Why digital money's widespread use depends on regulation as much as technology

Crypto, stablecoins and other digital currencies require global regulatory responses.

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The widespread use and long-term success of digital currencies, such as stablecoins, will depend as much on getting the regulation right as on technological advancements.

A new report on Digital Money, the eighth in a series produced by IESE's Banking Initiative and the Centre for Economic Policy Research, looks at how digital currencies present risks that are substantially different from other long-developing digitalization trends in the banking sector, demanding new regulatory responses.

While digital currencies are often presented mainly as a technological innovation — a financial tool with faster settlement and lower transaction costs, among other benefits — there are fundamental institutional questions that must be resolved for them to function as general-purpose money. Their growing use, along with the complex interplay between domestic monetary architecture, international dynamics and regulatory design, make digital money a matter of first-order importance for economic policy.

The report is coauthored by Stephen Cecchetti of Brandeis University, University of Bern's Dirk Niepelt, Helene Rey of London Business School and IESE's Xavier Vives, and examines such crucial questions as who issues money, who anchors it and who bears the cost when things go wrong.

How to approach CBDCs, tokenized deposits and stablecoins

Some of the report's key findings:

- **Central banks are key to trust.** While technology expands the menu of feasible monetary forms, it does not determine which of them comes to be widely trusted as money. General acceptance, which in turn hinges on singleness (one unit trading at par with any other), transferability and elasticity, determines which will be widely adopted as money. Those properties are the result of institutional foundations, and central banks are indispensable in any digital monetary system. Technology is a necessary complement to institutions, not a replacement.
- **Central Bank Digital Currencies (CBDCs) have limits.** The use of cash may be ebbing in everyday transactions, but retail CBDCs are unlikely to become a digital replacement. Other tools, such as regulated instant payment systems, are often a better option. However, retail CBDCs (or rCBDCs) may offer an alternative that strengthens competition and reduces fragility in the banking system, without replacing cash.
- **Tokenized deposits may edge out stablecoins.** Stablecoins are the most consequential digital development to date for the international monetary system, migrating money-like activity onto crypto rails. This has many implications for public finances, for demand for U.S. assets and for the risk of runs on the U.S. Treasuries that back them. Dollar-denominated stablecoins may extend U.S. monetary influence while weakening sovereignty and seigniorage in other economies. Despite the size of the stablecoin market, there is little evidence that they function as general-purpose money in the sense of a means of payment or a substitute for bank deposits. Tokenized bank deposits, which sit in supervised and regulated banks, may be better placed than stablecoins to develop into large-scale private digital money.
- **Regulation should be based on functional equivalence.** In approaching digital currency regulation, the underlying principle must be functional equivalence: Money-like instruments must face safeguards proportionate to the risks they create. Under that logic, tokenized deposits belong under bank-equivalent rules; stablecoins that aspire to circulate as money must have the institutional supports that come with it. Various countries and regions — the U.S., the EU and the U.K. among them — are introducing their own regulations, which create scope for regulatory arbitrage.

International coordination on minimum standards would be desirable, however difficult.

A hybrid future for currencies

Looking ahead, the report foresees a hybrid monetary landscape, in which stablecoins and tokenized deposits coexist, in some countries alongside rCBDCs. The U.S. is likely to support its dollar dominance through private stablecoins, while avoiding a rCBDC; the EU appears to be leaning toward an ecosystem that includes rCBDCs and their wholesale counterparts.

In this scenario, digital money is a high-stakes contest over institutional power as well as technical integrity. On the institutional side, central banks will defend seigniorage, monetary autonomy and the public anchor of the monetary order, while private banks will defend deposit franchises as well as profits from issuing money-like liabilities. On the technical side, the safety of digital channels is a condition for trust, not a detail of implementation. Whether these instruments function as money depends on institutions and technology working together.

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