The Digital Euro and the Structural Reform of Money and Banking

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The digital euro is an essential element of the structural change in money and banking**. Its main benefit is that it will end the problems of the current system** in which bank deposits are the only means of digital payment.

For more than a century, bank deposits have been the only non-physical means of payment used by citizens. However, since the Lehman crisis and with the explosion of new technologies, **alternative digital payment methods other than bank deposits have emerged**. There are some alternatives, such as Stablecoins, whose advantages and disadvantages deserve study, but **public digital money (CBDCs) is the one that has the most benefits for all citizens, especially the most disadvantaged.**

As soon as all citizens and all companies can access the digital money issued by the ECB, they will choose to use the Digital Euro because it solves many of the problems we currently have when using bank deposits as a means of payment.

The most important benefits of all citizens and companies being able to access the digital euros issued by the ECB are:

-we will not suffer banking crises again,

-we will be able to liberalize and open payment and credit services to all competitors,

-income from seigniorage will be obtained by citizens and not by banks,

-we will stop subsidizing the debt. There will be more capital financing which will give more stability to the system.

-The ECB will be able to carry out direct monetary policy. The amount of money will be able to increase without the need to manipulate interest rates.

All these benefits and some more will be seen in practically all countries in the world since there are more than 100 central banks that are studying giving their citizens access to CBDCs. But in **the eurozone we will have an additional benefit:**

- **We will have a single digital currency**. Now we have a single physical currency (euro notes). The physical euro is the same in all the countries of the Eurozone. However, we do not have a single digital currency. The digital means of payment that we use – deposits – are different depending on the risk of each of the banks and according to the financial strength of the States that support those banks. Remember the crisis of 2011-2012. **Now we can only say that we have a "cash union" but with the Digital Euro, we will have an identical digital currency in all the countries of the eurozone.**

Therefore, the main gains of the digital euro are simply to stop the problems that we now have with bank deposits. Therefore, to fully understand its benefits, **it is essential to analyze the problems we currently have**. And the way to best see the problems of bank deposits is precisely to compare them with the digital euro.

<u>Comparison of the digital euro with deposits</u>

Let's look at **the stability benefit**. The digital euro cannot enter into a crisis, its face value cannot change. However, bank deposits can go into crisis and payment flows collapse. **Deposit crises are not like the rest of the financial crises** that only affect those who participate in financial contracts (stock market, insurance, derivatives, credit, bonds, etc.). Bank deposit crises are catastrophic because they affect the entire economy. Its consequences are very grim for growth, employment, etc. as happened in the crisis of the 1930s. Even when all the banks have been bailout, as happened in the crisis that began in 2008, its consequences have been very serious.

<u>Why do bank deposits go into crisis and the digital euro cannot go into crisis?</u>

Because the fundamental difference between bank deposits and the digital euro is that **the digital euro is a safe asset** while **bank deposits are risky assets**; assets with financial risks (credit risk, liquidity risk, market risk, duration risks…) The digital euro is money, while bank deposits are not money, they are "a promise to return money." Thus, the digital euro never changes its face value while the promise of bank deposits may not be fulfilled. And that's when the depositor realizes that he didn't have money, but rather a promise to return money.

This fragility of deposits that can lead to catastrophic crises and collapse payments is what has led States to build over more than a century **a gigantic edifice of protections and privileges for banks.** (lending facilities, deposit insurance, resolution funds, access to public digital money, etc)

In addition to this protectionism, and to reduce the risk assumed by banks, prudential hyperregulation has been built (the so-called Basel III) through which States tell banking executives what risks they can take and which ones they cannot.

