



EUROPEAN CENTRAL BANK

EUROSYSTEM

Policy panel on central bank digital currencies

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Agenda

- 1 Background
- 2 Why issue a digital euro?
- 3 Two challenges

1

Background

The two-layer monetary system – public and private money



Liability of a central bank

- i. **Cash:** physical form, available to general public
 - ii. **Central bank deposits:** digital form, limited access
 - iii. **Central bank digital currency (CBDC):** digital form, available to general public
- complement to cash and central bank deposits



Liability of a private entity

- i. Commercial bank money
- ii. E-money
- iii. Some “stablecoins” that entail a claim on / liability of an identifiable entity

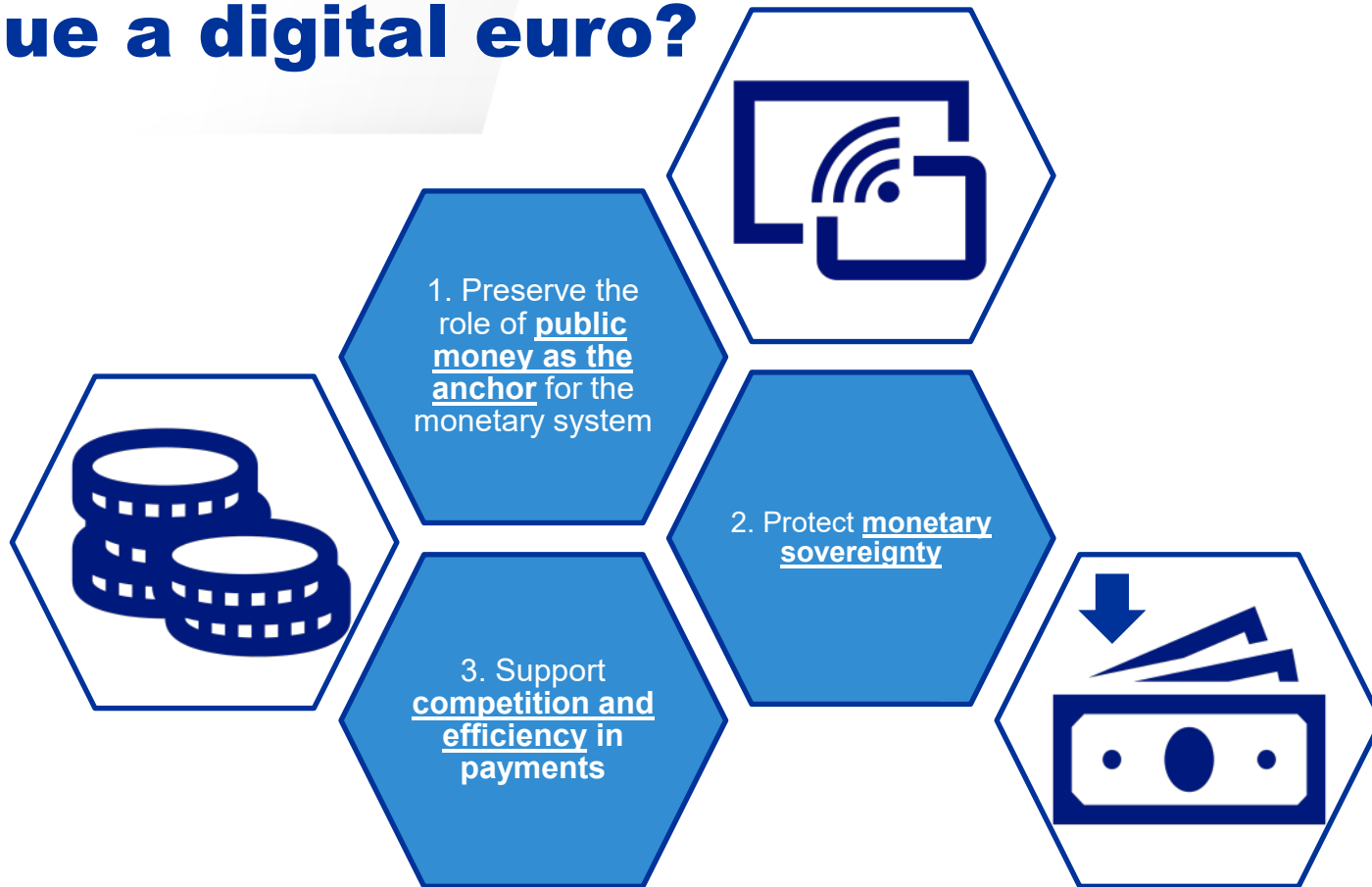
The co-existence of private and public money

