

# The Impact of Digital Currencies on the International Monetary System

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**Abstract**—Digital currency, as a frontier innovation of fintech, is gradually infiltrating into all levels of the global financial system, and has had a profound impact on the international monetary system. This paper explores in-depth the characteristics of the currency, development of digital currencies and their potential impact on the international monetary system, aiming to provide a comprehensive perspective and in-depth insight for policy makers, financial regulators and academia. Digital currency, based on blockchain technology and cryptographic algorithm, has the characteristics of decentralization, high security and low transaction costs, and has been classified as cryptocurrency, stablecoin and central bank digital currency. These characteristics not only pose new challenges to the formulation and implementation of monetary policy, but also bring about changes to cross-border payments, financial stability and the global economic structure. In terms of monetary policy, digital currency may weaken the central bank's ability to control the money supply and change the adaptability and effect of monetary policy tools. In the field of cross-border payment, the application of digital currency has improved payment efficiency and reduced costs, causing an impact on the traditional exchange rate mechanism and cross-border payment system. The volatility of the digital currency market has also brought new challenges to financial stability, especially in the areas of systemic risk assessment, anti-money laundering and anti-terrorism financing, which requires the joint efforts and cooperation of the international community. The impact of digital currencies on the structure of the global economy is also significant. They could trigger changes in the global reserve currency system, change the pattern of international trade and investment, and provide new development opportunities for developing countries, but also bring a series of challenges. The widespread application and increased acceptance of digital currencies will drive the global economy to a more efficient and transparent direction. This paper demonstrates the potential and challenges of digital currency in real financial activities. In terms of policy recommendations and future prospects, this paper proposes the necessity of international cooperation and regulatory framework construction, emphasizes the importance of digital currency regulatory policy, and predicts the potential trend of digital currency development.

**Keywords**—digital currency, cryptocurrency, digital currency of the central bank, international monetary system, and financial regulation

## I. INTRODUCTION

The international monetary system refers to the set of rules, agreements and regimes used globally to guide currency transactions, payment systems, exchange rate policies and financial regulation among countries. The course of development of this system is an important part of the evolution of international economic relations, reflecting changes in the structure of the global economy and the needs of international cooperation.

In the current international monetary system, there are more than 180 sovereign national currencies, and only a few currencies, such as the United States dollar, the euro and the Japanese yen, are widely used as foreign exchange reserves in international trade settlements and international financial transactions. Especially since 2008, the share of cross-border financial transactions denominated in dollars has surged (Maggiore *et al.*, 2020). In an international monetary system where multiple international currencies coexist, due to the differences in the status of different international currencies in terms of settlement, valuation and reserves, if a certain currency occupies a dominant position, that currency is also called the Dominant Currency (Dominant Currency), for example, the British Pound Sterling during the period of the gold standard and the current U.S. Dollar.

The course of monetary development can be centered on Marx's theory of the nature of money, Fisher, Marshall, Friedman's theory of the quantity of money, as well as Cassel's theory of purchasing power parity to explore, looking for the direction of the future development of the currency. From a historical point of view, the origin of the international monetary system can be traced back to the gold standard, which is a system that uses gold as a medium of international exchange and a reserve of value. With the growth of global trade and financial activities, the gold standard gradually evolved into the Bretton Woods system, a fixed exchange rate system centered on the U.S. dollar, which was pegged to gold, while the currencies of other member countries were pegged to the U.S. dollar.

The dissolution of the Bretton Woods system in the early 1970s marked the beginning of the floating exchange rate system. Under this system, the exchange rate of currencies was determined primarily by market supply and demand, rather than a fixed conversion to gold or other currencies. This shift increased the flexibility of exchange rates, but also brought more uncertainty and volatility. With global warming, countries have begun to pay attention to green and low-carbon development, and the carbon emissions trading market has been rapidly developed as a result. Button argues that the carbon market shows many characteristics of the money market, and carbon can be regarded as a form of currency. Descheneau similarly argues that carbon has a function similar to that of money, and that carbon emission reductions can be transformed into monetizable credits. Liu *et al.* proposed a new international monetary system based on carbon currency, which as a global currency can effectively solve the externality problems arising from excessive greenhouse gas emissions and the hegemony of the US dollar.

