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Working Paper

Opportunities for digital assets in a fractured world

CIGI Papers, No. 326

Provided in Cooperation with:

Centre for International Governance Innovation (CIGI), Waterloo, Ontario

Suggested Citation: Lane, Timothy D. (2025) : Opportunities for digital assets in a fractured world, CIGI Papers, No. 326, Centre for International Governance Innovation (CIGI), Waterloo, ON, Canada

This Version is available at:

<https://hdl.handle.net/10419/322469>

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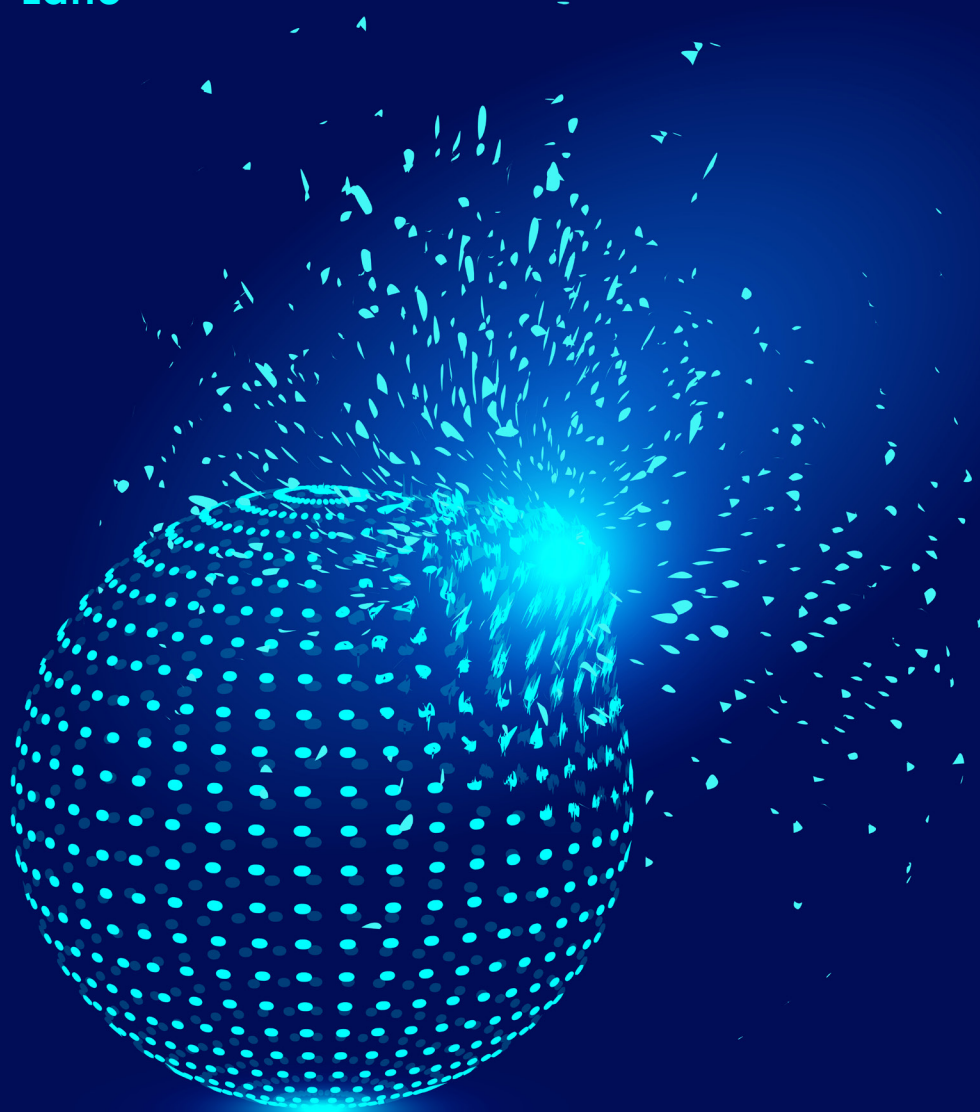
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Centre for International
Governance Innovation

CIGI Papers No. 326 – July 2025

Opportunities for Digital Assets in a Fractured World

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About the Author

Timothy (Tim) Lane is a senior fellow at CIGI and a former deputy governor of the Bank of Canada (BoC) from 2009 through 2022. He shared responsibility for monetary policy and undertook a series of other responsibilities covering all main areas of central bank policy making. He led the BoC's work on central bank digital currency and payments modernization, and chaired the Financial Stability Board's international working group on stablecoin regulation. Previously, he led the BoC's international work, serving as G7 and G20 Deputy.