This hyperregulation is as gigantic as that of protections and privileges. If we look at the number of words that all the laws and regulatory developments of the European Capital Directive or the Dodd-Frank law in the United States have, we will see that they have about two million words. Given that the Bible has about 700,000 words. This means that Bankers who want to know the regulations they must fulfill must read approximately 3 Bibles. The banking sector is without a doubt **the most protected and intervened sector of all economic sectors.**

How is it possible that **in recent decades the regulation of banking activities has moved in the opposite direction to that of other sectors in all the countries that have advanced in the liberalization** of services and in strengthening the State in the protection of users and consumers?

This enormous volume of protections and privileges and the exorbitant banking hyperregulation is explained because they are absolutely necessary as long as the digital means of payment that we use is the bank deposit. **All these protections and interventionist regulations are fully justified, because, if they did not exist, the economic catastrophes would be terrible.**

Thus, for example, it may seem very costly to us that in the last crisis, European taxpayers had to increase their taxes by 267 billion euros to bail out the banks. But, if the European banks had not been bail out, we would have suffered a catastrophe in the flow of payments as happened in the 1930s in the United States. We would have had very serious economic, social, and political consequences as happened then.

In this system of fragility and permanent threat of crisis in bank deposits and at the same time of enormous interventionism and privileges of the State to avoid the consequences of banking crises, we have been living while bank deposits have had no alternatives.

But now there are alternatives. We are no longer condemned to suffer from the instability of money and the absence of competition in banking activities. As soon as all the countries in the world issue their CBDCs. and in Europe, we have the Digital Euro, citizens will realize that all those regulations and privileges that destroy the market will no longer be necessary because there will no longer be the risk of a money crisis that must be avoided flooding the banking system with privileges and regulations.

The defense of **public physical money** and the defense of **public digital money**

Now we have to defend public digital money (the digital euro) against private money issued by banks (deposits). But if now all physical money is public, it is thanks to the fact that **our ancestors defended public physical money against private physical money**. And they won.

It is interesting to remember what happened in the 19th century with physical money, specifically with paper money, bank notes. So, in several countries the physical means of payment used were banknotes issued by private banks. In England there was an intense debate because it was very common for banks, which did not have the protections they have now, to continually go into bankruptcy. Finally, to have stability and have a means of payment that does not change in value, because the banks have made bad investments or do not have sufficient liquidity, **it was decided that only the physical bill issued by the Central Bank could be used as a means of physical payment. .**

This is where physical money is now around the world. Physical means of payment are money, not promises to return money. There is no country that allows banks to issue physical money, banknotes. And this is what will happen with digital money, that digital public money will be the generally used means of payment.

In the same way that the euro note cannot go into crisis, the digital euro cannot go into crisis either and by not being able to go into **crisis it will be unnecessary to maintain the entire extraordinary list of privileges and protections that banks have.**

The digital euro does not need deposit insurance, the digital euro does not need to bail out any financial institution and by making the digital euro accessible to citizens and companies, the current privilege that only private companies - banks - can access is ended. to digital public money. And I could go on mentioning many more privileges and protections but I'm not going to because you can see it in the document that I have sent to parliament.

It is easy to understand that, with the digital Euro, we will gain stability and put an end to banking crises because it is the obvious consequence of switching to using a safe asset instead of a risky asset, but

What do citizens gain by introducing the free market in lending and payment activities?

The moment the digital euro is used as a means of payment, all these protections and interventions become unnecessary and can therefore be eliminated. And, **if there are no protections, there can be competition**. As has happened in other liberalization processes, on the one hand, new competitors will enter, but the important thing is that **the playing field will be leveled for everyone**. There will no longer be any competitor that has advantages from the State. Everyone will be under the same conditions, and this is essential for competition to exist.

We have seen it in other sectors. The introduction of competition in international trade in telecommunications, transportation, etc., has consisted, precisely, of eliminating protections and privileges of the State. As soon as we have the digital euro, we can eliminate protections or privileges and level the playing field. All companies, without State aid, will compete to offer users better services at the lowest cost.

And not only will current services improve in cost and quality, but we will see something that is only possible if there is competition: innovation.