With the deep development of globalization, the

international monetary system has gradually evolved into a more complex and diversified system. On the one hand, major reserve currencies such as the dollar, the euro and the yen play an important role in international trade and finance; on the other hand, the process of regional monetary cooperation and integration, such as the euro in Europe, is also driving changes in the international monetary system.

In recent years, the emergence of digital currencies, especially the development of cryptocurrencies and central bank digital currencies, has brought new challenges and opportunities to the international monetary system. These emerging forms of money may have far-reaching implications for traditional money circulation, payment systems, monetary policy implementation and financial regulation.

## II. THE BASIC CONCEPT OF A DIGITAL CURRENCY

### *A. Definition and Characteristics of a Digital Currency*

The background and categorization of the rise of digital currencies is a multidimensional phenomenon whose development is closely related to the global financial environment and technological advances. With the development of Internet technology, especially the emergence of blockchain technology, digital currencies have emerged as a new form of money. The birth of Bitcoin in 2009 marked the beginning of the era of digital currencies, which utilizes decentralization, distributed ledger and cryptography to ensure the security and transparency of transactions. Digital currencies are unique compared to traditional currencies. Since then, digital currencies have grown rapidly, attracting the attention of a wide range of investors and technology developers, creating a large ecosystem.

With the rapid development of science and technology and the increasing globalization of the economy, digital currencies, as a brand new means of payment and storage of value, are gradually becoming a hot topic of concern. With the development of Internet technology and the improvement of the financial regulatory system, the field of financial technology has attracted extensive attention from major financial institutions, and the large-scale emergence of digital currencies has become the focus of research, and it is possible to solve the core problems encountered by other forms of currencies in the requirements of the nature of the currency, the limit on the number of currencies, and exchange rate debates by technological advances and credit upgrades, and at the same time, digital currencies have met the needs of the pursuit of circulation and the need for more convenient, more favorable storage methods. More convenient, more conducive to storage and payment circulation requirements. Digital currency is a kind of digital assets based on the principle of cryptography, realized through distributed ledger technology such as blockchain. It has decentralized characteristics and does not rely on any central institution to issue or manage, but is maintained through a network of nodes working together. The transaction records of digital currencies are open and transparent on the blockchain, but user identities can remain anonymous or pseudo-anonymous. They are highly programmable and can execute complex logic such as smart contracts. Digital currencies are global,

allow instantaneous transactions across geographies, are easy to distribute and carry, and have low transaction costs. However, they also carry risks such as high price volatility and limited market acceptance.

### *B. The Difference between a Digital Currency and a Traditional Currency*

Digital currencies differ significantly from traditional currencies in several ways. First, digital currencies are based on distributed ledger technology, such as blockchain, which enables decentralized management and issuance, while traditional currencies are usually controlled by national central banks or government agencies. Second, the transaction records of digital currencies are encrypted and tamper-proof, providing greater security and transparency, while transactions in traditional currencies rely on the record-keeping systems of financial institutions such as banks. Digital currencies allow for anonymous or pseudo-anonymous transactions, protecting user privacy, while transactions in traditional currencies often require identification and record keeping.

The global and portable nature of digital currencies gives them an advantage in cross-border transactions, as they can be transferred quickly and inexpensively, whereas cross-border transactions in traditional currencies often involve complex exchange rate conversions and fees. In addition, the supply of digital currencies is usually fixed, which helps prevent inflation, whereas the supply of traditional currencies is adjusted by central banks in line with economic policy. However, the digital currency market is relatively young and volatile, and prices can fluctuate dramatically, in contrast to traditional currencies, which typically have a more stable value. Digital currencies are also less accepted and popular than traditional currencies, with many merchants and service providers not yet accepting digital currencies as a form of payment. In addition, the regulatory framework for digital currencies is still developing, whereas traditional currencies are subject to well-established financial regulations and oversight by regulatory bodies.