Before joining the BoC, Tim served for 20 years at the International Monetary Fund (IMF), where he worked on a range of issues concerning advanced and emerging market economies. He has published research on monetary policy and on a variety of other topics related to economic and financial policy. He was also a visiting fellow at the University of Oxford. Prior to his work at the IMF, Tim served as assistant professor of economics at Michigan State University and at the University of Iowa. He received a B.A. from Carleton University in Ottawa and an M.A. and a Ph.D. from the University of Western Ontario in London.

Executive Summary

As the global economic and financial systems become increasingly fractured, this may undermine the US dollar's central role in international trade and finance. Dollar dominance stems from the US economy's weight in world trade, the depth and liquidity of its financial markets, and, more generally, trust that US dollar assets can be accessed with very limited risk of capital controls, confiscation or default. These foundations are weakening, but any potential replacement, including digital assets, would face considerable challenges.

For crypto-assets such as bitcoin, the inherent instability of their purchasing power limits their usefulness for international transactions. Stablecoins, in contrast, promise stable purchasing power through their link to fiat currency — primarily the US dollar. They are beginning to have a significant role in international transactions, especially remittances. But maintaining that link implies close connections with the US financial system and requires a sound regulatory framework. Stablecoins thus seem more likely to become a vehicle for expanding the role of the US dollar, rather than enabling other jurisdictions to lessen reliance on the United States.

In this context, many countries are exploring central bank digital currencies (CBDCs), including with a view to maintaining monetary sovereignty. Few economies are currently moving to launch a CBDC, but that could change. If several key countries launched their own CBDCs, recent experiments with making CBDCs interoperable could point the way to facilitating transactions outside the US orbit. But that approach would require an unusual degree of cooperation among participating jurisdictions.

Introduction

How will the world's money evolve in an age of geoeconomic fragmentation?¹ After decades of globalization — with the United States at the centre — the process of liberalizing world trade and finance has begun to be reversed. The world is increasingly becoming fractured along economic and financial as well as political lines. Does that spell the end of the US dollar's dominance? If so, does that create opportunities for digital assets to take its place?

These questions are related to the *trust* that is fundamental to all money and payments: trust that money can be transferred freely and accepted with a stable purchasing power. Internationally, the dominance of the US dollar relies on the currency's stability as a means of payment for imports. It also depends on the openness of the US financial system, with confidence that US-based assets can be used and transferred without interference.²

While trust among nations is always limited and conditional, it is now deteriorating. World trade is becoming increasingly segmented with mounting trade restrictions and the rejection of the rules-based framework for international trade (Gopinath 2023). The increasing application of financial sanctions that are not supported or respected by many key trading countries has weakened confidence that US-based assets can be transferred freely and raised questions about the use of US-centred financial infrastructure. These trends were already in play prior to this year, but they have been accelerated by the current US administration's actions and pronouncements — including erratic trade policy announcements, belligerence toward US allies, fiscal irresponsibility, and challenges to the Federal Reserve's independence and to the rule of law more generally. These forces may undermine the US dollar's central role as a reserve and trading currency.

1 The term “geoeconomic fragmentation,” used by Gita Gopinath (2023) and Ahn et al. (2023), seems best to characterize this set of developments.

2 Despite the general openness of major economies to financial flows, cross-border payments remain notoriously expensive, slow and lacking in transparency. The Group of Twenty has developed a road map for addressing these problems, but progress has so far been slow (Financial Stability Board [FSB] 2024).

In theory, this scenario could create opportunities for digital currencies, which are designed to be trust-free. Crypto-assets were originally motivated by the libertarian vision of eliminating the need for trusted third parties, such as the central bank and commercial banks, replacing them with an algorithm that creates an incentive mechanism to maintain the crypto asset's value and validate transactions. Could this be part of the solution to the breakdown of trust associated with geoeconomic fragmentation?

