Discussion of: Implications of Financial Architecture Change

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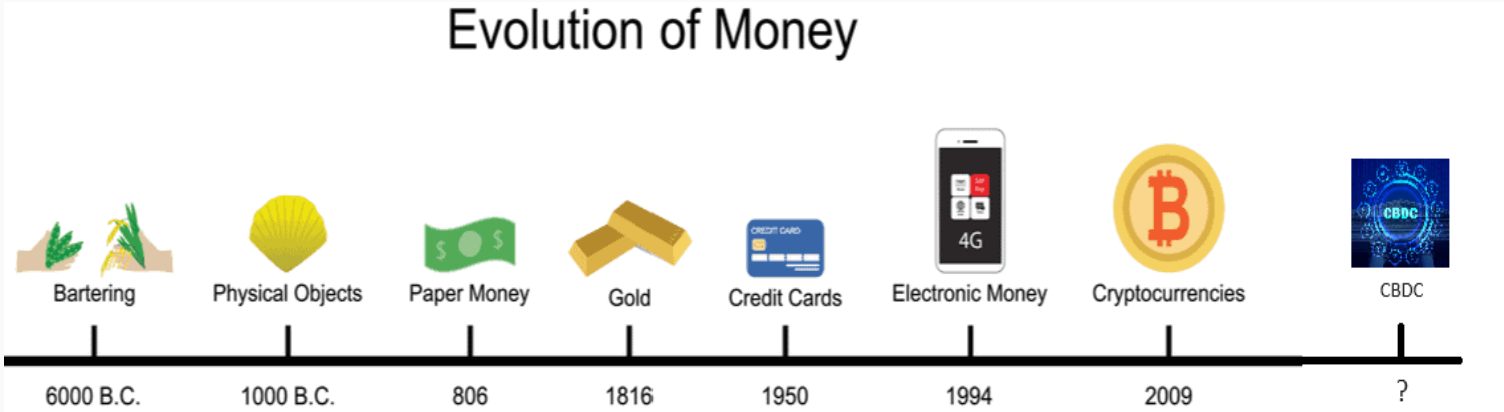
[a]The views expressed are those of the author and do not necessarily reflect the views of the ECB or the Eurosystem

Outline

1. Why you should read this paper
2. Summary of the paper
3. CBDC-policy lessons
4. Questions and suggestions

Why you should read this paper

- An ongoing seismic shift in the (international) payment system:



- Will this drastically change the financial architecture, or not?
  - CBDC: digital means of payment or also store of value?
  - Cryptocurrency: decentralized global money or speculative asset?

- This paper provides a sound theoretical framing to consider the economic impact of change:
  - "It is very much in the hands of policy makers"

Summary of the paper

- A general, unifying framework that nests other models (!)
- Three neutrality conditions, when a regime switch leaves the choice set of agents, and thus allocations and prices, unaltered.
- Three applications: retail CBDC, cryptocurrency, and the value of central-bank lender-of-last resort guarantees.

Lessons for CBDC-policy (1/2)

- **Question**: is it really "in the hands of policy makers"?
- Neutrality in the case of CBDC requires that:
  - the **central bank** issues CBDC, redeems reserves and lends to banks in the right proportions, at the right rate, with the right collateral requirement.
  - **government** transfers must adjust to satisfy budget constraints while preserving wealth distribution.
  - Politicians and **voters** information and understanding is unchanged.

Lessons for CBDC-policy (1/2)

- **Question**: is it really "in the hands of policy makers"?
- Neutrality in the case of CBDC requires that:
  - the **central bank** issues CBDC, redeems reserves and lends to banks in the right proportions, at the right rate, with the right collateral requirement $\rightarrow$ **possible in theory**
  - **government** transfers must adjust to satisfy budget constraints while preserving wealth distribution $\rightarrow$ **infeasible**
  - Politicians and **voters** information and understanding is unchanged $\rightarrow$ **unavoidable (?)**

Lessons for CBDC-policy (2/2)

- An implied central bank policy to limit CBDC-effects is:
  1. issue only a small amount of CBDC
  2. lend to banks at a favorable rate with soft collateral requirements
- Back-of-the envelope "fiscal costs of neutrality":
  - Suppose approximately 300 million adults in the euro area each withdraw €1500, leading to a €450bn loss of cheap deposit funding.
  - Provide €450bn central bank lending with a rate of DFR-3%. Banks place this money in their reserve accounts.
  - Effective cost of neutrality: 3% * €450bn = €13.5bn per year
- **My lessons:**
  1. The limited pass through of policy rates matters a lot, also in the CBDC debate.
  2. I doubt whether long run "wide ranging effects" can be avoided, but certainly not by the central bank alone.

Questions and suggestions

- On the neutrality conditions:
  - Deposit synergies: neutrality requires a CBDC with no additional privacy benefits?
  - International dimension: neutrality requires favorable CB lending to foreign banks (and no exchange rate effects)?
- On the empirical application:
  - Consider to move/adjust third application to be part of the CBDC section?
  - Could you also apply the model to past changes in the financial/payments architecture? i.e. emergence of credit cards vs cryptocurrencies
- Follow-up work?
  - Elaborate on sources of possible Pareto improvement (rather than neutrality vs non-neutrality)
  - Political-economy neutrality conditions.

Conclusion

- Great paper on a super important topic.
- The impact of CBDCs and private currencies depends heavily on policy design and implementation.
- I look forward to seeing how it develops and to your follow-up work!