Discussion of

Geopolitics and global interlinking of fast payment systems

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Stabilization policies amid shifting global relations

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* The views expressed here do not necessarily represent those of the Bank of Italy.

This paper

- Assembles a novel dataset of interlinking arrangements between payment systems
- Provides new stylized facts about interlinking of *fast* payment systems
  - multilateral links (regional platform) vs bilateral links
  - fragmented landscape, several disconnected clusters
- Evaluates how economic, technical and geopolitical factors influence the probability of establishing an interlinking arrangement.

  → geopolitical distance matters more than standard gravity variables!

Main exercise: in a nutshell

- **Goal:** estimate the probability that two countries interlink their FPSs based on **economic**, **technical**, and **geopolitical** factors.
- **Data:** annual dyadic panel
  117 countries, 2016–2023, 527 links (bilateral + multilateral)
- **Model:** Panel logit with origin/destination and year fixed effects:

$$\Pr\left(y_{ij,t} = 1 \mid \mathbf{X}_{ij,t}\right) = \frac{1}{1 + \exp\left[-\left(\beta' \mathbf{X}_{ij,t} + \alpha_i + \alpha_j + \lambda_t\right)\right]}$$

  - $y_{ij,t} = 1$ if fast payment systems of i and j are linked in year t
  - $\mathbf{X}_{ij,t}$ includes gravity variables (GDP, trade, geo distance), technical features (e.g. ISO 20022), and **geopolitical distance** (UN voting)

Results

- **Key finding:** A 1SD increase in geopolitical distance reduces the link probability twice as much as a 1SD rise in geographical distance.
  $\rightarrow$ **robust** and plausibly **causal** (IV) finding

- **Other findings:**

  - standard gravity variables (GDP, trade flows, geographical distance) have the expected impact on link formation

  - technical factors (common messaging, ISO 20022 standards) are important determinants as well

Thoughts on the paper

- Amazing data collection work: the dataset itself is a huge contribution
- A very enjoyable and pedagogical read
- Simple but neat and relevant empirical exercise
  - smart application of ideas developed for trade by Eichengreen, Mehl, and Chițu (2021) to the economics of payments
  - possibly the foundation for theoretical work on the topic [akin to models of trade agreements à la Thoenig (2024)]
- A whole battery of (convincing) robustness checks
- A good attempt to estimate the causal effects of geopolitical distance using genes, with some caveats

My (minor) comments

1. Causality: some remarks
2. Mechanisms: some thoughts on the *opportunity cost of war* channel
3. Suggestions and smaller points

- **Identification.**
  - The instrument is clearly relevant and exogenous/random
  - I don't think this is enough to say the the exclusion restriction is satisfied: Z (genetic dist.) being random does not imply that it does affect Y (link formation) only through X (geopol dist.)
  - Example (made up): genetic similarity influences the probability of link formation positively, through (for instance) legal similarity
    No big deal, though
  - As long as the direct effect of Z on Y is positive (as it likely is), IV estimates are **a lower bound for the true effect** (direct effect has opposite sign wrt first stage)

My comments

1. Causality - some remarks

- **Interpretation of results.**
  - IV identifies the LATE - the effect of geopolitics on link formation for a special subset of dyads (those for which genetic similarity shifts geopolitical alignment)
  - The coefficient on geographical distance in the same model identifies an ATE, i.e., the average effect across all dyads in the sample
  - The comparison between the magnitudes of these coefficients may be inappropriate
- **Estimation.** 2SLS: why not a control function approach?
  (maybe this is already what you do but I found it unclear)

My comments

2. Mechanisms: some thoughts on the *opportunity cost of war* channel

- In the paper, one of the channels that might drive the negative link between geopolitical distance and the probability of link formation is:

  "*[...] geopolitically close countries have an incentive to establish payment links to increase the opportunity cost of a war between them*"

- This incentive may however be *weaker* for geopolitically close countries than for distant ones!

- On the similar topic of regional trade agreements (RTAs), Martin, Mayer, and Thoenig (2012) state:

  "*[...] RTAs provide two types of peace-promoting security gains: by offering a political forum which facilitates settlement of future disputes, and by* **increasing the opportunity cost of future and potentially trade-disrupting wars**. *[...] RTAs are more beneficial to country pairs with a higher probability of war.*"

My comments

2. Mechanisms: some thoughts on the *opportunity cost of war* channel

- The authors mention an alternative channel
- Geopolitical similarity and preference alignment "*lowers the cost of establishing a contractual agreement around payment interlinking arrangments*"
- In light of the previous discussion, this mechanism may be the main driver behing the results
- Is there any way to disentangle the two channels, maybe estimating conflict probabilities as in Thoenig (2024)?

My comments

3. Suggestions and smaller points

- **Dynamic effects of interlinking.** Using propensity score matching to evaluate the dynamic effects of establishing an interlinking arrangments on both geopolitical distance and trade/GDP
  (maybe in another paper :D)

- **Weighting.**

  - Are all dyads treated in the same way in estimation?

  - Are results robust to weighting each link by value/volume of payments?

Taking stock

- A very well-executed (and fun to read) paper
- Incredible data collection work (just look at the Appendix!)
- Nice overview of fast payment systems and interlinking arrangements, with new stylized facts
- Relevant and robust empirical finding: geopolitical distance is a strong predictor of choices to interlink fast payment systems
- Some caution warranted, especially in the quantitative interpretation of IV results

References I

- Eichengreen, Barry, Arnaud Mehl, and Livia Chițu (2021). "Mars or Mercury redux: The geopolitics of bilateral trade agreements". In: *The World Economy* 44.1, pp. 21–44.
- Martin, Philippe, Thierry Mayer, and Mathias Thoenig (2012). "The geography of conflicts and regional trade agreements". In: *American Economic Journal: Macroeconomics* 4.4, pp. 1–35.
- Thoenig, Mathias (2024). "Trade in the shadow of war: A quantitative toolkit for geoeconomics". In: *Handbook of the Economics of Conflict*. Vol. 1. Elsevier, pp. 325–380.