This paper discusses how geoeconomic fragmentation may undermine the role of the US dollar. It then examines the potential role of digital assets, including crypto-assets, stablecoins and CBDCs. It concludes that none of these is yet in a position to supplant the US dollar as the world's money of the future.

Geoeconomic Fragmentation and the US Dollar

The US dollar is the dominant means of payment and invoicing unit in international trade, as well as the main international reserve currency. Likewise, global payments rely largely on infrastructures such as SWIFT (the Society for Worldwide Interbank Financial Telecommunication) that are subject to substantial US influence and control.

The dominance of the US dollar arose in the context of the unrivalled size and strength of the US economy in the aftermath of the Second World War. It has continued despite the declining US share in the world economy and global trade, and despite the emergence of other large currency areas. In the early 2000s, some observers expected the euro to take on a much larger international role given the economic weight of the euro area. Then, in the last decade, China's emergence as the world's second-largest economy, and rapid growth, seemed to set the stage for the renminbi (RMB) to challenge US dollar dominance. But neither of these currencies has made substantial inroads on the supremacy of the US dollar. In particular, despite China's active promotion of the internationalization of the RMB, marked by the International Monetary Fund's 2016

decision to include the RMB in the currency basket for the special drawing rights, China's currency still accounts for a small share of trade invoicing and payments and international reserve holdings, relative to the country's economic weight.

There has been much analysis of the dominance of the US dollar — termed “exorbitant privilege” as it enables the United States to spend beyond its income and borrow at lower market rates. Some key factors are the importance of the United States in world trade in the context of globalization, together with the depth, liquidity and openness of the US financial markets and the US government's strong creditworthiness, which has made US Treasury bonds the ultimate safe asset. There is a virtuous circle, in which invoicing of trade in US dollars and holding assets in that currency are mutually reinforcing (Gopinath and Stein 2021). Underpinning it all is confidence that US dollar assets can be accessed under all circumstances — with very limited risk of capital controls, confiscation or default.

How is this environment changing in an age of geoeconomic fragmentation? Globalization began to be reversed in the aftermath of the 2007–2008 global financial crisis. The fragility of supply chains in the wake of the COVID-19 pandemic further fuelled talk of reshoring or friendshoring, with heightened perceptions that the world is dividing into trading blocs. While trade between blocs continues to be enormous, this trade has been diverted through more roundabout channels, stretching the links with the United States (Fajgelbaum et al. 2024; Qiu, Shin and Zhang 2023).

Another challenge to US dollar dominance is the return of the “Triffin paradox” of the 1960s. The logic is that a reserve currency country needs to run balance of payments deficits to meet growing world demand for reserves, but those deficits can be viewed as a negative sign of the reserve currency country's economic health. The current US administration's obsession with bilateral trade deficits, and threats to impose tariffs to eliminate them, runs up against this paradox.³ A further contradiction is the threat to

3 In principle, even if trade were balanced, the United States could provide reserve assets to the rest of the world while acquiring foreign equity and other risky assets — and, indeed, this does happen to some extent. But financial fragmentation and geopolitical risk may limit such offsetting portfolio flows (Catalán et al. 2023).

impose tariffs on countries that move away from the US dollar as a reserve currency (Das 2024).

The increased use of financial sanctions also risks undermining the central role of the US dollar. These issues came to a head with Russia's invasion of Ukraine. The financial sanctions imposed in response, however justified, are a reminder that openness of the US financial system is subject to the will of US authorities: confiscation risk is real, even when assets are held in the United States. And because sanctions were not supported or observed by the other BRICS members (Brazil, India, China and South Africa), they had the effect of deepening the rift between US allies and BRICS countries rather than isolating Russia as intended. Resentment has arisen among countries not directly involved in the Russia-Ukraine conflict about spillovers from the sanctions (Patel 2024).

