EXECUTIVE SUMMARY

The digital euro: policy implications and perspectives

The European Central Bank (ECB) has decided to launch a two-year investigation phase of a possible digital euro. This announcement has raised many expectations and also many questions. What would be the purpose of a digital euro? How would it work? What would be the consequences for European citizens? Would it disrupt the activities of banks? How would it concur with fundamental European Union (EU) values, such as privacy? This study aims at identifying trade-offs and main policy options and possibilities.

The digital euro project is a response to a broader change: the digitalisation of money itself. A new type of money is emerging, based on virtual units of value moving on the internet. It can be broadly thought as “digital cash”. It can be stored on a mobile device or a computer. It can be instantly transferred, just like sending an email. It can be used directly to pay from person to person (peer-to-peer), irrespective of distances and borders.

The digitalisation of money brings several major transformations:

First, money is becoming more diverse. Money in digital form is easy to create. It can be tailored to almost any shape or usage. It can be managed through a great variety of ledgers and protocols.

Second, money may become more segmented. Digital money often prospers inside large "platforms" which aggregate many activities (e.g. commerce, entertainment, social media) and exploit their synergies. Those platforms tend to be organised as "closed-loop" ecosystems. The money they use and, possibly, create may not be easily transferable into other environments.

Finally, money is becoming more competitive. In a digital world, (almost) anybody with some expertise in cryptography and computer science can create money. Experiments in private money (cryptocurrencies) are now flourishing. Currency competition may also develop both inside and across borders, with some countries – or private operators – using their digital networks to circulate their currencies in other jurisdictions, creating so-called global stablecoins.

Some benefits of digitalisation are certain and visible. Retail payment systems have been pushed to improve and innovate. Major efforts are being made to accelerate cross-border payments and reduce their cost. In Europe, instant payments are being developed and strongly promoted by the authorities.

Other consequences will be more challenging.

For citizens, the aggregation of money and data will amplify concerns of privacy that are endemic to the digital world.
For banks, the emergence of “BigTech” as major competitors in payments (as well as deposit-taking activities) may increase their funding costs and destabilise their business model. This is not neutral, as banks play a major role in financial intermediation in the euro area and are also essential for the transmission mechanism of monetary policy.

The central policy question raised by digitalisation is the role of public money. It is issued by central banks, in the form of cash and reserves held by commercial banks. Public money is the anchor of the monetary system. Because all forms of money are ultimately convertible into public, it ensures that the currency is “uniform”: all monetary instruments with the same nominal value trade at par in all circumstances. They are equivalent. Public money also provides the unit of account, which serves as a standard of value for all transactions and contracts in the economy. Doing so, it also preserves monetary sovereignty, which can be defined as the ability of governments to control the unit of account in their jurisdiction in order to manage the macroeconomy.

To fulfil those functions, public money must be present and freely available in all sectors and parts of the economy. That ubiquity is doubly compromised by digitalisation. First, if cash were to disappear, the general public would not have access to central bank money anymore and would spend their lives in a universe of totally private currencies. Second, platforms and closed-loop systems could develop without any common reference of value, which would greatly compromise the uniformity of money.

The main rationale for developing a digital euro is therefore to preserve the role of public money in a digital economy.

Should the ECB Governing Council decide to issue the digital euro, its design will involve many policy choices and trade-offs.

First on privacy. Privacy is a core value for EU citizens and a central driver of the acceptability and trust in money. Privacy, however, comes into conflict with other, equally valid, policy objectives in which the EU is also a world leader: the fight against money laundering, the financing of terrorism and tax evasion.

A second choice is about banks and their role in financial intermediation. It may be that an attractive digital euro would compete with the deposit-taking activity of banks in addition to the pressures already coming from BigTech.

A third choice concerns the place that the central bank wants to take in the economy and society. Technology and digitalisation would enable it to directly open accounts to hundreds of millions of euro area citizens. Should it consider that possibility or rather issue the digital euro in the form of a “cash-like” bearer instrument?

Finally, on monetary policy. Contrary to cash, the digital euro could be issued with an interest rate. Should that possibility be used, as advocated by many economists? Or should public digital money stay as close as possible to the characteristics of cash?

Together, those choices open the possibility of radical changes in the current monetary and financial arrangements in the euro area. They could transform the relationship between citizens and money and put the central bank in a completely different position.

There is no indication, however, that this perspective is considered by the Eurosystem or any other EU institution. The study looks instead at a solution of continuity, where the digital euro would be issued as a digital version of cash and conceived to preserve, rather than disrupt, current monetary arrangements.

Even so, the precise design will require delicate trade-offs and choices. As public money, the digital euro will have to be universally accepted and widely accessible. It should be present everywhere. On the other hand,
the Eurosystem may not want to evict private money issuers (the banks) or private payment providers. It may not want to gain a monopoly or dominant position in retail payments. The digital euro will thus be placed into a strange and paradoxical position. It should be present everywhere but important nowhere. It should be successful but not too successful.

To that effect, the "specialisation" of the digital euro as a pure medium of exchange may be considered. The amounts necessary for transaction balances would be limited and therefore less disruptive. This solution would also be more advantageous from a privacy perspective, as anonymity is more justified for normal payments than for money stored as wealth.

To specialise the digital euro, the Eurosystem would have to set an acceptable level of transaction balances. Limits would have to be defined. Those limits can be set either through quantitative (ceiling) or price (tiering) mechanisms. A cap or ceiling on individual holdings is fully transparent, clear, and easily understood. Its quantitative impact can be directly assessed ex ante. Tiering would be based on a different principle. There would be no hard limit, but holdings above a certain threshold would be dissuaded, for instance, through a mechanism of fees. Both solutions are differently attractive and their costs and benefits need to be carefully weighted.

While the operational case for specialising the digital euro is straightforward, the economics are more uncertain and ambiguous. Money, as a perfectly safe and liquid asset, jointly performs three functions. Separating them by design, however justified, introduces a discontinuity that may have negative side effects.

Finally, for the digital euro to produce all its expected benefits, it must develop in an appropriate regulatory environment, sufficiently conducive to the uniformity of the currency. Payments sit at the intersection of many current policies of the EU. They have a close link with money (the topic of this study). Private and regulatory initiatives are all in a state of flux. There is now an opportunity to define and shape the architecture of a unified European payments area.