<u>The importance of innovation</u>

Innovation is perhaps **the most important benefit of introducing competition**, although now we do not know and cannot say what that innovation will consist of. Innovation is something that by definition we cannot predict now. Now **we don't know what is going to be innovated in payments, but we do know that when entrepreneurs are allowed to compete to obtain customers, innovation will appear.**

A clear example is what has happened with the liberalization of telecommunications. When in the last century we liberalized telecommunications, which then, like banks now, were dominated by monopolies, no one could even imagine that the liberalization of telecommunications would lead to something like the creation of the smartphone or initiatives like WhatsApp that allow this moment that all the inhabitants of the world and especially the most disadvantaged can speak for free. The poorest of the migrants can talk to their families and send digital videos and photographs. Nobody predicted this. But liberalization has produced it. Well, the same will happen if we liberalize payment and credit activities. But this liberalization will only be possible if we have the digital euro.

<u>Citizens will **only realize the advantages** of the Digital Euro if it is a means of payment that they can access</u>

Because **as long as the digital euro is only an idea - as is the case now - it is very difficult for citizens and small and medium-sized companies to realize its advantages.** But the moment it exists, the moment all of them can access the digital euro as the banks can now access, they would realize it.

Think, for example, of the crisis that occurred this year in Silicon Valley Bank and other medium-sized banks in the US. A significant number of technology companies had placed money in that bank's deposits to be able to pay their employees and suppliers. And suddenly they got a call from the bank saying they couldn't use the money from the deposits. Imagine what these companies would have done if the digital dollar had existed. These companies would have had their money in digital dollars because they would have the security that no one could ever call them to tell them that their money has lost its value and that they cannot pay employees and suppliers. And there would have been no crisis.

But, also, remember what happened and that is that at night the FDIC, the Treasury and the Fed had to meet to, once again, as is always done with banks, increase the aid and privileges to those banks to avoid a payment collapse catastrophe. Indeed, at that meeting, they decided to increase the deposit guarantee without limit and invented new liquidity facilities to prevent the collapse in payments.

And, if we continue to use deposits, economic authorities, central banks and treasuries will continue to be anguished, continually asking themselves what they should do to avoid banking crises.

The **effect on banks and limitations on the use of the Digital Euro**

The effects of the digital euro are very positive for citizens and for all types of companies, financial and non-financial, small, medium and large. But there is a group of companies - **the banks - that will be forced to carry out an unpleasant task: that of changing their business model**. Banks will no longer have the privileges and protections they have today because they will no longer be necessary as soon as the means of payment is the Digital Euro, and they will have to compete with other companies in the free market. As has happened in other liberalizations (telecommunications or air transport) that terminated monopolies, banks will have to separate their activities into two, one to provide payment services with digital euro and another to provide credit or financing services.

This is obviously something that is not pleasant for a monopoly and hence the banks have done everything possible to prevent the study of the digital euro and now, which is already unstoppable because it is a global movement, it is doing everything possible to delay and limit its use

As has happened with the liberalization of telecommunications and air transport, we will see how a group of banks will disappear because they have not been prepared to work in competition. But there will also be others that will continue to be important payment and financing companies in a system based on the Digital Euro.

Regarding the introduction of **limits on the use of the digital euro**, it would be an absurd measure if it were permanent. If it does not make sense to maintain the current banking privileges and they must be eliminated, it makes less sense to introduce limitations or other obstacles that harm the use of the digital euro. Limits on use would only make any sense if they were temporary, to give banks some time to transform.

But for this purpose, **it is better to design measures that help banks compete than to put obstacles in the way of the Digital Euro**. It makes sense, for example, to help banks separate companies and make it easier for them to maintain their clients with digital euros. This type of aid to banks makes sense because it would not be aimed at maintaining the current system with its serious problems but would serve to facilitate the transition to a new system in which there will no longer be banking crises and in which banking activities will be provided. in full competition.