## III. THE IMPACT OF DIGITAL CURRENCIES ON THE MONETARY SYSTEM

### *A. Impact on the Central Bank's Ability to Control Money*

With the advancement of technology, the emergence of digital currencies has had a profound impact on the traditional monetary and financial systems. The monetary control ability of the central bank refers to the central bank's use of its monetary policy tools, such as open market operations, reserve requirement ratio and discount rate, to regulate the level of money supply and interest rate in the economy in order to achieve its macroeconomic objectives, such as controlling inflation, promoting employment and economic growth. However, in the context of digital currencies, this ability of central banks to exercise control may be somewhat compromised.

The decentralized nature of digital currencies means that they are not under the control of any single institution, which may weaken the direct control of central banks over the money supply. If digital currencies become widely accepted and used as a medium of exchange, they may compete with fiat currencies, affecting the velocity of circulation of central

bank money and the money multiplier effect. In addition, digital currencies may alter the response of savers and investors to changes in interest rates, thereby affecting the ability of central banks to influence economic activity by adjusting interest rates. At the same time, the global and portable nature of digital currencies may exacerbate the volatility of capital flows and cause disruptions to the implementation of central bank monetary policy.

Nonetheless, central banks are actively exploring the issuance of their own digital currencies, known as Central Bank Digital Currencies (CBDCs), in order to adapt to the development of the digital economy. CBDCs can enhance the central bank's ability to regulate the flow of money and improve the efficiency of monetary policy transmission, as well as provide new opportunities for financial innovation and improving the efficiency of the payment system. Thus, the monetary control capacity of central banks faces both challenges and opportunities for transformation and adaptation in the era of digital money.

#### *B. Impact on Cross-border Payments*

The use of central bank digital currency for cross-border payments will certainly become a major trend. The current situation of cross-border payments is characterized by diversification and digitization, and with the growth of global trade and the popularity of e-commerce, the cross-border payment industry is experiencing rapid development and change. Relevant documents clearly put forward that digital RMB is more used in domestic retail payment, which can also realize cross-border payment. On the one hand, the traditional payment model is gradually being replaced by emerging payment service providers and fintech companies that utilize new technologies, such as distributed ledgers, to provide consumers and businesses with a variety of alternatives that change the traditional roles of payments and loans. E-commerce giants such as Amazon, eBay and Alibaba are also offering their customers cross-border payment services that rely on new technologies. On the other hand, challenges faced by the cross-border payments industry include high costs, slow speeds, restricted access and lack of transparency. These challenges have prompted organizations to seek to build faster, cheaper, more transparent and inclusive cross-border payment systems. China's cross-border payment industry is experiencing rapid growth and change. The industry is currently dominated by the correspondent bank model, with an increasingly diverse set of front-end institutions and a rapidly growing number of third-party payment providers. In terms of the competitive landscape, China's cross-border payment market can be categorized into two main echelons: the head echelon and other players. Head-tier cross-border payment companies include Ant Group's Wanlihui and Alipay, and Tencent's Caixit, which are divided into specialists, competitors and forerunners depending on their business focus.

Whether it is a single reserve currency system, or multiple reserve currency system, it is difficult to fundamentally solve the "Triffin problem": when a country's currency as an international reserve currency, as the world currency, due to the existence of other countries on the issuer's currency demand, which requires that the country's trade deficit in order to meet the currency sent abroad; at the same time, as a

country's currency, in order to ensure that the country's currency, the country's currency, the currency of the country's trade deficit. A country's currency, in order to ensure the stability of the value of the country's currency, the country must also ensure that the trade surplus. That is to say, the currency issuing country in maintaining the international money supply and currency value of the goal of stability there is a paradox. The digital currency based on P2P network, its right of issue independent of any country or structure, as the international reserve currency, digital currency can be said to fundamentally solve the "Triffin problem".

