Digital Currencies and their Implications

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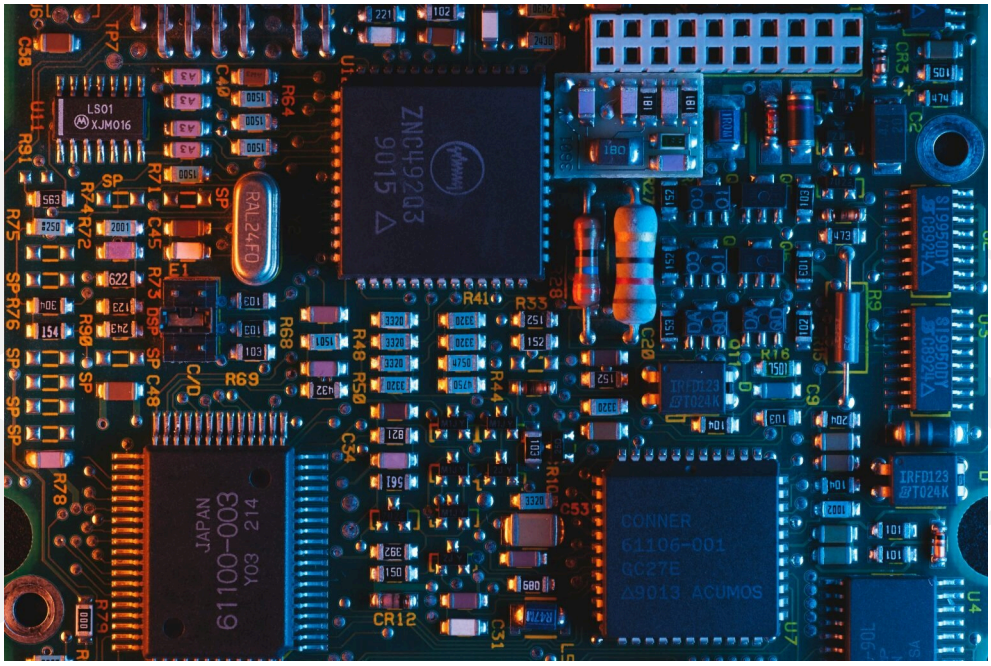


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Digital Currencies and Their Implications for International Relations: The Case of the Euro

Research Question

How could the introduction of the digital euro reshape international relations in terms of monetary power and cross-border economic relations?

Introduction

The financial sector is undergoing a current wave of digitalization, putting pressure on the evolution and modernization of the international monetary system. Evidence for this is the decrease in cash usage: in 2022, cash accounted for almost 60% of transactions, whereas today that share is 52%, a figure that continues to decline (Balz, 2022, p. 2). In response, central banks

have been exploring the development of Central Bank Digital Currencies (CBDCs). However, these extend beyond technological innovations and carry significant geopolitical importance; their introduction could affect payment systems, monetary sovereignty, financial stability, and the balance of power (Westermeier, 2024, pp 1570-1571). A strong case for the urgency of modernization for technological and strategic purposes is the European Union's (EU) proposal for a digital euro, which aims to enhance the Union's competitiveness in the international monetary system, particularly against the dollar and the yuan. Therefore, the introduction of this policy creates the opportunity for the E.U. to consolidate itself as a normative power and to reinforce the monetary sovereignty that they currently lack.

Background: digitalization of finance and the European Central Bank

New technologies have enabled faster transactions, reduced costs, and introduced new forms of economic interaction. In addition, there has been a rise in the number of big tech companies and an increase in the popularity of cryptocurrencies, with almost 600 million users worldwide up until 2025 (Eleshin et al., 2025, p. 1). Nevertheless, these changes have raised questions about the extent to which the state retains control over payment infrastructures and money, as well as how the role of the Central Bank is being challenged (Balz, 2022, p. 2). Thus, digital currencies are being framed as a tool to preserve monetary sovereignty, referring to the control and state authority over their currency and monetary policies (Landau & Nicole, p. 5, 2024)

In definition, CBDCs are the digitalized version of what we know as central bank money, backed by the institution, centralized, and integrated into existing monetary systems (European Central Bank, n.d.). Therefore, it is just an alternative form of payment, not an intended replacement for physical cash. The European Central Bank has explained that through this alternative, the intention is to ensure a risk-free access to money in an era of technological transition and to reduce the dependence on non-European payment providers such as Visa, MasterCard, or PayPal (European Central Bank, n.d.). This reliance is not only an economic concern but also geopolitical, as given that these firms operate under U.S. jurisdiction, they are subject to U.S. regulations and sanctions. This creates a risk for the EU as transactions are regulated by third-party states, and data can be stored, processed, and governed outside the EU.

