Discussion of:

The Payment-Credit-Privacy Trilemma

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The views expressed here are those of the authors and do not necessarily reflect the position of the Federal Reserve Bank of New York or the Federal Reserve System.

Overview

- Part of an interesting research agenda focusing on:
  - digital ledgers, platforms, information and market power

My plan:

- Summarize some of the ideas
  - paper covers a lot of ground; I will focus more narrowly on the privacy issues
  - start with some basic background, then bring in ideas from the paper
  - suggest a way of reframing some questions and results
- Ask about:
  - optimal policy
  - privacy: what do we care about?

Unsecured credit

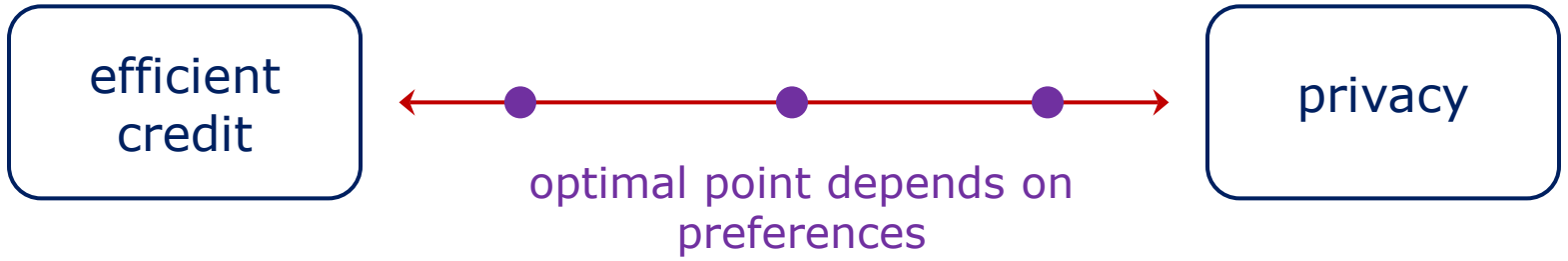
- Starting point: It is difficult for people with few assets to borrow
  - think of someone running (or starting) a small business
  - lenders are wary of making a loan because:
    - it is difficult to evaluate the borrower's likely ability to repay, and
    - it is relatively easy for the borrower to default even if they are able to repay
- Digital platforms and payment ledgers have the potential to change this
- Idea: if the business receives payments through the platform/ledger
  - operator gets information that is useful for evaluating ability to repay, and …
  - exclusion from the platform/ledger may be costly → incentive for borrowers to repay
  - examples: Alibaba & Tencent (China), Paytm (India), Mercado Credito (Argentina), Amazon Lending (U.S.)

Privacy

- The operator is able to grant credit because the business is using the platform/ledger
  - which gives the operator transaction-level data about the business
- Suppose privacy = ability to disassociate transactions from one's identity
  - i.e., to make transactions that are not monitored by a third party (like the operator)
  - potentially valuable for both merchants and consumers (more on this point later)
- One way to get privacy: transact off the platform and settle off-ledger
  - example: sell direct and do payments in cash
- But if a merchant can operate just as well without the platform/ledger …
  - … then being excluded following default is not costly
  - so the incentive to repay is undermined → less unsecured credit is viable

A dilemma

- Dilemma: cannot have the efficient level of unsecured credit and perfect privacy
- More generally, a tradeoff:
  - there are degrees of privacy : less costly to transact off-ledger ≡ more privacy
  - more privacy means less unsecured credit (and vice versa)
- Policymakers can choose a point along this tradeoff
  - if the private payment option is cash, by making cash more/less attractive to use
    - or by choosing design features of a digital currency
  - if multiple private ledgers, by regulating information sharing, interoperability



Payments and market power

- Key feature of the paper: focus on the IO of the platform/ledger operator(s)
- If exclusion from the platform/ledger is costly …
  - which is necessary to incentivize repayment …
- … the operator likely has market power
- The operator will tend to use this market power to generate monopoly rents
  - can charge higher fees to process transactions
  - these higher costs will discourage economic activity
- Add another policy objective: low-cost payments
  - ask: how does this interact with the tradeoff between efficient credit and privacy?