#### *C. The Impact of Digital Currencies on Exchange-rate Mechanisms*

Whether the floating exchange rate system or fixed exchange rate system have certain defects. Floating exchange rate system, the exchange rate instability, increased the risk of international trade, increased costing and international settlement difficulties, thus impeding the normal development of international trade; fixed exchange rate system, as a result of the obligation to maintain exchange rate stability, thus weakening the autonomy of the domestic monetary policy, prone to inflation, rising prices make the cost of exports increase, resulting in a reduction in exports, balance of payments deficit, causing instability of the value of the local currency. And the impact of digital currencies on the exchange rate mechanism is manifested at several levels. First, the popularity of digital currencies may increase the speed and frequency of cross-border financial flows as they provide a fast and cost-effective way of transferring funds, which may have a more direct and immediate impact on exchange rate volatility. Second, the decentralized nature of digital currencies may weaken the intermediary role of traditional banking and payment systems in currency exchange and exchange rate setting, thereby altering the formation and transmission mechanisms of exchange rates. In addition, certain stablecoins are pegged to fiat currencies with the aim of reducing price volatility, which may have an impact on exchange rate stability, particularly in countries where currency volatility is high. However, volatility and regulatory uncertainty in the digital currency market may also pose a risk to the exchange rate mechanism, as their legitimacy and acceptance varies across countries. Finally, with the development of Central Bank Digital Currencies (CBDCs), new exchange rate regimes may emerge, especially if CBDCs from multiple countries become interoperable, which could reshape the international monetary system and exchange rate policy.

#### *D. The Impact of Digital Currencies on the Global Economic Structure*

##### *1) The transformation of the global reserve currency system*

Changes in the global reserve currency system are taking place with the rise of digital currencies. Digital currencies offer a new form of money, which could change the strategies and preferences of central banks in holding reserve assets. Due to the convenience and efficiency of digital currencies, especially Central Bank Digital Currencies (CBDCs), they have the potential to become part of international reserve assets, competing with traditional reserve currencies such as

the U.S. dollar and the euro. This change may lead to a more diversified and decentralized global financial system, while also potentially increasing the efficiency of international transactions and reducing costs and risks. However, it will also require the cooperation of global regulators and international organizations to develop appropriate policies and standards to ensure the stability and security of the new system. Thus, the development of digital currencies and the transformation of the global reserve currency system are dynamic processes that affect and promote each other.

### *2) A new pattern of international trade and investment*

The development of digital currencies is shaping the new landscape of international trade and investment. As cross-border payments and settlements become more efficient and cost-effective, the process of international trade is significantly simplified. The convenience of digital currencies has facilitated the growth of small and high-frequency transactions, which has a positive impact on e-commerce and trade in emerging markets. At the same time, the global nature of digital currencies helps to break down geographical constraints and provides Small and Medium-sized Enterprises (SMEs) with greater access to international markets.

In addition, the programmability of digital currencies brings innovative financial tools to international trade, such as smart contracts, which can automate the execution of contract terms and reduce the cost of trust and the risk of default for both parties to a transaction. In the investment arena, digital currencies offer new asset classes that increase portfolio diversity and may attract more foreign direct investment.

However, digital currencies also posed regulatory challenges, with differences in legal and regulatory frameworks for digital currencies in different countries and regions, which could affect the consistency and predictability of international trade and investment. In addition, the volatility of digital currency markets could have an impact on international investment decisions, requiring more careful risk assessment by investors.

### *3) Opportunities and challenges in developing countries*

Under the new development pattern of the “double cycle”, the financial industry has accelerated its digital transformation and the development of digital finance has accelerated. Digital currency brings a series of opportunities and challenges for developing countries. On the one hand, the low-cost and high-efficiency cross-border payment characteristics of digital currencies can help enterprises in these countries to participate in international trade more conveniently, reduce transaction costs, improve capital liquidity, and thus promote economic growth. The spread of digital currencies may also help developing countries to improve financial inclusion by giving the unbanked access to financial services and enhancing opportunities for savings and investment.