Another factor is some weakening of absolute confidence in the safety of US dollar assets held as reserves (Kamin and Sobel 2024). In 2011, the S&P downgraded US debt from its AAA status in the wake of fights over the debt ceiling. (Other credit rating agencies eventually followed suit — most recently Moody's in May 2025.) Since that time, there have been several further episodes of debt brinkmanship reflecting broader political conflict. Such episodes involve a game of “chicken”: in all cases so far, agreement has been reached at the eleventh hour, but the nature of that game is that there must be some actual risk of a collision. Concerns over US creditworthiness have been heightened by historically large deficits during and after the COVID-19 pandemic, and projections that large deficits will continue indefinitely under the current US administration's policies. There is already evidence that large fiscal imbalances, combined with quantitative easing by the Federal Reserve, have contributed to investor perceptions of a “risky bond regime” (Gómez-Cram, Kung and Lustig 2024), and recent movements in bond and foreign exchange markets suggest that such concerns have sharply intensified. Political actions to limit the Federal Reserve's ability to backstop support of financial markets in a crisis, and recent challenges to the Fed's independence, also tend to undermine the US dollar as a reserve currency.

Beyond this, the climate for international cooperation is becoming less favourable, reflecting a more inward-focused US administration together with a more controlling Chinese regime. This spells less will to work together on common problems

affecting international debt and market functioning, including the determination needed to maintain open borders and financial flows (Gopinath 2023).

Are Digital Assets Part of the Solution?

All of these factors suggest that the continued dominance of the US dollar is not assured. But no obvious replacement for the US dollar has emerged. Could digital assets be an alternative?

In a world of geoeconomic fragmentation, there are three potential avenues for digital assets to be explored. One is the possibility that a digital asset could become a form of global money that supplants the US dollar and bridges across the different blocs that are emerging. A second is that one or several digital assets could be used among those jurisdictions that wish to avoid reliance on the US financial system. A third, which goes in a different direction, is that digital assets could become a vehicle for enhancing the global reach of the US dollar in the face of other factors that undermine it.

The adoption of a global money that is not reliant on a single jurisdiction harks back to the gold standard that supported the earlier era of globalization in the nineteenth and early twentieth centuries. Gold continued to be the foundation of the world monetary system despite the imperial rivalries of that period. It is tempting to think that digital currency, which is also created outside any single jurisdiction, could play a similar role in the twenty-first century. Could digital assets facilitate international commerce and finance in the face of global rifts?

Such considerations gain particular relevance in light of the current US administration's enthusiasm for crypto-assets. That enthusiasm has its own contradictions — between the libertarian vision of crypto as money independent of government and President Donald Trump's aspiration to make the United States “the bitcoin superpower of the world” (da Silva and Edwards 2024), with proposals for a “Strategic Bitcoin Reserve” (The White House 2025), as well as with his insistence on the pre-eminence

of the US dollar. But it does give greater immediacy to the potential role for crypto-assets.

Any major role for crypto-assets (such as bitcoin) as global money runs into the same limitations as it does domestically. While the proof-of-work mechanism underlying bitcoin prevents its overissuance, the lack of elastic supply in the face of shifts in demand results in wide swings in its purchasing power — far beyond those of any but the most unstable fiat currencies. The lack of stable purchasing power implies that its use for paying for goods and services, or for borrowing and lending, must inevitably remain marginal. (That volatility itself, of course, is a major reason for its popularity as an investment asset.) Furthermore, a financial system based on a crypto-asset (as distinct from the emergence of crypto as an asset class within the financial system) is also hampered by the fact that the automatic and decentralized nature of issuance prevents any agency acting as a lender of last resort to stabilize the system in case of a crisis. The hallmark of a crisis is that illiquidity can morph into insolvency, which implies that crypto-based assets are more likely to have unacceptable levels of default risk than those based on fiat currency.

Of course, there remains a role for crypto-assets for those transactions where the need for anonymity is such to override the unstable purchasing power. These include transactions that circumvent regulations to evade anti-money laundering (AML)/countering-the-financing-of-terrorism checks, as well as for bribery, tax evasion, ransoms and purchases of illegal items (guns, drugs, human trafficking and so forth). Crypto-assets have also been used to avoid sanctions. In addition, in some countries without access to a stable monetary standard (for example, with hyperinflation), crypto-assets may be the best available means of payment. But crypto-assets cannot replace the US dollar as the central vehicle for global trade and finance.