The EU is not the only power that has proposed a digital currency; multiple others are also in the process of development. China can serve as an example and be considered one of the early movers, as they have already started a trial run of an e-CNY or digital yuan in multiple cities around the country (Paulovici, 2025, p. 2979). With this move, China could gain structural advantages in payment systems, surpassing other nations that aim to

be a normative financial power and dominant in the economic and financial sector.

The three motivations behind the digital euro

Digital currencies and more specifically the euro have been driven by a combination of political, economic, and strategic factors. Three categories that highlight the use of technology to increase a country's relative advantages.

Firstly, the EU seeks to achieve monetary sovereignty by reducing its dependence on non-European providers, such as Visa or Mastercard, which combined have a market share of almost 90% (European Court of Auditors, 2025). A greater control over the payments landscape gives the organization better monitoring power over regulatory and data privacy compliance, as well as the opportunity to increase efficiency by unifying the sector and supporting competition and innovation. A digital euro would then increase the strength of the EU's financial infrastructure, one strong enough that it would reduce reliance on external third-party providers (Giovani, 2023, p. 25).

Furthermore, the EU aims to improve its economic position and increase its international relevance. This has increased in urgency as the yuan continues to rise, the dollar continues to be dominant and preserve its position as the reserve currency, and the talks on digital currencies from other emerging economies are starting (Heidebrecht, 2026, p. 3). All these factors that affect the union's foreign policy not only highlight the incentive and priority to modernize but also the direction of the international monetary order, which is opening space for new powers to emerge and challenge the long-lasting dominance of the U.S. Thus, to enhance its position and maintain its competitiveness the EU has to be able to offer a credible and trusted digital currency within its regulatory framework.

Finally, while economic and political factors are the main drivers of this policy, there is also a broader strategic aim of the EU to act as a normative force (Heidebrecht, 2026, p. 4). As with the General Data Protection Regulation (GDPR), through the design of a digital currency, the EU can protect its regulatory standards internationally, embedding principles such as privacy protection, consumer rights, and data governance. This process is often referred to as the Brussels effect, whereby the EU unilaterally shapes global regulations and companies adopt them to access the market (Bradford, p. 2, 2020).

Comparative analysis between the digital yuan and the digital euro and its financial implications

The digital yuan and the digital euro are two of the biggest projects that are reshaping monetary and financial infrastructure. While both examples are similar in definition, they differ in their political, ideological, and insti-

tutional models of digital finance, hence having different implications for their financial and monetary systems.

On the one hand, China's digital yuan represents a more state-centric and centralized model. The design attributes great control to the government, giving authorities power to monitor transactions, financial data, and overall strengthen control over the financial sector (Paulovici, 2025, p. 2982). Conversely, the EU promotes a rule-based model emphasizing principles of privacy protection and regulatory transparency, limiting the control the state has over financial transactions (pp. 2985-2986). Their design not only shows the role of ideology in policymaking but also exhibits the normative competition between two powers with very different models of digital finance.

Their variations in design make both currencies have different implications at each level. Firstly, in terms of monetary policy, the digital yuan would provide real-time economic data on spending patterns to the People's Bank of China (PBC), allowing faster policy interventions and a more precise monitoring of economic activity (p. 2991). The digital euro, on the other hand, is more cautious, focusing more on preserving the stability of the system. This tool would increase the efficiency of the European Central Bank to influence the velocity of money circulation, interest rates, and money supply. Therefore, its function would be limited to complementing existing monetary tools while simultaneously reinforcing the stability of the system. Another implication concerns Central Banks and the risk that digital currencies could reduce the role of banks as intermediaries in the financial system. This occurs when consumers shift their money from commercial banks into their digital central bank wallets. To mitigate this risk, China is proposing two solutions: the enforcement of caps, limiting the money a consumer can keep digitally with the central bank, and, secondly, tiered remuneration, which is when different interest rates depend on the balance. Similarly, the ECB also proposed a cap; however, their alternative solution is an indirect insurance model where banks distribute and manage digital euro wallets instead of the ECB dealing with citizens, minimizing systemic constraints. Finally, where both approaches relate the most is in their digital currencies' potential to increase financial inclusivity. Both the yuan and the digital euro would allow underbanked communities to access financial services; however, their target audiences diverge. China is focusing more on rural communities, while the European Union is extending it to all digitally illiterate and all underbanked regions around the Eurozone (p. 2989).