On the other hand, the volatility of digital currencies poses economic stability challenges for developing countries. As the price of digital currencies is volatile, it may have an impact on national monetary policies and financial stability. In addition, the lack of experience and capacity to regulate digital currencies may lead to an increased risk of illegal

financial activities such as money-laundering and terrorist financing.

Developing countries also need to pay attention to the construction of digital currency technology infrastructure, such as the establishment of safe and reliable digital currency trading platforms and payment systems. At the same time, education and training related to digital currencies need to be strengthened to enhance the public’s understanding of and ability to use digital currencies.

The establishment and improvement of the regulatory framework is also an important challenge for developing countries. The formulation of sound regulatory policies that protect the interests of consumers and investors while encouraging financial innovation and technological development is key to realizing the positive impact of digital currencies.

## **IV. POLICY ADVICE FOR DIGITAL CURRENCIES**

Digital currencies are traded through public key technology, and transactions can be completely anonymous and untraceable. In addition, digital currency transactions do not pass through any financial or governmental institutions, and there is no third party that can control digital currency transactions. The fact that users don’t really know how it works and what the risks are, coupled with legal uncertainty and lack of regulation, can easily lead to information asymmetry, resulting in high risk. Digital currencies are prone to criminal activities such as black-market trading and money laundering, which is not conducive to economic stability. According to the European Banking Authority, digital currencies pose potential risks to users, non-user market participants, financial stability, payment systems and payment service providers, and regulatory authorities. If digital currencies are to be used as true liquid currencies, especially as global transaction currencies, this potential transaction risk must be controlled, which requires further technical controls and legal regulation. Without the credit support of sovereign states and a unified legal and regulatory center, it is difficult for digital currencies to be successfully circulated and traded globally. Moreover, the decentralization of digital currencies, price instability, network security technology and other issues are the key “bottlenecks” in the circulation and trading of digital currencies.

### *A. Construction of an International Cooperation and Regulatory Framework*

Strengthen research and improve the supply of legal and regulatory systems. The construction of international cooperation and regulatory framework is crucial in the field of digital currency. With the popularization of digital currencies, cross-border financial activities become frequent, which requires enhanced cooperation among global regulators to jointly address cross-border financial risks. In order to effectively regulate digital currencies, there is a need to establish harmonized international standards and regulatory policies to promote regulatory consistency and transparency. At the same time, the regulatory framework should be flexible to accommodate the rapid development and innovation of digital currency technology. In addition, regulators need to cooperate with fintech companies and

utilize regulatory technology to improve regulatory efficiency and responsiveness. Through international cooperation, illegal activities such as money-laundering and terrorist financing could be combated more effectively and consumer rights protected, while promoting the healthy and sustainable development of digital currencies.

### *B. Policy Advice for Digital Currency Regulation*

Policy recommendations for the regulation of digital currencies need to take into account the balance between promoting innovation and preventing risks, ensuring financial stability and consumer protection, while preventing illegal activities. It is prudent to promote relevant early warning, meltdown and countermeasure mechanisms. This requires policymakers to provide a clear legal framework for digital currencies, including defining their legal status, attributes and categorization. Regulatory policies should strengthen consumer protection measures, ensure financial security, provide risk disclosure and education, and establish effective dispute resolution mechanisms. At the same time, anti-money-laundering and counter-terrorist financing measures should be implemented, including the regulation of digital currency exchanges and wallet service providers, as well as the monitoring of large-value transactions and suspicious activities. In addition, policy recommendations should include transparency requirements for digital currency issuance and trading, as well as crackdowns on market manipulation and fraud. The regulatory framework should be adaptable to cope with rapid technological developments and encourage international cooperation to harmonize cross-border regulatory actions and share best practices. Establishing a multifaceted and co-governance regulatory system should, firstly, clarify the regulatory body. The regulatory subjects of virtual digital currencies can be the government, civil self-regulatory organizations, and the public. The government exercises public power under the guarantee of national coercive force and has high regulatory effectiveness, so it should be dominated by administrative regulation. The social public is more sensitive to the capture of information on virtual digital currency projects in the market, has a certain information advantage, and has higher regulatory enthusiasm. Second, the implementation of regulatory responsibilities. The government should clarify the responsibilities and powers of each internal regulatory body, and put forward a specific plan on how to realize synergistic regulation between the main bodies. Finally, strengthen communication and cooperation. The government should actively listen to the feedback and suggestions of civil self-regulatory organizations and the public, so as to obtain the latest development of virtual digital currencies in society in a timely manner, break the asymmetry of information, and bring into play the cooperative advantages of joint governance of all subjects, in order to improve the overall regulatory capacity.

