T20 Policy Brief

Task Force 05
INCLUSIVE DIGITAL TRANSFORMATION

The G20's Path to Inclusive Digital Asset Integration

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Abstract

As the digital asset market expands, the G20 has a critical opportunity to guide the integration and regulation of these assets across various sectors. Establishing a framework for digital asset compatibility and interoperability is essential. The G20's leadership in refining assessment methodologies and regulations could enhance cross-border operations via blockchain, promoting SDG achievement through increased market transparency and improved risk management associated with digital assets. Effective digital asset interoperability involves technical compatibility across platforms and consideration of various legal, political, and cultural factors to facilitate global exchanges.

Keywords: Digital Asset Interoperability, G20 Regulation Framework, Cross-border Blockchain Utilisation, Transparency and Risk Management, Digital Inclusion Strategy

Diagnosis of the Issue

Blockchain technologies have opened up new opportunities for global trade. Through distributed ledger technology, G20 countries have access to Central Bank Digital Currencies (CBDCs), Cryptocurrencies, Security Tokens, Utility Tokens, Stablecoin and Non-Fungible Tokens, among other forms of digital assets. With all these emerging forms of digital assets, the global trade systems lack a comprehensive framework for digital asset integration and exchange. This framework is critical given the applications of these technologies across sectors and throughout global supply chains. Without an overarching global framework initiated by an institution like the G20, there is a significant risk of countries introducing disjointed and incompatible regulatory and exchange frameworks. The G20 is well-positioned to recommend a global framework due to its far-reaching influence based on its inclusive membership, representing the world's major economies. While the G20 may not have formal mechanisms to enforce such a framework directly, its ability to set global agendas and influence international policy on key economic issues makes it an appropriate body to catalyse action and cooperation among member states, international organisations, and other stakeholders.

The Bank of Russia, for instance, has recognised these integration challenges by highlighting the impacts of regulatory divergence, market fragmentation, interoperability challenges, and security risks (Russian Federation 2022). Regulatory divergence leads to a disjointed and incompatible regulatory and exchange framework. Subsequently, market fragmentation can arise, resulting in varied digital asset adoption. Ideally, regulators should promote digital asset interoperability to benefit the consumer and market integrity.

The interconnectedness of digital asset systems and the consequent reliance of businesses, governments, and individuals on these systems pose substantial risks for multinational enterprises. These risks arise from the need to ensure compliance with both international standards and diverse national regulations across the countries in which they operate (Luo 2022). Non-compliance can lead to added costs, reputational damage, and operational disruptions.

Financial systems are expected to rely more on digital assets, requiring a global framework prioritising cross-border interoperability. Promoting interoperability has clear implications for achieving the Sustainable Development Goals (SDGs). Digital assets provide opportunities to expand services to marginalised communities in banking, credit and insurance. Providing a framework that undergirds these services will contribute to poverty reduction (SDG1) and economic growth (SDG8) (Gabor and Brooks 2017). Given that these assets are unaffected by pro-inflationary policies, the assets promote increased liquidity. Thus, digital assets are valuable tools for public wealth management (Antoncheva and Apanasenko 2022). Further, there is evidence that digital asset adoption is positively related to internet usage in developing and emerging countries like China, India, Nigeria and South Africa. This increase in digital asset adoption was further positively associated with increased financial inclusion, lower transaction costs, increased cross-border transactions, and increased financial services targeted at the unbanked, which are cited as reasons for boosts in financial inclusion (Vincent and Evans 2019). These technologies will also provide a platform for the future global economy. Thus, focusing on sustainability in the design of these systems is crucial and can be enabled through a global framework. Understanding that digital asset infrastructure is highly energy-intensive, suggests that future financial management systems might need to incorporate green energies, thereby promoting sustainable cities and communities (Buckley, Arner, and Zetzsche 2019). With further interrogation, one might find further connections to a range of SDGs and international targets, emphasising the need for global interoperability standards.

