In support of the digital euro and a European public money system *dec 2025*

The European Parliament is facing a historic decision on the future of the European financial system and thus on the future of Europe. In a recent article, the European Parliament's rapporteur on the digital euro file, centre-right MEP Fernando Navarrete, suggests that the digital euro, as proposed by the European Central Bank (ECB), is the solution to a non-existent problem; "why are we discussing something citizens are not asking for ? ". The article then dissects the contribution of the digital euro on "a wide range of specific sub-problems". However these sub-problems are indeed non-existing or irrelevant, in strong contrast with the key problems which are to be solved by the digital euro:

The digital euro can solve the most important problem for citizens to be protected from the next financial crisis and the astronomical amounts of money they have to pay as taxpayers to bail out private banks. They also can be protected from the accompanying economic depression. The digital euro enables the gradual, but fundamental shift from the current, pro-cyclical, inherently unstable system to a counter-cyclical, stable financial system. At least a significant part of the money than is then no longer created by the private banks, but by the ECB as a public digital euro. This money can be brought into circulation through joint European projects, such as infrastructure, education, economic stimulation / innovation and/or defence. As such, it serves the general interest of European citizens and constitutes the guiding capacity of the European Government, as democratically legitimized by the European Parliament. It will give Europeans control over their money in the digital age.

In summary, the ECB's digital euro has the following advantages:

- In all cases, the introduction of the digital euro contributes significantly to the stability of the financial system. In the case of a (hypothetical) 100% digital euro, the system has changed from pro-cyclical-unstable to fully countercyclical-robust. But significant improvements in stability can also be achieved at lower implementation levels.
- Risk of a financial crisis and subsequent economic recession (austerity) will be very much lower .
- Public and private roles and responsibilities are disentangled; huge private losses are no longer transferred to public taxpayers;
- Taxes for European citizens will decrease significantly (dependent upon the fraction of digital euro's in the money system, up to €500 billion per year; > 3% of GDP, > 7% of government budgets);
- The guiding power of the government will increase by channelling the new money through the politically most relevant social and economic sectors, such as currently defence spending.
- Economic stability will increase as well (as a result of increased financial stability), which in turn leads to more political stability and thus a reduction in social discontent and populism.

The usually mentioned disadvantages can be overcome and warranted by:

- legally limiting the ***amount*** of new money created annually by the (public) ECB, after which the ***allocation***/destination of the newly created money is left to the democratic system;
- preventing feared shortages of credit for new economic investments by lending part of the publicly created money to companies through the private (intermediary) banking sector, if necessary;
- channelling newly created money directly to individual countries when it proves politically impossible to finance joint European projects (agriculture, defence, etc.);
- legally guaranteeing the privacy of citizens. So far, the privacy risks seem to be greater with 'big tech' and 'big finance' than with the democratically responsible government;
- installing (already developed) 'pass-through' scenarios to prevent instability in the private banking sector during the transition to a money system which is largely based on the public digital euro.
- delegating technical innovation and development of the payment system to market-driven companies.

Explanation:

The financial crisis of 2008

According to Adair Turner, then head of the British financial regulator, "the financial crisis of 2008 came about because we failed to curb the creation of private credit and private money." Because of this private money creation, the financial system is 'naturally' unstable. In this system, 'money' is created almost exclusively by private banks when granting loans. This is not about 'real' 'public' money (coins, banknotes), as it can only be created by the Central Bank, but about private 'claims' on that real public money. At a time when the economy is already growing and house prices are already rising, (too) many of these claims ('euros') are put into circulation by providing loans, causing prices to rise even further. If things go badly, private money creation comes to a halt. This means that the up and down cyclical movements become increasingly strong (pro-cyclic) and the system is therefore 'naturally' unstable. As a result, the system is always on the way to the next crisis.

The astronomical sums of money used to bail out private banks in 2008 were passed on to taxpayers, resulting in a period of austerity and economic stagnation. According to chief economist of the Financial Times, this was an important cause of the strong shift to right-wing populist parties that started immediately after 2008.

