Asian Development Bank Institute)

Teuku Riefky (Institute for Economic and Social Research, University of Indonesia)

Abstract

Safeguarding macrofinancial stability in an era of growing digitalisation in cross-border trade and financial flows has become increasingly challenging for policy makers. Digital money, crypto assets and related innovations in cross-border payment systems, which may not be subject to existing financial regulation, can complicate the effective macroeconomic management of the economy via capital flow volatility, rising exposure to financial contagion and monetary policy spillovers. This policy brief proposes a number of actionable policy measures and role for the Group of 20 in tackling the prevailing challenges.

Challenges

Macrofinancial stability risks have become more pronounced at the global level in an era of rising digitalisation in cross-border capital flows. The rapidly transforming landscape in cross-border digital payments systems and advances in digital money pose challenges for the macroeconomic management of the economy (e.g. Beirne et al., 2022; Philippon, 2016). On digital money, defined in broad terms to cover all innovations that facilitate e-payments and e-transactions (including crypto-assets, stablecoins, central bank digital currencies and e-money), a key financial stability risk pertains to the scope for currency substitution, which would also have implications for the effectiveness of monetary policy and spillovers of negative externalities (IMF, 2021). Related to this, managing capital flows becomes more complex. In particular, digital innovations in cross-border payment systems and international financial transactions may be able to circumvent existing financial regulation controls. This would render such a framework incapable of appropriately dealing with volatility in flows that would arise from digital finance and digital payments mechanisms, thereby complicating regulation of the financial sector and the macroeconomy.

The challenge for policymakers in this context is how economies can ensure continued integration in international capital markets while also mitigating risks posed by digital payments and digital money. This issue is particularly important for emerging market economies (EMEs), where there is greater susceptibility to capital flow volatility and related risks to macrofinancial stability. In particular, easier access to foreign currency financing through crypto assets and spillovers from crypto to traditional asset markets may amplify vulnerabilities in EME financial markets. Ensuring effective policy solutions requires a coordinated and concerted approach at the global level, including on central bank digital currencies (CBDCs) and how to mitigate financial stability risks posed by crypto assets and digital cross-border payments (Beirne et al., 2022; FSB, 2022). The G20 forum could provide a mechanism to champion a global approach to this increasingly important policy issue.

Proposal

Actionable policy proposals are outlined for national governments, monetary and financial authorities and the international community at the global level for economies to mitigate and manage risks to financial stability caused by rising digitalisation in cross-border capital flow transactions. Focusing on the role of the G20, these recommendations pertain to four main areas: (i) development of comprehensive taxonomy of digital finance innovations in payments systems and establishment of national digital finance committees; (ii) vulnerability assessment exercises of exposure to risks from digital cross-border financial transactions; (iii) adjustment of prudential and supervisory frameworks to financial stability risks from digital finance and innovations in payments systems and (iv) international support and coordination on effective capital flow management measures for the digital age. Each of the four proposals are discussed in turn in the following paragraphs.

1. DEVELOPMENT OF COMPREHENSIVE TAXONOMY OF DIGITAL FINANCE INNOVATIONS IN PAYMENTS SYSTEMS AND ESTABLISHMENT OF NATIONAL DIGITAL FINANCE COMMITTEES

Innovations in digital finance and payments systems are fast-changing. Understanding the range of digital finance platforms and crypto assets in existence through devising an appropriate digital finance taxonomy is a crucial first step for devising appropriate policy responses. As well as this, national authorities need to engage in technical testing of digital innovations in payment systems and digital money more broadly. A dedicated national digital finance committee should be established, comprising the central bank, financial supervisor and government departments in order to ensure that all relevant national authorities are represented on providing input to the taxonomy and ultimately on devising measures aimed at safeguarding. Measures can be formulated from a monetary, macroprudential and fiscal policy perspective. A G20 working group should be established to provide a framework for the taxonomy and consistency in the composition of the national digital finance committee across member countries.