What about stablecoins? They offer a stable value in fiat currency but are held and transferred on digital platforms rather than through conventional payments systems. They could thus, in principle, avoid the instability of purchasing power associated with crypto-assets while circumventing the existing US-centred payments architecture. But the vast majority of stablecoins are linked to the US dollar, and to the extent that their issuers need to hold reserves to stabilize their value, these assets will rely upon — or at least be linked to — the US financial system. It is unlikely that a

US dollar-linked stablecoin arrangement would be viable without a significant US presence, even if the stablecoin is issued offshore.

There are already signs that the use of stablecoins is broadening — not primarily as a response to geoeconomic fragmentation but to other challenges. Until recently, stablecoins were used mainly as on- and off-ramps for crypto-asset investments, with few links to the mainstream financial system and the real economy. However, their use is beginning to increase as a means of payment for goods and services, as well as for cross-border finance. A particularly important use case is for remittances, where stablecoins offer a lower-cost alternative to the very expensive, slow and unreliable conventional channels for cross-border payments. Beyond this, there is the potential for tokenization of many kinds of financial assets and the use of distributed ledgers to simplify a whole array of transactions. If this turns out to be the way of the future, it could give stablecoins a very central role in the financial system.

Because stablecoins purport to offer a stable value in fiat currency, they involve risks similar to those associated with banking. If stablecoins are to be used more widely, a robust and coherent regulatory framework is needed to ensure that issuers can make good on their commitments to holders, including when the financial system is under stress.

Progress with regulation of stablecoins globally has, however, been uneven. The FSB agreed on general principles for stablecoin regulation in 2020, but their implementation is not straightforward (FSB and IMF 2024). In many jurisdictions, including the United States, the regulatory framework for stablecoins has been a work in progress. The United States has until recently been slow to act, although the GENIUS Act (currently on its way through Congress) would establish a regulatory framework that is a lighter version of bank regulation.

Regulation of US dollar-referenced stablecoins could enable these to become a vehicle for expanding the use of the US dollar worldwide, separate from the conventional financial system. An important question, though, is whether the US administration, in its quest to develop the crypto space, would be prepared to see US dollar-backed stablecoins become a widely used channel for circumventing financial sanctions, AML rules and other restrictions associated with using conventional US-based payments systems. It seems likely that, rather than ceding that degree of control, it would seek

to find ways of re-establishing it — for instance, by requiring that US sanctions and other policies be incorporated into the smart contracts that govern their use. If that occurred, though, it could discourage their use in other jurisdictions.

Moreover, if stablecoins were promoting further dollarization, other jurisdictions would likely move to launch digital versions of their own currencies. This could occur through the private market, with the issuance of stablecoins linked to other currencies such as the euro. More likely, the challenge of US dollar stablecoins could spur the launch of CBDCs.⁴ Indeed, maintaining monetary sovereignty is an important reason that many central banks have been exploring the possibility of launching a CBDC (see, for example, Brooks 2021).

Whereas stablecoins are linked to fiat money, a CBDC is fiat money, thus relying on trust in the central bank to maintain stable purchasing power but using tokenization to enable a different set of transactions possibilities. Two possible versions of CBDCs have been explored: “retail” CBDCs that are made available to the general public like cash, versus “wholesale CBDCs” that are essentially tokenized bank reserves whose use is restricted to a limited set of financial institutions. Wholesale CBDCs generally operate on permissioned blockchains and thus do not circumvent the existing set of established financial institutions, including the central bank, and only change the way these institutions carry out and keep track of their transactions with one another.

If major countries adopted wholesale CBDCs, that would create the potential for establishing distributed ledger technology (DLT) platforms permitting the direct exchange of CBDCs issued in countries other than the United States, without using the US dollar as a vehicle currency or going through the US payments system. There has been extensive research on how CBDCs could be made interoperable, permitting cross-border and cross-currency transactions on distributed ledgers. The Bank of Canada’s Project Jasper, later expanded across borders to connect with Singapore and the United Kingdom, was a trailblazer in this regard (Bank of Canada, Bank of England and Monetary Authority of Singapore 2018). More recently, the Bank for International Settlements (BIS) has done

extensive work in this area through its Innovation Hub. Much of this work involves live experiments carrying out actual transactions, albeit on a limited scale and with a restricted set of participants.