In any case, if it were decided to impose these limitations**, it would be preferable to have a digital Euro with limitations soon than to delay its existence**. Because, once the digital Euro exists, citizens and companies will demand that these limitations disappear.

A digital euro regulation that does not allow small merchants and medium-sized companies to use it and must make their transactions through banks will not be sustainable.

Likewise, it is absurd to prohibit the use of the digital euro for international trade. Last week, an oil purchase contract was signed with e-yuan (China's public digital currency) worth $90 million. And soon transactions for international trade will be able to be carried out in other public digital currencies. And we are going to prohibit these transactions from being made in digital euros? because? So that the banks do not suffer?

Another example of the unsustainability of limiting the volume of transactions or balances in digital euros. Let's imagine that, once we have the Digital Euro, an Italian businessman wants to buy a 10 million euro machine from a Korean and will only be able to pay him 3,000 euros (or whatever limit is imposed) with digital euros at a cost of 0.01. % commission. He will then be forced to pay the rest. (9,997,000 euros) through a private bank that will charge you between 1 or 2%. of commissions. This will favor the banks, but the Italian businessman will not understand it.

We must realize that **what we must do is not help the banks to continue existing as they do now,** creating the problems of instability and lack of competition that we currently have. What we must do is encourage banks to transform themselves to be able to provide payment services with safe and public money that do not generate banking crises and subject all banking activities, fundamentally payment and credit services, to the free market.

<u>The “vision of the user” and the “vision of the citizens”</u>

In my speech, I talked about the impact of the digital euro on the stability and competition of the monetary system. This is the vision of the public interest, the “citizens' vision.” **And I have talked very little about the “user vision” of all the design features of the digital euro** such as privacy, interoperability, technology, cybersecurity, etc. All this is very important to have a digital Euro that is attractive to the user. And, if I have not spoken about this it is because, apart from some aspects such as the one I have pointed out regarding the limitations**, I believe that the work carried out by the European Central Bank has been very good and I have little to say.**

It is important to realize that the digital euro is the first step of a very positive structural reform. But in this phase, the most important thing is to support the work of the Commission and the European Central Bank so that, as soon as possible, citizens and companies have an infrastructure that allows them to access digital public money. Because **public opinion will only be aware of the enormous advantages of the digital euro when it stops being an idea and they can actually use it**.

<u>The digital euro is not a new means of payment. The digital Euro already exists.</u>

Supporters of maintaining the current monetary system, based on fragile bank deposits, proclaim that Central Banks should not create CBDCs (digital money issued by central banks). Specifically**, the ECB should not issue the Digital Euro because the citizens of the Eurozone would gain nothing.**

This approach is incorrect. It cannot be said that the ECB should not issue a CBDC, that is, digital money issued by central banks, for the simple reason that it is not what the ECB intends to do. **The question is not whether the ECB should issue digital money, because the ECB**, in addition to issuing physical money, that is, euro banknotes, **now also issues public digital money.** The ECB already issues a CBDC, what we now call “reserves” (banks' deposits in the central bank).

So, what does the Digital Euro project consist of?

The problem is that now digital money issued by central banks can only be used by banks. What the ECB is doing is designing an infrastructure so that citizens and non-financial companies can also use the public digital money that already exists but can only be used by banks.

The question is not, therefore, to ask what reasons there are to create the Digital Euro? because it already exists. **The question is, should the ECB create an infrastructure so that all citizens and companies can use the digital euro or should we continue as now, that only banks can use it?**

The second idea of those who want to stop the ECB project is that, even if citizens could use the digital Euro, they were not going to gain anything; They would not be interested in accessing the Digital Euro.

But this decision should not be made by those in favor of citizens not being able to use the digital euro. **It is the citizens themselves who must decide whether or not they are interested in using the digital Euro**. The ECB project lets citizens decide if they want to have their money in digital euros from the ECB or prefer to have it in commercial bank deposits.