Cash

- A first thought: perhaps low-cost payments and privacy go hand-in-hand
- Reason: cash naturally provides both
  - option to use (low cost) cash limits the fees private providers can charge
    - this is perceived to be an important role of cash in practice
  - … and cash by its nature provides privacy
- In the digital economy, a privacy-preserving digital currency can play this role

Smart CBDC or Co-opetition

Q: Do payments concerns necessarily push us toward choosing more privacy?

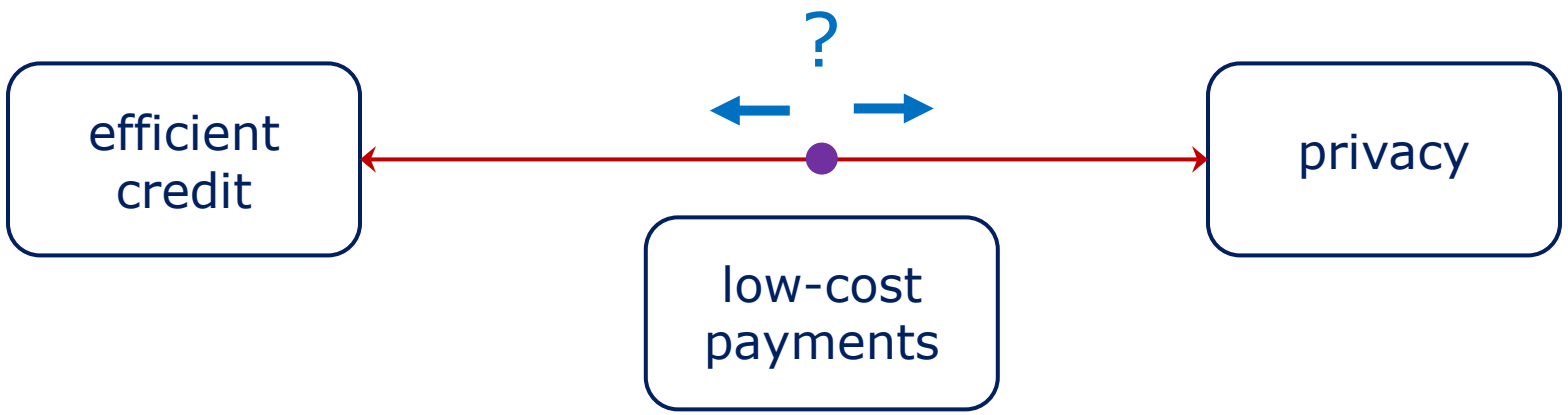
A: No.

- Paper shows: we can also have low-cost payments and efficient unsecured credit
- Two routes:
  - smart CBDC: a public ledger that supports contract-contingent settlement
  - co-opetition: private providers compete on fees, but share relevant credit information

Reframing the question

- Paper presents this result as a *trilemma*
  - we cannot have efficient unsecured credit, perfect privacy, and low-cost payments
- Alternatively: promoting competition in payments does not *resolve* the tension between unsecured credit and privacy
- I might ask:

Does the desire for low-cost payments shift the optimal point? If so, how?



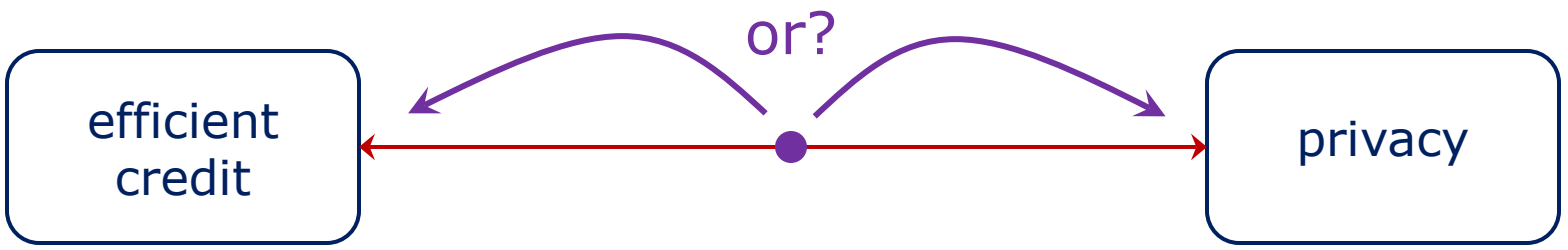
Optimal policy (1)

- Suppose the optimal point was initially in the middle

Q: Does market power and the desire for low-cost payments push us to an extreme?