In addition, the complexity of the systems used to manage digital assets requires that institutions ensure transparency to protect the market participants from the technological risks inherent in these systems. Blockchain systems, for instance, require a distributed network requiring investments in computational power. If not managed, this can impede transactional speed, impacting the scalability of such systems (Ozili 2023). There is a need for interoperable and transparent governance frameworks, which participating members share. Developing interoperable and transparent governance frameworks is essential for fostering trust, mitigating risks, and promoting the sustainable growth of the digital assets market, ultimately contributing to a more efficient and inclusive global financial system. These views are supported by a working paper proposed by the International Monetary Fund (IMF) called the Access Service Asset Platform (ASAP) Model. The authors describe the proliferation of digital asset platforms leading to market and liquidity fragmentation. These challenges necessitate common standards and global coordination (Budau and Tourpe 2024). While in the proposal stage, the convergence of ideas with IMF staff highlights the need for global institutions to initiate a shared governance framework.

Adoption of these digital assets will continue to grow. While many countries do not recognise cryptocurrencies as legal tender for payments, there is a need for global acceptance of their role as a store of value. South Africa, for instance, has accepted the rapid growth of digital asset adoption and usage, making it prudent to regulate its usage (Makina 2024). To this end, the Organisation for Economic Cooperation and Development (OECD) has also established the Crypto-Asset Reporting Framework to standardise how nations report on cryptocurrency transactions and to introduce a

Common Reporting Standard. The OECD, driven by an awareness of crypto asset market growth, tax compliance risks, the lack of reporting standards and the erosion of global tax transparency, introduced these reporting standards (OECD 2022). However, this framework is limited to crypto assets and only defines a global tax transparency framework, describing how tax information can be exchanged. The framework does not define rules for interoperability or international exchanges.

Given the rapid growth of the digital asset market, the lack of a clear framework for integrating digital assets may lead to unintended consequences, such as exacerbating inequalities, hindering innovation, and increasing financial instability, underlining the critical importance of proactively addressing this need. Legal, political, and cultural considerations must be understood to effectively enable a global exchange of ideas and standards to produce fair and inclusive interoperability standards. Thus, a comprehensive digital inclusion strategy is needed to produce these interoperability standards, focusing on digital infrastructure and literacy to ensure equitable access to the digital asset market, support economic growth, bridge the digital divide, and promote universal connectivity.

Recommendations

Recommendation 1: Establish a G20 Digital Asset Task Force to Strengthen Global Governance and Coordination

To improve global governance, this task force should create a unified framework that addresses legal, political, and technical aspects of digital asset management. It should facilitate international dialogue and establish common protocols for Anti-Money Laundering (AML)and Know-Your-Customer (KYC) initiatives. A shared approach to these processes can facilitate a secure and seamless global exchange of digital assets.

To balance the views, the Task Force must establish global forums for international dialogue, allowing industry stakeholders to continuously engage with international and national dialogues to determine the principles needed and review how international standards will influence national usage and requirements. A dual approach is needed to ensure the task force's work is transparent and benefits all member nations.

Recommendation 2: Establish G20 Regulatory Frameworks that foster Market Transparency

Global standards that ensure digital asset interoperability are essential. This view is shared by multiple multinational institutions, including the OECD (2022), BRICS (2020), Bank for International Settlements (BIS) (2020) and the World Economic Forum (2023), among other multinational institutions. There is a need to define an interface that integrates the new digital assets with the traditional payment systems to allow for seamless communication and exchange. Global standards will allow the efficient exchange of transactions, which are conducted securely.

The G20 can introduce a clear regulatory framework that defines these agreed standards, underscoring how global markets integrate alternative pathways for cross-border transactions. This framework must recognise the dynamism of the digital asset market and allow for the evolution of digital assets. In addition, the regulatory framework must enforce rules enabling market transparency concerning digital asset transactions, particularly for integrating new digital assets with traditional fiat currencies. Previously, the G20 has concurred with this argument, noting that such transparency enabled via a comprehensive risk management strategy is needed to promote investor confidence (IMF 2023).