## **V. CONCLUSION**

Trends in the development of digital currencies portend that they will play a more important role in the financial system of the future. As technology continues to advance, the scope of application of digital currencies will expand and become more widely accepted as a means of transaction and

stored value. The regulatory framework will also mature to meet the challenges posed by emerging markets and ensure financial stability and security. The development of Central Bank Digital Currencies (CBDC) will change the way monetary policy is implemented and financial transactions are conducted, potentially improving the efficiency of cross-border payments and settlements. Meanwhile, the convergence of digital currencies with emerging technologies such as blockchain, smart contracts and Decentralized Finance (DeFi) will further drive financial innovation and create new business models and services. However, market volatility, regulatory uncertainty and technical security issues remain key concerns for the development of digital currencies. As an innovation in the field of financial technology, it has had a profound impact on the international monetary system. By exploring the characteristics of digital currencies, their current state of development, and their potential impact on the international monetary system, this paper aims to provide a comprehensive perspective and in-depth insights for policymakers, financial regulators, and academics.

Digital currencies, based on the technological foundation of blockchain and cryptographic algorithms, offer advantages such as decentralization, high security, and low transaction costs, and these characteristics pose new challenges to traditional monetary policy tools and financial regulatory frameworks. The monetary control ability of central banks may be affected by the decentralized nature of digital currencies, while at the same time, the emergence of Central Bank Digital Currencies (CBDC) provides new tools and instruments for monetary policy implementation and financial regulation. In the field of cross-border payments, the application of digital currencies has greatly improved the efficiency of payments, reduced transaction costs, and impacted the traditional exchange rate mechanism and cross-border payment system. The volatility of the digital currency market has also brought new challenges to financial stability, especially in terms of systemic risk assessment and anti-money laundering and counter-terrorism financing, which require the joint efforts and cooperation of the international community. The impact of digital currencies on the global economic structure should likewise not be overlooked. They may trigger changes in the global reserve currency system, alter the pattern of international trade and investment, and provide new development opportunities for developing countries, while at the same time posing a series of challenges. The widespread use and increased acceptance of digital currencies will drive the global economy in the direction of greater efficiency and transparency.

With the advancement of technology and the improvement of regulation, digital currencies will play a more important role in the future international monetary system. The impact of digital currencies on the international monetary system is multifaceted, and it brings challenges as well as provides opportunities for development. In the future, with the continuous development of digital currency technology and the depth of its application, we have reason to believe that digital currency will play a more positive role in promoting the change of the global financial system and promoting international economic cooperation. At the same time, this also requires us to continuously strengthen our research and

deeply explore the inherent laws and development trends of digital currencies, so as to contribute wisdom and strength to the construction of a more just, reasonable and efficient international monetary system. In the long run, when the external conditions of digital currency such as legal regulation and credit guarantee are ripe, and the internal problems such as decentralization and network technology security are solved, digital currency may be able to take on the responsibility of the world's currencies alone.

#### CONFLICT OF INTEREST

The author declares no conflict of interest.

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