Discussion of "The Coming Battle of Digital Currencies" by Lin William Cong and Simon Mayer

Discussant: Egemen Eren (BIS)

SKEMA-ESSEC Conference

Nice, May 2022

Summary of results

- Currency competition features feedback effects, leads to dollarization (which is bad).
- Crypto hurts strong currencies, but if it mitigates dollarization: benefit weaker currencies.
- Weaker currency's CBDC hurts crypto more.
- CBDC issuance pecking order.
- Stablecoins can do the legwork for dominant currencies. Weaker countries might face a digital dollarization challenge.

Main points

- Overall assessment:
  - This is a nice model on competition between “convenience providers” with different characteristics.
  - The paper aims to marry two hot topics: international monetary system and CBDC.
  - It is a very hard to do this in a satisfactory manner. The paper would benefit from a narrower scope.

- Big picture comments:
  - Too stylized to study the international monetary system.
  - Not really about CBDC: Everyone can already access every currency digitally. Does (cross-border) CBDC add any marginal convenience (Eichengreen (2021))?
  - Better focus: competition in innovation between the CB, banks, fintechs to provide convenience (same currency)?

- Model comments:
  - Limitations of OLG: risk compensation, UIP?
  - Debt?
  - Bubbles and bursts in crypto.
  - Stablecoins are banks?
  - Empirical backing to some of the claims?

CBDC working through convenience yields: not a good assumption

- All payments that matter for the international monetary system are already digital.
- Cash is only used for domestic small-value transactions – no relevance for the IMS.
- Problems of convertibility, trust in China etc remain with CBDC.

- Cross-border payments and CBDC (Eichengreen (2021)):
  - There are 150 currencies. With a vehicle currency, you need 149 bilateral arrangements.
  - If we did cross-border settlements with CBDC, you would need >11,000 bilateral arrangements.
  - I don't see how this is more convenient. Even if it is, to what extent would it matter for the IMS?
  - You need strong arguments against Eichengreen if CBDC works through convenience and matters for the IMS.

- Cash: zero return, CBDC would probably pay + interest. Eat into seignoriage revenues.

Less is more? Narrower scope can make the model shine

- The framework is ideally suited (perhaps with some modifications) to discuss competition between the central bank (A), banks (B) and payment firms/crypto etc as (C) as “convenience providers” within the same currency.

- Model competition in innovation between these players.

- How do banks’ incentives to innovate change with the entry of fintech players? What are the implications for the central bank (CB innovation can be CBDC here)?

- Some of your pecking order insights might probably work in this setup: in countries with weakest banks, payment firms are gaining more market share (eg M-Pesa).

Questions about the model

- Where is the risk compensation? What is the time horizon?
  - Normally, there should be a UIP condition with interest rates, risk premia that compensates investors for risk.
  - OLG complicates things. New generations cannot contract, so they are facing debasement.
  - How realistic is this? What is the time horizon in your mind? To say something about the IMS: need UIP.

- Dollar's dominance in finance is more prevalent than in the real economy (CGFS (2020)).
  - Theoretically, borrowers like currencies that depreciate in bad times (Eren and Malamud (2022)).
  - If endowments come later and you need to borrow first, then that would give country B an advantage. Potentially overturns a lot of the results. Worth trying to solve a version with debt.

- "The dominant currency A is the stronger currency because it has less inflation/depreciation."
  - Why is A the USD and not JPY or CHF or EUR (inflation is lower in all)?

- Bubbles and busts in crypto?
  - The price process for crypto is key in determining if dollarization is bad.
  - What happens if there is a bubble component in crypto which can probabilistically burst? Similar to the tax?

- Stablecoins are banks? Can you make a historical case for the role of banks for the USD dominance?

It would help to stay away from vague statements

- What do statements like this mean? Is there any evidence on digitization and inflation?

  "In as much the high core inflation in the United States challenge the predominance of the dollar, this high inflation can also increase the government's incentives to accelerate dollar digitization."

- There are many such vague/loose statements in the paper, especially in parts related to the IMS. It would help you to drop those.

- You assume there is a link between inflation and crypto adoption. Is this true in the data? If anything, there seems to be an opposite relationship.

- Overall, some data to back some of the assumptions/discussions that validates them would be very welcome.