Russian law has established a digital framework using distributed ledger technology for issuing and managing digital assets, ensuring transparency, security, and immutability of transactions. It defines Utilitarian Digital Rights and Cyber Financial Assets, facilitating access to digital services and recognising digital currencies for financial activities. This model could guide the G20 in developing standardised regulations that promote market transparency and adapt to various digital assets (Russian Federation 2022).

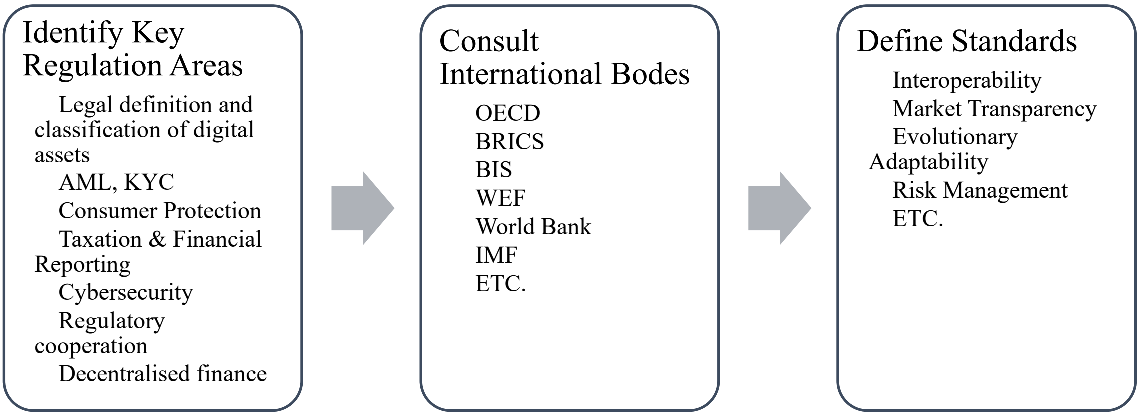

FIGURE 1 – Process to Establish a G20 Regulatory Framework

Recommendation 3: G20 Nations to Invest in Infrastructure, Supporting Inclusive Growth

Advancements in digital asset development compel G20 nations, through their central banks, to invest in national digital infrastructure to experiment and test new products and services. These nations require the regulatory and developmental sandboxes for central banks and the private sector to collaborate and produce new, secure, scalable financial assets and cross-border payment platforms. This infrastructure is also needed to provide the backend infrastructure used by distributed ledger technologies (World Bank 2020). Given the novelty of the technology, there is a need to define appropriate hardware specifications that can distributed in an international setting. To this end, international collaboration in shared spaces will promote innovation and demystify the design of digital financial products.

In this developmental process, inclusion is a priority. Thus, the new digital assets must democratise access to new products, enabling market diversity. By committing to policies promoting economic stability and inclusivity, digital assets can enhance financial inclusion. Digital assets have the potential to provide utility value similar to or beyond that of existing financial services, such as mobile money, credit, and insurance. For example, digital assets can enable faster and cheaper cross-border remittances, provide secure and transparent record-keeping for micro-insurance policies, and facilitate access to micro-credit through decentralised lending platforms. By committing to policies promoting economic stability and inclusivity, digital assets can enhance financial inclusion. The potential of these assets to reduce transaction costs dramatically and improve access to financial services, is particularly significant in addressing the financial needs of marginalised and underserved communities (BRICS 2020). Leveraging digital technology for inclusion ensures that innovations in the financial sector do not widen existing social and economic disparities but rather bridge the digital divide.

These infrastructure investments must also be used to encourage future research and development into fields such as blockchain and digital asset technology development. Greater international collaboration between the public, private and academic institutions can catalyse future advancements. As noted by institutions such as the BIS (2020), such development can place these technologies at the centre of the future financial ecosystem.

