THE ESSENTIALS ABOUT...

Commission des AFFAIRES EUROPÉENNES

SÉNAT

...the commission's recommendations on the project

DIGITAL EURO

In June 2023, the European Commission presented a **proposal for a regulation on the digital euro**[1] . The aim of this proposal is to introduce a **central bank digital currency** in the eurozone, **which would be directly accessible by individuals**. This proposal follows on from the work carried out by the European Central Bank (ECB) on the subject over the last several years. In October 2023, the ECB's Governing Council decided to launch the "**preparatory phase**" of the digital euro project, which succeeded the "study phase" conducted since October 2021.

At the end of the experiments currently underway and once the European Union's legislative process has been completed, it will be up to the ECB's Governing Council to decide whether or not to issue a digital euro. The actual decision to launch a digital euro could only be taken **starting in 2027 or 2028**.

1. WHY ISN'T THE EURO ALREADY 'DIGITAL'?

A. COMPLEMENTARITY BETWEEN CENTRAL BANK MONEY AND COMMERCIAL MONEY

The monetary architecture is based on the complementary nature of **commercial money and central bank money**. The **convertibility of these two forms of currency at par** is the cornerstone of the smooth functioning of payments.

Commercial money refers to the **deposits of commercial banks** and circulates via means of payment such as SEPA payments (credit transfer, settlement) or payment cards. When Europeans pay using digital solutions, they are paying **with commercial money**, which is private and not public.

Central bank money, which alone is legal tender, is issued and guaranteed in the eurozone by the ECB. **Cash (notes and coins) is currently the only form of central bank money that is directly accessible to individuals**. While many changes have affected payments since the adoption of the euro 25 years ago, central bank money is still only accessible to individuals in the form of cash.

[1] COM (2023) 369 final, Proposal for a Regulation of the European Parliament and of the Council establishing the digital euro, 28 June 2023.

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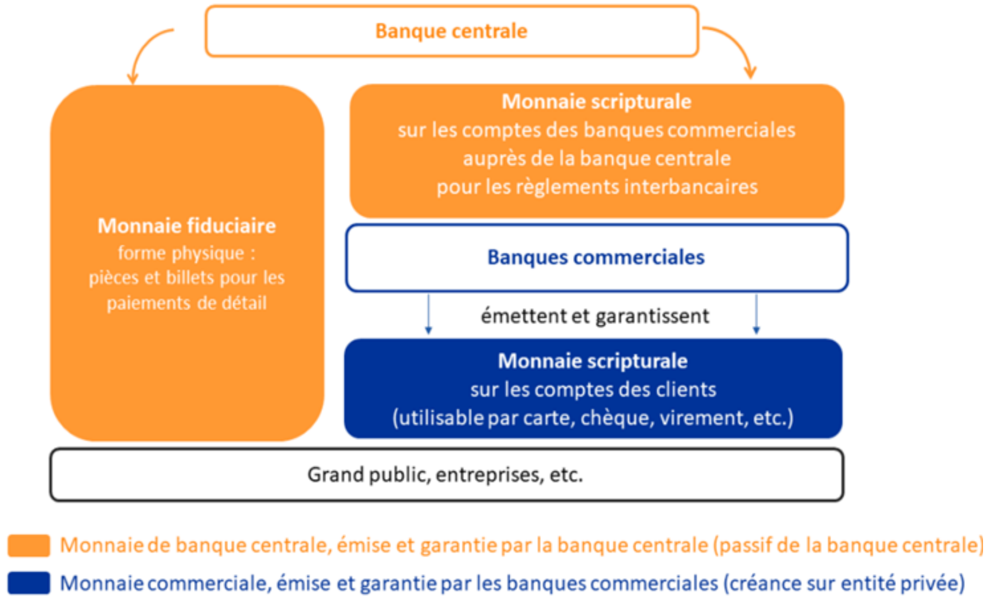
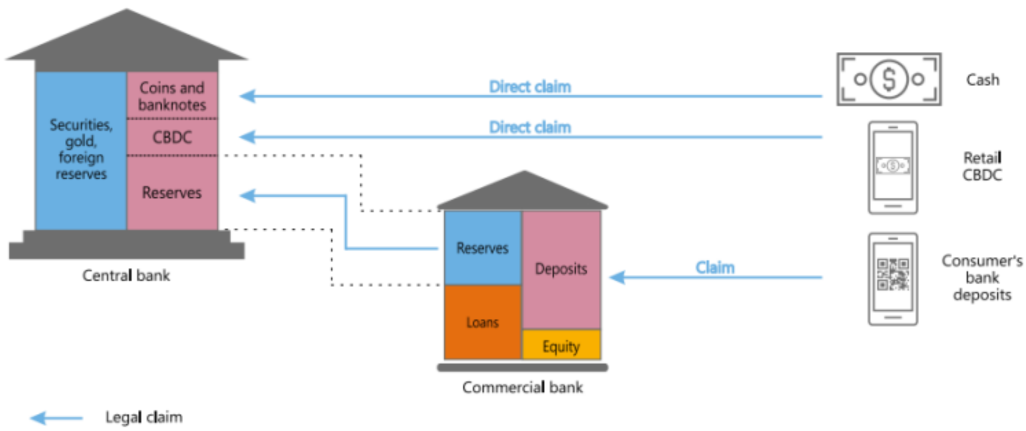


