

Point of View

Why Europe Needs a Digital Euro

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It would safeguard monetary stability, fend off private payment monopolies, and stand as a potent symbol of European unity



The digital euro project has a simple motivation: to ensure that people in a digital world retain the option to make or receive payments in central bank money. Supplementing physical cash with digital cash will support the modernization of the traditional two-tier monetary system that allows both cash and bank deposits as a medium of exchange.

The evolution of the two-tier monetary system over the past 300 years has provided a strong foundation for the operation of the broader financial system and has enabled central banks to deliver price stability effectively. While it is possible to theorize about alternative monetary systems in which central bank money plays only a wholesale role,

prudence suggests that the retail role should be preserved, including through the introduction of a digital euro.

Central banks have a mandate to safeguard monetary stability in all circumstances. This calls for a cautious yet forward-looking approach that takes into account not only baseline scenarios but also tail risks of the future development of the monetary system. A digital euro will minimize the likelihood of adverse economic outcomes in the future and ensure the resilience of the monetary system in an increasingly digital world.

Cash issued by the central bank has historically played a critical role in maintaining trust in the convertibility of commercial bank money to central bank money. While convertibility is largely taken for granted, it's not obvious that the two-tier monetary system would necessarily remain stable if ongoing digitalization meant that convertibility to physical cash lost relevance and a digital cash option was not made available.

Monopoly power

Compared with other services, payment instruments exhibit exceptionally strong network externalities—they gain value as more people use them. This is one reason using central bank money for payments improves economic efficiency: It limits the scope for commercial payment systems to exploit monopoly power by charging excessive fees. As the share of digital transactions increases, the option to make payments in digital euros can limit the potential monopoly power of the firms at the center of private sector payment networks.

In addition, public access to central bank money provides a reliable fallback option to using commercial bank money for some types of transactions if there is disruption of the commercial banking system, whether from technical problems or a cyberattack. This is one reason policymakers want a digital euro to work offline as well as online.

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Some argue that an alternative approach in adapting the monetary system to a digital age would be to promote stablecoins, issued and operated by private sector intermediaries. However, stablecoins are best understood as expanding the private money universe—as another substitute for bank deposits—rather than as a true substitute for central bank money. A stable value of a stablecoin in terms of currency is not intrinsic (unlike a liability of the central bank). Even a highly liquid backing portfolio does not guarantee convertibility under all scenarios.

By contrast, a well-designed digital euro promises to modernize the two-tier monetary system without destabilizing financial institutions or disrupting monetary policy implementation or transmission. Among other features, appropriately calibrated limits on digital euro holdings can provide people sufficient digital cash for transactions while preventing excessive outflows from commercial banks and outsize expansion of the central bank balance sheet.

Moreover, since people will set up digital euro accounts primarily via their banks (or other payment service providers), close interconnection will continue between central bank money and commercial bank money. If banks and other payment service providers carry out the necessary know-your-customer checks, maximum privacy will be maintained, and the central bank will not be privy to individual account details.

Unifying fragmented markets

For the euro area, a digital euro offers additional benefits in a multicountry

monetary union. Among other factors, the euro area payment system is highly fragmented along national lines: Customers must typically rely on non-European card or e-wallet providers to make payments across the euro area. By mandating acceptance of a digital euro, instant network effects would help unify the currently fragmented market.

A digital euro would reduce costs for merchants and businesses by providing the network infrastructure for an area-wide payment system on a not-for-profit basis. It would increase bargaining power vis-à-vis international card networks for both in-person transactions and e-commerce. A digital euro thereby promises to enable an area-wide fast payment system at the point of interaction (POI) between customers and merchants. With conflicting incentives across operators of legacy national payment systems, such an area-wide POI fast payment system will not likely develop without a digital euro.

A digital euro would also provide an important foundation for fintech innovation across the continent. A standardized, pan-European platform would allow private providers to innovate while benefiting from the economies of scale of the underlying digital euro network, ultimately reducing costs for consumers and businesses alike.

In particular, by linking customers and merchants across the euro area via a system of digital euro accounts, card and e-wallet providers could focus on additional payment services while the underlying payments travel via the rails of a digital euro system. Separation of the basic plumbing of the payment system (the digital euro network) from the delivery of add-on services also lowers

the risk of lock-in effects—when one private payment network with a transitory technological advantage suppresses subsequent innovation in order to keep the upper hand.

Symbol of unity

To sum up, a retail role for central bank money is arguably integral to the sovereign foundations of the monetary system. In particular, the singleness, effectiveness, and stability of the monetary system are ultimately underpinned by the sovereign (or, in the case of the euro area, the joint sovereignty of the European Union's member states). The monetary role of the sovereign spans the institutional foundations of the monetary system (including the definition and enforcement of legal tender), the maintenance of the budgetary discipline required to ensure that monetary policy is insulated from fiscal dominance, and the delegation of various monetary tasks to the central bank.

A retail role for central bank money maintains the direct monetary relationship between the sovereign and the citizen. It reinforces public understanding that monetary stability is intrinsic to sovereignty. This consideration is especially relevant in a European context, with the common currency seen as a critical mechanism for greater economic and political integration among member countries. Beyond its economic and monetary roles, the euro is an important symbol of European unity. This must be maintained in a digital age. **F&D**

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