

A digital euro: what's new?

A digital euro supplanting cold hard cash is nothing new. That said, shaken faith in the euro's issuer is opening up novel questions about the role of banks in a cashless society.



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I. Paper money

Standing behind the counter, you have just accepted a 10-euro note from a customer in exchange for a cup of coffee and a croissant (you run a fancy coffee shop), and you have

stashed it in your cash register. Why have you accepted a piece of paper in exchange for a very tangible breakfast? At first sight, because everyone does it; in fact, you are required by law to accept it as a means of payment: a euro banknote is legal tender in the eurozone.

But what does that piece of paper do for you? It gives you the right to buy a piece of the eurozone's GDP, anything that strikes your fancy and costs no more than 10 euros: it is a very convenient medium of exchange. (This is why a 10-euro note is used in the example; 500-euro notes are not so much a medium of exchange as a store of wealth, transported in the trunk of a car to a tax haven.) But if, for some reason, prices go up, the piece of GDP your 10-euro note can buy becomes smaller. Now look at it from another angle: if, for some reason, the amount of notes in circulation increases while GDP stays the same, that GDP will be claimed by a higher number of notes: the piece every note can claim will necessarily be smaller. How is that done in real life? By prices going up. You stash the 10-euro note in your cash register because you believe the piece of GDP you can buy with it will not shrink, that prices will be reasonably stable. And you believe it because you trust whoever is in charge of printing money to keep an appropriate balance between the amount of money and the size of GDP. (The difficult art of defining and keeping that balance is called monetary policy.) Otherwise, on receiving the 10-euro note, you would have to run out to buy something tangible with it before it lost value. It is said that in Germany, during the hyperinflation (1923), people drank two cups of coffee in the morning and none in the evening, because in the course of the day the price of a cup would go up by 30%. In short, there are two conditions, not independent of one another, for a system of paper money to work: general acceptance and trust in the issuer.

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