The role of the State and the Market in a structural reform

The value of a structural reform consists of assigning to the State what it does well and to the Market what it does well. Normally, all production and trade activities of goods and services should be left to the Market, eliminating unnecessary protections, privileges, and regulations. But at the same time, it is important to assign to the State those functions that it does well, such as the protection of users and investors, data protection, the defense of competition and antitrust, etc. **In the case of payment and banking activities and money, a 180º change must be made because, on the one hand, what the State knows how to do well, which is issuing money, is now left in the hands of private banks**, which are the ones that they create the deposits **and, in exchange, the State is dedicated to protecting and privileging private activities instead of withdrawing and leaving them to the free market to operate in competition**

One of the problems with the current system of letting banks issue deposits is that they are very different from each other since they depend on the risk of the commercial bank and the strength of the states that support them. And money is a measure of value and in general**, when it comes to units and measurements, it seems more reasonable for the State to take care of them and not private companies**. On the other hand, what is totally absurd is that the State interferes in the activity of private companies, favoring and giving privileges to some and not to others. Even giving a monopoly to the banks when it comes to payments. All of this prevents the free market from functioning in banking activities and that is why **it is important to suppress all types of privileges, protections, and hyper regulations to allow the playing field to be level and for competitors** to fight on equal terms because that is when the benefits are obtained. of the competition.

The Digital Euro

Stability, Competition and Much More

Digital Euro and Banking Liberalization

(A Structural Reform For The 21st Century)

- **STABILITY**
- **COMPETITION**
- **And More:**
  - Monetary policy will be direct. More effective.
  - The interest rate (price of the financing market) will not be controlled/manipulated by the Sta
  - Seigniorage goes to all citizens (vs private firms)
  - Decentralization. Citizens decide.
  - Debt will not be subsidized.
  - No monetary financing anymore
  - Fiscal Discipline

XX-CENTURY STRUCTURAL REFORMS
Sectors

- International Trade liberalization
- Telecommunications
- Air Transport
- Liberal professions
- Labor Markets
- Retail opening hours
- Housing rent regulations
- China structural reforms

Money and Banking Reform

Stability . **Money** reform
- From Fragile Money (bank deposits) to Safe Money (CBDC)
- No more banking crisis, no more debt bubbles, no more long recoveries...
- More effective Monetary Policy

Competition. Banking Structural Reform
- With Bank Money (deposits) Banking activities are Hyper regulated & Hyper protected
- With CBDC it is possible to introduce competition in lending and payment services (Banking activities)
- Benefits of competition. Efficiency, growth, user satisfaction. Innovation.

The Users' View

Important to make the digital euro an attractive mean of payment.

Focus on the characteristics desired by users:

- Fast and Cheap transactions
- Privacy and Data protection
- Interoperable
- Security
- Inclusion. Widely available
- Convenient to use. Smartphone wallets..
- Improve cross-border payments
- Competition between private payment providers.
- Do not prohibit or impair cash payments
- Etc

The Citizens' View

- Focus: The benefits of the digital euro for all citizens (not just users)
- The digital euro solves the problems of bank deposits:
  - Costs of Money collapses. INSTABILITY
    (Bank runs, Bankruptcies…)
  - Costs to avoid money collapses. REMEDIES
    (Protectionism, Bailouts, Subsidies, Prudential requirements…)
  - Cost of Unleveled Playing Field. NO FREE MARKET
    (banking Oligopoly, No competition. No innovation…)
  - Cost of Interest rate manipulation. MONETARY POLICY
    (Bubbles, Slow recoveries and resources misallocation)

Bank Deposits REMEDIES

(State Protectionism & Interventionism)