2. VULNERABILITY ASSESSMENT FRAMEWORK TO ASSESS EXPOSURE TO RISKS FROM DIGITAL CROSS-BORDER FINANCIAL TRANSACTIONS

Economies need to examine their risk-exposure to digital cross-border capital transactions and identify appropriate policy responses to address these risks. These policy responses should include macroeconomic, regulatory and technological aspects. As has been noted by the International Monetary Fund (2021), rises in digital money will likely lead to rises in gross

capital flows, which would occur whether prevailing capital flow management measures (CFMs) are sufficiently effective or not. While digital money may help to foster greater market integration and improved efficiency, there can also be costs linked to financial contagion exposure. The related implications for capital flow volatility should be a core element of vulnerability exercises that economies should undertake, including scenario analyses based on simulations of the projected future path of digital finance in terms of digital cross-border payments and financial transactions, as well as exchange rate effects. The G20 would have an important coordinating role in: (i) ensuring a common approach to the vulnerability exercises across countries and best practice implementation; (ii) identification of technical assistance requirements and gaps in expertise, including on cross-border CBDC interoperability and (iii) providing a forum for input by technical experts at international financial institutions (notably the IMF and Financial Stability Board).

3. ADJUSTMENT OF PRUDENTIAL AND SUPERVISORY FRAMEWORKS TO FINANCIAL STABILITY RISKS FROM DIGITAL FINANCE AND INNOVATIONS IN PAYMENTS SYSTEMS

Given the rise of fintech over the past decade, our understanding of macro- and microprudential risks and their implications have become more complex than ever. While fintech fundamentally changes the payments systems landscape, including the delivery of financial services, it could lower barriers of entry to the financial services market and amplify credit risk. Such fintech-related changes may require bank supervisors to reassess their current supervisory models and resources in order to ensure continued effective oversight of the banking system (BIS, 2018). Striking the right balance of a regulatory structure that spurs fintech growth while maintaining the prudence and stability of the financial sector might not be an easy task for policymakers as the nature of fintech is still evolving and there is no well-established framework that is commonly accepted at the current juncture. The proposed role of the G20 is as follows: (i) mainstreaming the assessment of costs and benefits of digital money and payments systems into national financial regulatory and prudential frameworks; (ii) providing a forum for the development of consistent and coherent country-specific road maps on digital macrofinancial stability (i.e. recognising cross-country differences in the level of financial development and stage of digital finance adoption). Such a framework should be fully integrated with the FSB's framework for surveillance of the financial sector (FSB, 2020) and also support the FSB's work on stablecoins and crypto-assets; (iii) facilitating a platform for regular assessment and review of digital macrofinancial vulnerabilities, also enabling adjustments as digital innovations in payments would continue to advance and (iv) supporting the Financial Action Task Force's guidance for virtual asset service providers, and the Basel Committee for Banking Supervision's prudential treatment of crypto-asset exposures.

4. INTERNATIONAL SUPPORT AND COORDINATION ON EFFECTIVE CAPITAL FLOW MANAGEMENT MEASURES FOR THE DIGITAL AGE

International support is needed to oversee the development and implementation of enhanced CFMs equipped for the digital age. The Organisation for Economic Co-operation and Development (OECD), in the context of its Code of Liberalisation of Capital Movements – the only legally binding agreement between OECD member countries on capital flow management – would be expected to have an important role to play, as well as the IMF, FSB and the G20 forum. Together with foreign exchange intervention and macroprudential policies, CFMs need to factor in the implications brought by digital finance innovations in cross-border payments systems and financial transactions across borders. This requires a strong coordination at the global level to ensure the development and implementation of CFMs that would help to also manage capital flow volatility due to advances in digital money and cross-border digital payments. This should build upon the FSB road map on challenges to cross-border payments that was endorsed by the G20 in October 2020 (FSB, 2020), but which does not include provisions for the development of enhanced “digital-proof” CFMs. While that initiative served as an important step taken in the right direction, the fast-changing nature of the digital finance landscape and related prevailing uncertainties also mean that further policy action by authorities is necessary. The G20 forum could contribute to the agenda on CFMs in the digital age as follows: (i) taking a leadership role in coordinating with the IMF, FSB and Bank for International Settlements (BIS) in anticipating the changing nature and behaviour of global capital flows in light of CBDCs and non-central bank-issued cryptocurrencies; (ii) encouraging international technical and institutional support provisions and financial resource mobilisation towards capacity building and training on digital finance surveillance and negative spillovers to the domestic financial system via capital flow volatility and (iii) providing a forum for discussion by stakeholders in aligning the development of enhanced CFMs for the digital age with existing related collaborative global initiatives, such as the G20 Sustainable Finance Roadmap.

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