Inadequate European policies

The European Central Bank (ECB) itself does not have the right tools to stabilise the system and fulfil its formal task of price stability (with a target inflation of 2%):

- For example, in the economic recession that followed the 2008 crisis, the ECB was not allowed to put the much-needed money into circulation to support governments (Quantitative Easing; QE), but private banks first had to buy government bonds, which were then sold on to the ECB. As a result of this indirect route, the large amount of money (in the order of 5000 billion) remained in the financial sector, stock prices and real estate prices rose, too little money initially ended up in the real economy and inflation initially remained at a much too low level.
- Later, inflation became (much) too high again due to various factors. Apart from the late flow of the money created into the real economy, the end of the COVID crisis played a role in this. Over the period 2023-2025, the policy rate was raised from around 2% to around 4%, in order to bring inflation back down to the targeted 2%. In the aftermath of the purchase of government bonds through private banks in the QE program, the ECB, and thus the European taxpayer, still pays 120 billion euros in interest payments to European private banks every year.

Understanding the functioning of the financial (Eurozone) system

The functioning of the Eurozone financial system, as it has developed since the digitisation and liberalisation of private banks since 1980, has been reconstructed on the basis of a system-dynamic model,[1] which is as close as possible to the actual development based on statistical data. [2]

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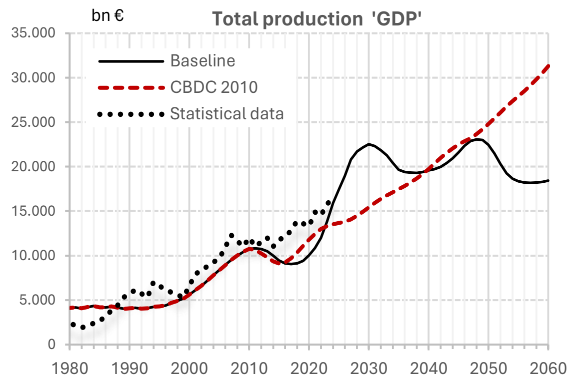
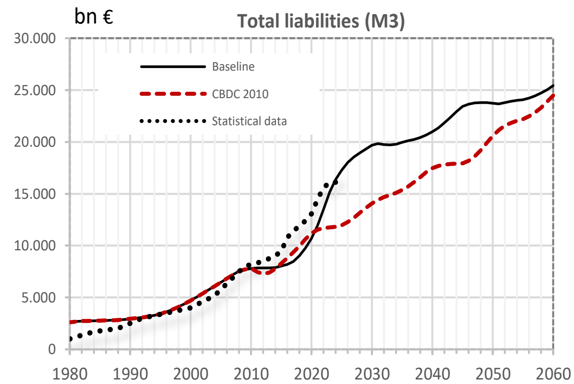
[1] Reforming the Eurozone financial system: A system-dynamics approach – International Review of Financial Analysis (van Egmond & de Vries, 2024). https://www.sciencedirect.com/science/article/pii/S1057521924001248
The model simulates a number of key variables of the financial and economic system for a manufacturing, a service and a public sector, in combination with four categories of consumers. The dynamic, non-equilibrium model of economic development is combined with a stock-flow representation of the financial sector in the form of a stylized bank balance sheet with assets and liabilities for the banking system.

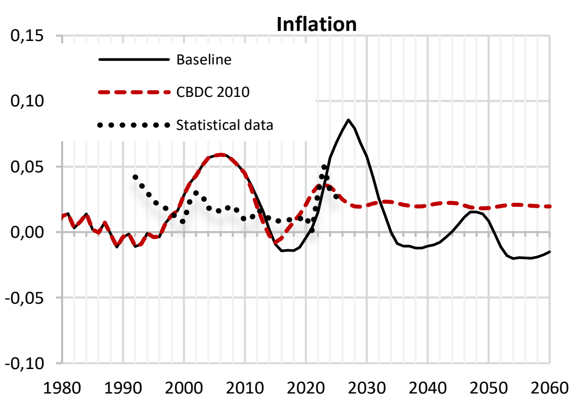
[2] Trading Economics (2024) Indicators. Datasets on https://tradingeconomics.com/