Access Points

Payment Solutions

Collaboration Platforms

Regulatory Sandboxes

Cloud Computing Services

High Capacity Networks

Data Centres

FIGURE 2 – Digital Asset Infrastructure Needed for Inclusive Growth

Recommendation 4: G20 to Pilot and Experiment with Digital Asset Technologies

Digital asset integration with the traditional payment sector is a potentially complex endeavour, requiring substantial testing to ensure interoperability and compliance with multiple regulatory frameworks. With different countries' varied acceptance of such technologies, the overarching regulatory framework will evolve as national policies adapt. Considering this reality, a pragmatic approach is necessary to pilot digital asset integration into the global financial architecture. Further testing is necessary to develop a robust, scalable, universally accepted digital asset ecosystem. China's national approach to managing FinTech regulation provides guidance on opening access to data to promote innovative development and testing while providing regulators and policymakers opportunities to understand the implications of technology's design and implementation (Han and Xu 2022). Notably, this access has enabled the expansion of China's FinTech sector and is cited as a driver of local innovation (Wang 2022). A shared sandbox environment for G20 nations provides the opportunity for international regulatory harmonisation, which also supports stability within the financial ecosystem, further promoting integrity. Evidence from China demonstrates that sandbox environments provide opportunities to promote regulatory stability in the financial ecosystem by allowing FinTech innovations to be tested in a controlled setting, which helps align regulatory reforms with technological advancements while protecting consumers (Chang and Hu 2020.) This environment also allows international academic collaboration, allowing the academic community across G20 nations to partner on research in innovative research fields (IMF 2023). Their collaboration advances the methodological rigour of testing and creates pathways for centring financial inclusion on the design of these systems.

Scenario of Outcomes

The above recommendations establish that the G20 countries should coordinate initiatives that govern, regulate, develop, and invest in the technologies and infrastructure needed for a forward-looking vision for a comprehensive financial ecosystem that integrates traditional payment methods with innovative digital assets. Realising these recommendations could lead to various outcomes based on the interplay of diverse regulation, adoption and inclusion levels. The following are two possible scenarios that result from their implementation.

Scenario 1: Harmonised digital asset integration

The uniform acceptance of the need to globally regulate digital asset integration allows nations to convene the proposed task force and regulatory frameworks. Further, as nations gradually invest in the necessary infrastructure, they allow countries with diverse inclusion levels to experiment with technologies that identify optimal pathways for technology rollout. A clear outcome is the improved alignment of the financial ecosystem, followed by improving levels of financial inclusion. Such technologies offer alternative opportunities to access financial products that are potentially more cost-effective, reducing costs and advancing accessibility. Such advancements promote equity and narrow the digital divide.

Achieving regulatory harmonisation is a complex effort that requires a close examination of the legal and political implications of a new financial ecosystem with multiple channels for trade. Balancing an international regulatory framework against international sovereignty is also complex. However, having the opportunity to test the technology in a shared sandbox allows nations to experiment and study the implications on economic inclusion, market dynamics, regulatory complexity and innovation. The sandbox also allows countries with concerns over sovereignty infringements to test their adoption in a gradual and phased manner, providing their constituents with data about the change to the financial system and the opportunity to develop their trust in the new technology and regulatory framework.

Scenario 2: Divergent digital asset acceptance, adoption and integration

If G20 nations fail to adopt a standardised regulatory framework, they may develop digital assets independently without coordination through an international Digital Asset Task Force. This could lead to divergent adoption rates, a fragmented digital asset ecosystem, and complex interoperability issues due to varying national regulations. The absence of a global standard may cause nations to form diverging bilateral agreements, complicating international exchanges and increasing transaction costs. This fragmentation could result in unequal economic advancement among countries, isolating progress and limiting international trade opportunities. Partial support for the G20 Task Force may dilute its effectiveness, undermining global governance, coordination, and security objectives. Countries not fully integrating into this framework might face economic disparities, widening the digital and financial divide.

In both scenarios, the success of the G20 recommendations depends on finding a balance between global coordination and respect for national sovereignty, fostering innovation while ensuring inclusivity, and navigating the complexities of a unified regulatory approach in a diverse global landscape.

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