- is it easier to get low-cost payments if we have perfect credit or perfect privacy?
- if so, does it make one of these extremes more attractive than the other?

- Or can we achieve low-cost payments with any point along the tradeoff?

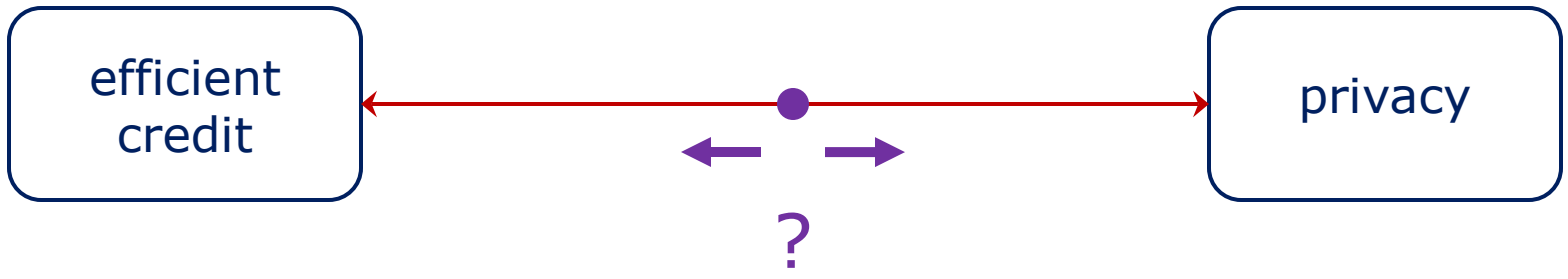


Optimal policy (2)

- If low-cost payments are consistent with many combinations of credit/privacy …

Q: Does the desire for low-cost payments 'tilt' the tradeoff in some way?

- For a given level of privacy, do policies that promote low-cost payments:
  - decrease the equilibrium quantity of unsecured credit?
    - meaning privacy becomes more costly → may want less of it
  - or do they make privacy less costly at the margin?
  - or do they have no effect on the tradeoff and the optimal balance?



What is privacy?

- Answers to these questions may depend on why, exactly, we care about privacy
- Easy to think of examples:
  - merchants might worry about others learning the details of their business model
  - consumers might worry about others learning their preferences → increased price discrimination
- Here: privacy = ability to transact without being monitored by any third party
- Perhaps that definition is too strict/coarse
  - for consumers: perhaps privacy = no one party sees too many of my transactions
  - then 2 private ledgers with $\chi = 0$ may jointly offer privacy if I can split my transactions
    - and they are not allowed to share data

    ⇒ interesting interaction between interoperability, regulation, and privacy

- Put differently:
  - efficient credit does not require that everyone observe all transactions
  - privacy does not require that no third party observe any transaction
- Being more explicit about what privacy is can help us:
  - understand the optimal point on the credit/privacy frontier …
  - .. and how it may be affected by market power, desire for low-cost payments
- But it also may give insight into the frontier itself
- Would like to think more about the information structure: who observes what?
  - what features are needed for efficient unsecured credit?
  - what features are needed for privacy?
- Can digital technology/regulation ease the credit/privacy tradeoff?

Summary

- An interesting paper with many insights
  - I have only touched on some of them
- Focuses on highlighting tradeoffs …
  - between interoperability and credit, and between privacy and credit
- … which clearly is an important first step
- In future work, it would be interesting to study optimal policy
  - may require more detail about what we value in terms of privacy
  - this detail may also help sharpen our view of the underlying tradeoffs as well