Cross-border payments and international economic relations

International payments today are costly, complex, and slow due to the fragmented structures and multiple intermediaries. The digital euro could help simplify transactions not only within the union but also with external

partners and other CBDCs, creating a multilateral payment framework (Demertsiz & Martins, 2023, p. 197).

While initiatives like the SEPA have improved transaction speeds within the EU, cross-border payments remain fragmented and dependent on multiple intermediaries. This inefficiency is largely due to the reliance on banking networks and systems such as SWIFT, which can take up to days and involve fees of around 6-7%. Hence, the unification of the system through a digital euro would increase efficiency by reducing costs, connecting central banks, and enabling the use of local currencies for international transactions (p. 199). For small and medium-sized enterprises, this is particularly beneficial as they are the most affected by high transaction costs in international trade. As a result, this would increase cross-border volumes and improve market access, strengthening economic integration within and outside of the EU.

This is highly significant as the system is overwhelmingly dominated by the dollar, involved in almost 90% of all trades. In this context, digital currencies would reduce dependencies on the United States, allowing central banks to reduce the number of transactions in dollars and to trade in their own currencies.

On the other hand, for international relations, this unification would destabilize the current balance of power, reducing the dominance of the United States and its ability to weaponize interdependence. This term refers to states holding key positions in financial networks to exert coercive power or push for change in a certain actor's policy. Meanwhile, for the EU, a widely used digital euro embedded in cross-border settlement platforms would increase its structural power, requiring businesses or third parties seeking investment to comply with European regulations and expectations (Westermeier, 2024, pp. 1580-1583).

Risks and limitations

Despite its benefits for European autonomy and rise as a normative power, the digital euro comes with great risks and constraints. For consumers, the new alternative might not be attractive, so to protect central banks, policymakers have to introduce caps or regulatory restrictions on holdings. This not only makes the digital euro less attractive as a store of value but also highlights how private alternatives might still be more competitive (Gütschow & Lucke, 2025, pp. 9-14). In addition, a complex regulation might also create challenges, complicating the adoption among consumers.

Financial stability is another concern. Some scholars argue that in times of uncertainty, the digital euro facilitates a rapid transfer of deposits from commercial banks into digital euros, creating a higher risk of bank runs and destabilizing the financial system. However, it is important to acknowledge that the introduction of caps or an indirect insurance model would over-

come this challenge, measures that the EU is already planning to undertake, as previously mentioned (Esposito, 2022, p. 8).

Finally, cybersecurity plays a major role with big concerns about financial surveillance and data protection among citizens. A digital euro increases the risks of cyber attacks, fraud, and technical failure, weakening trust among users and partners. Ultimately, the effectiveness of the digital euro will depend on the EU's ability to solve these problems, maintaining confidence in the security and governance of the system (Duhnevich, 2025, p. 49).

Policy implications

Overall, while the current world context creates an urgency to modernize and innovate, the design and implementation of these tools will have long-term consequences, which can translate to diplomatic issues or a current power imbalance. Thus, policymakers will need to consider a series of priorities:

Europe needs to reduce its dependence on American corporations and strengthen its financial infrastructure; however, an excess of protectionism can impact the success of its digital euro and international adoption. European policymakers thus need to find a balance between achieving monetary sovereignty and ensuring interoperability with global financial systems.

On the same line, the digital euro creates an opportunity to build on alliances and create new strategic partnerships. The cooperation with other like-minded economies helps set new standards and shared norms on trust, data use, and cybersecurity. An early cooperation and establishment of norms can increase the attractiveness of digital finance among other democracies.

While the new version of the euro can increase efficiency, reduce costs, and bring in new consumers, this can also become a threat to financial stability without strong regulation. Hence, the organization will need to either introduce caps on holdings or impose other conditions to prevent massive transfers of money from commercial banks into central banks. These regulations will be key to preventing and maintaining control during economic crises.

Finally, an early move to digitalize currencies allows the European Union to rise as a normative power. The integration of rules on transparency, data governance, and consumer protection increases the EU's global influence and makes it an important power in the governance of digital finance

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