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Old Debate, New Ways: a (digital) euro for a digital age

Keynote address by Gillian Phelan, Central Bank of Ireland, at the BPFI/Bearing Point Roundtable on Practical Considerations of a Digital Euro

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Advances in payments are at the forefront in challenging and reshaping the structure and functioning of the financial system. This process, driven by digitalisation, has resulted in a shift away from physical cash towards payment methods such as contactless cards and digital wallets. Issuing a digital euro, represents a natural evolution in response to this transformation.

In one line, a digital euro would be a digital form of cash, issued by the central bank and available to everyone in the euro area (Cipollone, 2024).[1] Around 100 central banks are now operating, piloting, developing or exploring retail Central Bank Digital Currencies (CBDCs). Each country has their own set of reasons but retaining access to central bank money when cash use is declining is universal.

Within the euro area context, there are 3 core reasons. The first is adapting to these trends: the economy is becoming increasingly digital and cash use is declining. A digital euro would integrate central bank money and the latest payment trends.

In many ways, this is a confluence of an old debate with new ways. The 'old debate' is around the very nature of money which looks at the foundation of our monetary system and the role central bank money plays in ensuring the euro remains a safe and effective medium of exchange and store of value. The 'new ways' are the technological innovations that now make it possible to issue a digital version of cash.

The second reason the Eurosystem seeks to issue a digital euro is to facilitate choice. It would be universally assessable and an additional 'way to pay' for euro area citizens, complementing cash. It would have legal tender status, and, as such, would be accepted wherever digital payments are accepted, in all payment scenarios across the euro area.

The third reason is the evolving geopolitical landscape. After decades of global economic integration, Europe is now facing the risks generated by geoeconomic fragmentation. In this context, there is an emphasis on the need to preserve our autonomy and monetary sovereignty.

The payments infrastructure is a critical infrastructure and as such it should be owned and operated within the EU. The public payments infrastructure that needs to be built to facilitate a digital euro would, not only fill the gaps in our current fragmented infrastructure, but would also foster

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[1] https://www.ecb.europa.eu/press/key/date/2024/html/ecb.sp240923~cccba29006.en.html

innovation and competition in the European payments space- with benefits for payments service providers, business and consumers.[2]

What would the payments landscape look like, with the introduction of a digital euro?

In terms of its design principles, a digital euro is aiming to replicate "cash-like features", in so far as possible. Like cash, it would have pan-European reach and would be public money issued and backed by the Central Bank. It would be free for basic use so that includes for making transactions, and for funding and defunding your digital euro wallet. It would be respectful of privacy in that it plans to adopt the most advanced privacy features that will be technically feasible at the time of launch. It would also be available offline, which is a feature that aims to replicate the true anonymity of cash. These, offline transactions would only be known to the payer and the payee.

Current means of payment (cash, card, bank account and other digital payments) will continue to coexist and the digital euro could act as a complementary means of payment that addresses specific use cases and market failures as well as a catalyst for continued innovation in payments, finance and commerce at large.

What is the role of Payments Services Intermediaries (PSP's)? And what would be the impact on them?

In line with the legislative proposal presented by the European Commission, all euro area banks should offer digital euro to customers who ask for it, and all euro area merchants accepting digital payments will also have to accept digital euro. Financial and digital inclusion is an important aspect of the project and this will also be supported via the legislative proposal.

Public-private cooperation would be crucial in the digital euro environment. Customers would open accounts through their normal intermediaries in existence today (Banks, non-banks etc.). In this way, they would maintain their customer relations. PSPs would also benefit from open standards which overtime would lead to greater harmonisation of payment standards.

This set-up allows the public and private sectors to exploit their respective comparative advantages: central banks can focus on ensuring trust, stability and integrity in the payments system and let private-sector PSPs keep doing what they should do best—innovate, interfacing with customers and compete amongst each other to win customer preferences and expand the market for digital payments. This coexistence would require a level playing field aimed to make sure that competition is open and fair, including between market incumbents and new entrants.

Much of the concern from PSP's about a digital euro, and CBDCs generally, has been around the risk of disintermediation- i.e. the risk that they would lose some of their deposit funding to digital

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[2] This would address some key themes in the Draghi and Letta reports:
https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en
https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf

euro. However, a number of design features will be in place to mitigate that risk. The aim is that a healthy equilibrium between central bank money and commercial money remains. This is important for the maintenance of monetary policy and financial stability.

The holding limit is a key - though not the only - design feature to mitigate the digital euro's impact on bank intermediation. Other related design features include a zero holding limit for corporates, no remuneration, and functionality to draw from/to a commercial account.[3]

It is important to note, that in terms of usability, the holding limit doesn't get in the way of making and receiving larger payments. People can link their digital euro account to their commercial account allowing funds to flow to/from it to their digital euro account as necessary. If, for example, someone wants to make a digital euro payment that is higher than the holding limit. They can still pay with digital euro. Once the payment is initiated funds can flow from their current account into their digital euro account to make the payment.

Developing a methodology to set a holding limit has been a key objective in this phase of the ECB project. The Eurosystem has established a multidisciplinary workstream that also involves extensive industry engagement. It will develop a methodology which will allow policy makers to calibrate the holding limit.

The framework for the analysis looks at 3 blocks of work: usability, monetary policy and financial stability. Ensuring the digital euro's usability as a convenient means of payment, means that the holding limit should be sufficiently high so as not to unduly hinder its use. From a monetary policy perspective, the holding limit should not disrupt the Eurosystem's ability to define and implement monetary policy, consistent with the policy stance. Financial stability could be impaired if the holding limit was so high as to impact banks' balance sheets to a significant extent. This work has involved a large data collection and modelling exercise, the results of which should be concluded in the first half of next year.

A world without digital euro: The counterfactual?

Predicting, or indeed down the road assessing, the impact of the digital euro on the financial system is not straightforward. A world without digital euro does not mean that the world stays as it is now - digitalisation is re-shaping it anyway. Nevertheless, anticipating how the financial system will reshape if the central banks didn't keep pace and we didn't have a digital euro is the correct framing.

It would provide the pan-European rails for private solutions. The ECB in conjunction with National Central Banks will build the infrastructure and the basic products that can run on it. This will offer a platform for innovation, based on which private providers can build value added services; enable private retail payment solutions to leverage digital euro infrastructure for pan-European reach; and increase competiveness and reduce our dependence on other non-European players.

[3] Just like cash, digital euro will not be remunerated. Therefore, if no interest can be paid there is less of an incentive for people to convert deposits to digital euro.

This approach is akin to creating a unified European railway network or European energy grid, where various companies could competitively operate their own services and deliver added value to customers.

There is a gap left by the absence of a European retail digital payment solution that is available and accepted free of charge throughout Europe, both online and offline. The cost is that payments are not as simple, efficient and affordable as they could be.

What's next?

Taken together, the reasons for issuing a digital euro are strong. It is the clear next step for our currency. It's a new way to pay, using an age old form of money (cash), in a digital age.

The decision to launch a digital euro has not yet been made and will only be taken after the legislative process has concluded. In the meantime, the ECB in conjunction with the National Central Banks of the Eurosystem, will continue to lay the foundations and pave the way for future issuance.