- Privileges, Protections, Subsidies…
  1) Access to Safe Money: Only banks can hold current accounts at the CB.
  2) Deposits Insurance
  3) Liquidity Support
  4) Tax-payers money to Bailout
  5) Bankruptcy Laws are not enforced. Special Resolution
  6) Subsidy: digital Seigniorage
  7) Competition and Antitrust laws are not enforced
  8) Supervisors and Central Banks are "di facto", guardians of the profitability of banks
- Hyperregulation
  1) Capital requirements
  2) Liquidity requirements,
  3) Anti-cyclical buffers,
  4) Remunerations
  5) Governance
  6) Exposure rules,
  7) Leverage ratio
  8) Structural Measures
  9) TBTF…
- Market interventions
  - Price of financing is distorted: Interest rates are not fixed by savers and borrowers
  - Composition of financing is changed: debt financing is subsidized versus equity financing

Digital Euro Benefits

- STABILITY Benefits
  - **Digital Euro is a safe asset.** It's a stable face value. Not a promise to pay. No Collapses of payments (no runs, no banking crisis .
  - Public creation of money. No Procyclicality. No Leverage.
- No need for STATE REMEDIES
  - Removal of State Protections, Privileges, Subsidies…
  - Removal of State Interventionist regulation. Basel III
  - State (Central banks) do not distort interest rates anymore
- FREE MARKET Benefits
  - No more PROBLEMS created by State REMEDIES
  - Competition, Innovation, and Best allocation of resources. More growth, more public means…
  - Direct Monetary policy. No need for CB Massive Interventions

Banking The Most Protected Sector

(State Privileges, protections, subsidies, entry barriers…)

1) Access to Safe Money privilege: only banks can hold current accounts at the CB.
2) Deposits Insurance.
3) Liquidity Support. Lending facilities (From LLR to today lending facilities).
4) Bailouts with tax -payers money
5) Bankruptcy Laws are not enforced. Special Resolution.
6) Competition and Antitrust laws are not enforced.
7) Consumer Protection Waivers: Misleading denominations (deposits), No risk alerts.
8) Public Institutions: Supervisors and Central Banks are "de facto" guardians of the profitability of banks.
9) Senoriage.
10) Central bank Reserves Remuneration.
11) Other protections: QE. TLTRO injections, Pandemia: Provisions, Credit Guarantees, Lenient Supervision: Shares buybacks, no anticyclical buffers…
12) Money Creation: no other financial entity can create money.
13) Entry barriers. Restrictive authorization.
14) Regulations imposing limitations on the use of safe digital money (CBDCs) or Stablecoins

A Specific Advantage of **Digital Euro** Save the Monetary Union

- The problem of **FRAGMENTATION**
  - We do not yet have a Monetary Union. Now we only have a "Cash" Union.
  - Euro notes are uniform . But digital means of Payment- deposits- are diverse. We do not have a "digital currency" Union
  - Face value of bank deposits depends on banks solidity and national budgets capacity to bail out them
- <u>Proposals to **REMEDY** FRAGMENTATION :</u>
  - With bank deposits
    - ECB help weak states
    - EU Federalization: common bailout fund, common deposits Insurance fund…
  - With Digital Euro.
    - It does not need ECB support. Neither taxpayers' (National or EU) support. The solidity o the Eurowillbenot affected by unsound banks or lax national fiscal policies.
    - We will have a Monetary Union

CBDCs Main Advantages

- The CBDC is a safe asset. No changes in face value. No problems with reimbursing fiat money because it is money, it is not a promise to pay money.
- Stability. No more money crisis. Similar to cash, CB notes
- No need for State interventionism to avoid instability and crisis. No need for protections, privileges, or Basel III
- It is possible to introduce competition without fear of instability.
- Payment services and credit may be open to competition among all providers

CBDCs Other Advantages

- Monetary policy will be direct. More effective.
- The interest rate (price of the financing market) will not be controlled/manipulated by the State.
- Seigniorage goes to all citizens (vs private firms)
- Decentralization. Citizens decide.
- Debt will not be subsidized.
- No monetary financing anymore
- Fiscal Discipline