- Most money is private (~85% of M1), but public money has a crucial function as the anchor of the monetary system.
- In everyday life, most people consider a euro in the bank equivalent to a euro in their pocket (cash).
- Trust in private money rests on 1-to-1 convertibility, which is safeguarded by regulation, bank supervision and deposit insurance.
- History shows that when private money is not convertible (due to poor regulation or crises) the financial system is subject to significant risks.
 - Examples: free banking era in the 19th century, money market funds in the global financial crisis, Terra/Luna in 2022

2

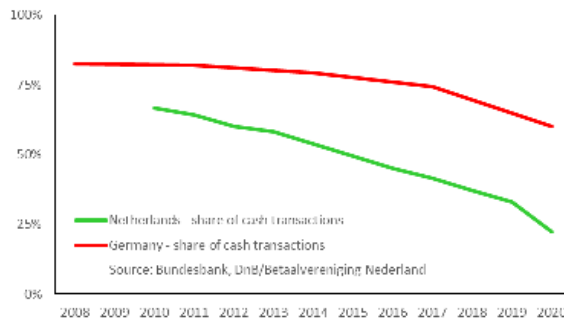
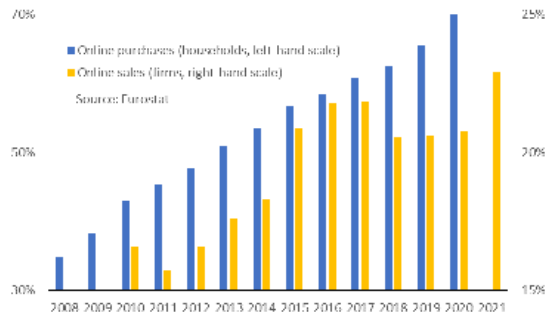
Why issue a digital
euro?

Why issue a digital euro?



1. Digital public money: the monetary anchor in a digital world

- Cash usage is declining: a digital economy needs digital money.



Left panel

Notes: "Online purchases" represents the percentage of individuals that have purchased at least one item online over the last 12 months. "Online sales" refers to the share of firms with online sales. Countries: BE, DE, EE, IE, GR, ES, FR, IT, CY, LV, LT, LU, MT, NL, AT, PT, SI, SK, FI. All series are aggregated using GDP weights.

Right panel

Note: The chart shows the share of retail payments made in cash, based on data from retail payment diaries in Germany and the Netherlands.

- If cash is no longer used, the promise of 1-to-1 convertibility loses bite.
- Digital public money: natural evolution to guarantee that the two-layer monetary system remains viable.

2. Safeguarding monetary sovereignty

- Technology enables the creation of new forms of digital money.
- Global stablecoins issued by big tech firms could become dominant and threaten public control over the unit of account (Brunnermeier, James and Landau, 2019).
- This could inhibit the ability of central banks to conduct monetary policy and act as lender of last resort, and ultimately reduce public welfare.
- A similar argument can be made for foreign CBDCs.

3. Enhancing competition and efficiency in payments

- Strong network effects in payments create high market concentration.
- Crucially, the euro area payments market is dominated by a few foreign entities.
- A digital euro could increase competition by ensuring universal access to an efficient digital means of payment that is not motivated by profit and by allowing intermediaries to offer services on top (“digital euro inside”).
- A digital euro would also improve the euro area’s strategic autonomy by reducing reliance on foreign entities.

3

Two challenges

1. A digital euro should not be “too successful”...

- The euro area has a bank-centric system.
- If a digital euro is used as investment, it may crowd out bank deposits.
 - This could harm credit supply.
- Recent research shows that this need not happen:
 - Increased competition may encourage banks to offer more attractive contracts, thus raising deposit volumes (Andolfatto, 2021; Chiu et al., 2022).
- In addition, safeguards will prevent an excessive take-up of a digital euro (Bindseil and Panetta, 2020):
 - Tiered remuneration.
 - Holding limits.

2. ... but it should be “successful enough”

- The market for payments is two-sided (Rochet and Tirole, 2003):
 - Success requires adoption by consumers and merchants.
 - Legal tender status can facilitate acceptance, but is likely insufficient.
- A digital euro needs to add value, satisfying preferences across users:
 - Consumers: broad acceptance (“pay everywhere”), ease of use, low cost, high speed, security, consumer protection.
 - Merchants: low cost, ease of use and integration with existing systems.
- Privacy:
 - Digital euro needs to meet highest standards.
 - It needs to allow users to choose what data they want to share (Ahnert et al., 2022).
- Financial inclusion.