Source: Banque de France

B. THE DIGITAL EURO: CENTRAL BANK DIGITAL MONEY DIRECTLY ACCESSIBLE TO INDIVIDUALS

The digital euro project would complete this architecture by giving private individuals **direct** access to **a digital form of central bank money**. This project would offer them a means of paying digitally without having to use commercial money. The digital euro could then be seen as **the digital equivalent of the banknote**.



Source: R Auer and R Böhme, "Central bank digital currency: the quest for minimally invasive technology", *BIS Working Papers*, no 948, June 2021.

The digital euro does not exist today in the **sense that the euro as a central currency is not digitally accessible by individuals**. The retail digital euro would constitute a claim on the ECB. Plans for a wholesale central bank digital currency (**wholesale MNBC**) for interbank payments are also being discussed. This subject is not covered by the European Commission's proposal of June 2023, which deals exclusively with **the retail digital euro**.

2. A NECESSARY PROJECT TO STRENGTHEN PAYMENT SOVEREIGNTY IN EUROPE

The distinction between central bank money and commercial money **appears theoretical in the eyes of our fellow citizens**. They can already pay digitally, so it is difficult for them to see the point of the digital euro solution. As some have argued, the digital euro would be a "solution in search of a problem".

The European Affairs Committee of the French Senate nevertheless considers that the digital euro is a **necessary project to ensure the sovereignty of payments**. The increasing digitisation of payments is leading to domination **by non-European players**. This is particularly true of **card payments**, which are dominated by the American duopoly of Visa and Mastercard. **The emergence of BigTech**, with its X Pay mobile payment solutions, further reinforces this trend. In the future, digital payments could even involve **private money solutions**, as demonstrated by **Meta's Libra/Diem project** (abandoned in the end), or **MNBCs from countries outside the eurozone**.

More than

Private currency projects such as

Visa and Mastercard account for over 70% of card payments in Europe

of the world's central banks have initiated or launched MNBC pilot projects

have been launched. While Meta has abandoned the Libra project, Paypal is developing its own *stablecoin*, denominated in dollars.

The digital euro would make it possible to **overcome the dependence on non-European solutions in the area of payments** by offering a European digital payment solution universally accepted in the eurozone, which does **not currently exist**.

These **situations of dependence**, which are already problematic in normal times, could prove dangerous in the **event of a crisis**. The digital euro is therefore a response more to a **political project** than an economic motivation: that of reinforcing sovereignty over payments in Europe.

The digital euro is a response to payment dependency rather than market failure.

Main Features of the Digital Euro, as Proposed by the Commission

Currency Status

- **The digital euro would be legal tender**, meaning that its acceptance would be compulsory. However, there will be exemptions for merchants who do not already accept digital payment methods, for micro-companies and for purely personal payments.
- **The digital euro would not lead to the disappearance of cash.** It would be introduced to complement cash, not replace it.
- **The ECB and the central banks would be responsible for issuing the digital euro.**

Distribution

- **The digital euro would be distributed by payment service providers (PSPs, i.e., banks and similar entities)**. This means decentralised distribution via financial intermediaries. The PSPs would be responsible for all interactions with users, including account opening and customer relations.
- **Banks should provide the basic services of the digital euro free of charge to individuals.**
- **For merchants, the fees paid to PSPs would be regulated**.

Terms and Conditions and Limitations

- **The digital euro could be used online or offline (i.e., without using the internet).**
- **The digital euro should not be a programmable currency**. This means that it would not be possible to impose limitations on, for example, the place or time of use, the product or service paid for, or the person using it.
- **The digital euro would be neither positively nor negatively remunerated**.
- **A cap could be set on the number of digital euros held**, to limit the impact on financial stability (risk of deposit drain).

3. CONFIDENTIALITY, A KEY CONDITION FOR THE ADOPTION OF THE DIGITAL EURO

Given the already highly competitive payment landscape in Europe, **confidentiality would be an added value of the digital euro that would** encourage its adoption by European citizens. Data protection and respect for privacy in the event of the launch of the digital euro will be a major concern. In a public consultation carried out by the ECB and published in 2021, **43% of respondents** considered that the protection of privacy was **the most important aspect of the digital euro –** far ahead of other considerations.

Several provisions in the proposal ensure a **higher level of privacy protection**, although complete anonymity is explicitly excluded by the proposal. Personal data would not be visible to the ECB, which would **only** have access to **pseudonymised data**. In addition, a high level of confidentiality would be provided by the **offline feature**.