A particularly important example of such BIS work is Project mBridge (BIS Innovation Hub 2022). This project, based at the BIS Innovation Hub in Hong Kong, developed a DLT platform with participation from several of the BRICS+ group.⁵ While implementation of the project was generally successful, the BIS ended its own involvement and transferred the project to the participating countries. In principle, mBridge could provide a template for wholesale transactions among BRICS+ countries in the event that these members introduced their own wholesale CBDCs.

This experience illustrates both the potential and the challenges of using digital currency to supplant the US dollar if geoeconomic fragmentation continues. It has been demonstrated that a DLT can be used for transactions among CBDCs. However, the development and use of such a framework would require considerable cooperation and trust among the participating jurisdictions, as they are relying on one another to control access to the platform. It also requires a degree of acceptance by each country that their central bank reserves are being used outside their own control in other participating countries. It is far from clear whether members of the BRICS+ group would be prepared to give up the element of sovereign control required to bring such a framework into the mainstream.

Finally, the BRICS+ group has floated a plan to reduce reliance on the US dollar by launching a common currency in digital form (Das 2024). Despite the hyperbolic response from the US president, the prospects for such a currency are remote. It would require substantial sharing of sovereignty among participating countries. Moreover, major structural changes in those countries to establish deep liquid and open financial markets (and/or a massive deterioration in those aspects of the US economy) would be required to enable a BRICS+ currency to displace the US dollar (Kamin and Sobel 2024).

More generally, such cross-border use of CBDCs would probably need to flow from domestic adoption in relevant jurisdictions. In many

4 The introduction of a CBDC in the United States would be a game changer at a global level, but for political reasons, there is no prospect that this will occur in the foreseeable future.

5 Brazil, Russia, India, China, South Africa, Egypt, Ethiopia, Indonesia, Iran and the United Arab Emirates.

advanced economies, though, the case for domestic adoption is less than compelling, especially if its use is limited by the traditional divide between retail and wholesale. Consumers may see little advantage to using CBDCs for retail transactions when they have access to fast, contactless payments. At the same time, wholesale transactions are already handled electronically quite efficiently though real-time gross settlement systems.

Where CBDCs do have greater transformative potential is in the context of widespread tokenization of a range of financial assets — which has the potential to simplify transactions and reduce duplication, thereby enabling many new kinds of financial activity, including decentralized finance. The potential for transformation is greatest when tokenization is combined with other innovations, including smart contracts and artificial intelligence. But unlocking this potential would surely break down the traditional boundaries between retail and wholesale — whereas most central bank explorations of CBDC are working within those confines. For example, the European Central Bank has been developing a digital euro that would be used exclusively for small retail transactions, with strict limits on transaction size and holdings. Another example is the People's Bank of China's digital RMB (e-CNY) pilot, launched in response to the wildly popular retail payments apps provided by China's large tech companies. An expanded global role for CBDCs would require a wider vision of how the whole financial system could change with wider adoption of digital ledgers and related technologies.⁶ It seems likely to be, in that context, that CBDCs would have greater potential to counter the role of stablecoins in advancing dollarization, or to encroach on the international dominance of the US dollar.

Conclusion

Recent trends toward global fragmentation do weaken the underpinnings of the dominance of the US dollar. However, there are considerable challenges to any potential replacement, including digital assets. The lack of stable purchasing power of crypto-assets, and the reliance of stablecoins on a sound regulatory framework, limits their use for international transactions. There is some potential for interoperable CBDCs to facilitate transactions outside the US orbit, but that would require a degree of cooperation among those jurisdictions that so far has not been forthcoming.

This is a space that is evolving rapidly, and there may well be further developments enabled by technology that will change the landscape. But enthusiasm about the potential for digital assets should be tempered by realism about what it can achieve in the near term.

⁶ One such vision is the “finternet” discussed by Agustín Carstens and Nandan Nilekani (2024).

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