The European Affairs Committee recommends additional measures to ensure **selective confidentiality**, bringing the digital euro as close as possible **to a digital version of cash**. To this end, the rapporteurs propose to introduce a **confidentiality threshold for small transactions** and to **not allow multiple digital euro accounts,** which requires more information to be shared and makes the user experience more complex. They also draw attention to the lack of clarity surrounding the **technical details of the offline feature, which does** not yet appear to have been perfected.

More generally, in addition to the confidentiality of payments, **the security of digital euro payments** must be ensured in order to prevent **cyber risks**. Such threats should not be overlooked, as the Eurosystem could be faced with attacks aimed at destabilising the financial system and confidence in the euro in general.

4. THE IMPACT ON FINANCIAL STABILITY SHOULD BE LIMITED, BUT THE ECONOMIC MODEL IS STILL UNCERTAIN

A. A FEAR OF DEPOSIT DRAIN, WHICH SHOULD NOT, HOWEVER, BE MASSIVE

The introduction of a digital euro is raising concerns about its impact on **financial intermediation**, with the risk of **deposit drain**. The digital euro can be obtained either by converting cash or by converting deposits. Banks are very cautious about the digital euro project, fearing that the conversion of deposits into digital euros will **erode their sources of funding** and increase their financing costs. This higher cost could have repercussions on the **credit channel**, by reducing the number of loans granted, at a time when bank financing remains the predominant source of financing for European businesses.

This risk must be taken seriously: the digital euro cannot jeopardise financial stability or the ability to finance the European economy. Nevertheless, the characteristics adopted – the introduction of a **holding limit** and the **non-remuneration of the digital euro** – make it possible to limit the use of the euro as a store of value. In fact, **initial studies** indicate a moderate macroeconomic impact in terms of deposit drain if the holding limit is set at 3,000 euros.

The European Affairs Committee recommends that the European Commission and the ECB be required to carry out **more in-depth analyses** to assess the impact of the proposed limits on the holding of digital euros **on different types of banks** and **in different Member States**. The preparatory phase of the digital euro project should be used to assess these impacts in detail. The **co-legislators must be involved in setting the limit**, either by fixing the amount in the text of the proposal or by providing for a revision clause on the limit set by the ECB.

B. A PRICING MODEL STILL SHROUDED IN UNCERTAINTY

There are major uncertainties surrounding the **pricing model** for the digital euro, particularly with regard to **the costs for merchants** and the cost of providing **basic services free of charge.**

The associations representing merchants, such as Mercatel and Eurocommerce, have confirmed to the rapporteurs that **they support the digital euro project in principle**. For merchants, the digital euro could lead to a **reduction in costs, while the fees paid to Mastercard and Visa have risen sharply** in recent years **(+75% between 2016 and 2021).** However, merchants are concerned about **how the one-off costs of adapting payment infrastructures will be met** if the digital euro is introduced. In particular, they want to know whether or not existing infrastructures can be reused. As the **proposal currently stands, these costs are not objectively assessed.** In the longer term, we also need to know what the **economic model and method** will be for **regulating the fees** charged to merchants by payment service providers (PSPs).

The European Affairs Committee recommends guaranteeing that the costs of the digital euro for merchants are lower than those of existing digital payment solutions. In its view, this framework is an essential counterpart to the obligation to accept digital euros. Furthermore, while the **free provision of basic services in digital euros** has been criticised, the committee recommends that **this principle be retained** and that the list of services concerned be reviewed.

Negotiations Currently Deadlocked

Following the presentation of the European Commission's proposal on the digital euro in June 2023, **the co-legislators (European Council and Parliament) began examining the text**.

On the Council side, discussions were intense during the Spanish Presidency of the Council of the EU (second half of 2023). One of the main points revolved around **the division of roles between the ECB, the European Commission and the co-legislators** in determining the arrangements for the digital euro. The ECB, asserting its independence and exclusive competence in matters of monetary policy, seeks to retain control not only over the decision to issue the euro but also over the definition of certain parameters. On the other hand, a number of Member States are stressing the need for **these decisions to be democratically based**, through the intervention of the co-legislators. The Belgian Presidency of the Council (first half of 2024) has made little progress on this issue, as the digital euro is not one of its priorities. The next presidencies of the Council will be held by **countries that are not members of the eurozone**: Hungary, Poland and Denmark.

Discussions **in the European Parliament** have been slow. The Committee on Economic and Monetary Affairs (ECON) has heard several times from the ECB members responsible for the project. The rapporteur of the text for the ECON committee was very reserved about the project, pointing out the lack of added value for the consumer. **The European Parliament did not adopt a position on the digital euro proposal** before the European elections in June. Work will therefore have to resume once the European Parliament is reconstituted.

Negotiations on the proposal for a digital euro are **still at an early stage**. For this reason, the rapporteurs will provide a further update on the digital euro project once the position of the European Parliament has been decided. A motion for a European resolution could then be presented. The rapporteurs are already insisting on the need for **greater involvement of the co-legislators** and **greater political control over the design phase** of the digital euro, which is in the hands of the ECB and is still surrounded by many uncertainties.

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