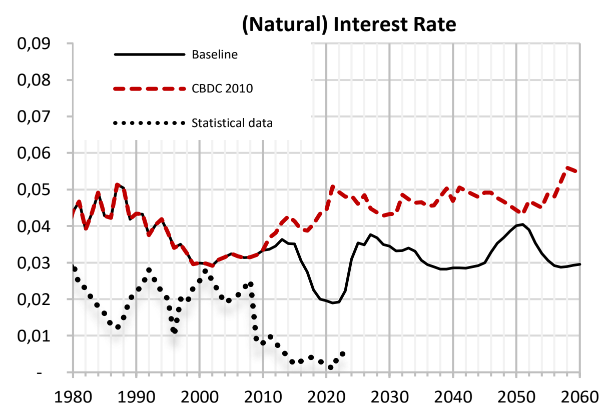
In the figures below, the actual Baseline developments for total production (as GDP or GDP) and the total amount of (M3) money in the system is represented by the black dotted lines (statistical data). The black lines drawn represent the model-based reconstruction and the subsequent forward calculation.





The model reasonably reconstructs the dynamical behaviour of the financial system in the Eurozone over time. This implies that the amount of money (M3) in the system can be understood from the total production GDP (and vice versa). Apart from the ECB-Quantitative Easing (QE) program (2014-2022), this money is created by the private banking sector in granting loans to corporate business and, in particular to the financing of real assets, such as mortgages. The model calculations supported by observations (dotted lines), show that in the period leading to the 2008-financial crisis (2000-2008) some € 3500 billion of new money was created and put into circulation by private banks, which amounts to 6% to 8% per year. In the period after the financial crisis, from 2008 to 2025, banks created a net € 4500 billion, while the ECB created € 5000 billion in the aforementioned QE program, to prevent inflation and to restore the economy through the purchase of government and corporate bonds through private banks. Creating the money for lending (by private banks) in the boom-part of the cycle (when economic activity and prices are already increasing), further increase in partly speculative lending provokes unsustainable asset prices and subsequent system collapse into financial crisis ('Minsky-moment'). Given this inherent pro-cyclical (instable) nature of the system, the model predicts financial crises again in the coming years. The exact moments (2030 and 2025) are of course surrounded by very large uncertainties and has to be seen as indicative.





The calculated inflation level (see figure) varies more than the 'actual' (definition-related) inflation level, but it does follow its dynamics. Both levels show how inflation fell after 2008 and, despite the QE-programme that has been running since 2014, only started to rise from 2020 onwards, but then so much that an additional interest rate hike was necessary to bring inflation back to the 2% target level. The level of the 'natural interest', as it occurs in the financial markets, also deviates from the actual 'measured' natural interest rate, but here too the calculated development follows its dynamics.

Lessons not learned

Nothing has changed substantially since 2008. The risks are still as great as they were then and the system is still 'naturally' unstable (pro-cyclical). All the more so since the banking sector is now pushing for the scrapping of the bank tax, relaxation of the bonus ceiling, reduction of the bank buffers and (therefore) increase of the permissible debt ratio. At the same time, it advocates the formation of a banking union and encourages the merger into even larger banks in order to compete with the US and China. But the concentration of non-democratic power is thereby even greater. In the same vein, the packaging of loans (securitisation) will be allowed again. These '*sub-prime mortgages'* were the main cause of the financial crisis in 2008. An additional risk currently comes from the recent intention of nine European banks to 'launch a *stablecoin* pegged to the euro'. As early as 2026, that *stablecoin* must be in use for 'exchanging cryptocurrencies and international payments'. These (private) banks aim to 'fulfil a utility function with their *stablecoin*'. Private and public roles and responsibilities will then become even more intertwined. Against these backgrounds, another crisis is in line with expectations. Under the current (geo-)political conditions, the social and economic consequences of this will be incalculable.

The prospect of the digital euro

Against these worrying backgrounds, it is seen as urgent to increase the robustness of the European monetary and financial system as soon as possible. This can be achieved through the already foreseen generous introduction of the 'digital euro' as a Central Bank Digital Currency (CBDC) through a gradually rising holding limit. Herewith, public and private roles and responsibilities are distinguished and balanced. Rather than the current pro-cyclic, and thus instable private financial system, in which money is created on the basis of a commercial profit motive, the digital euro is increasingly created by the ECB at the moment when the economy weakens and prices tend to fall (deflation). The public digital euro-system is therefore countercyclical and stable by nature.

To demonstrate the functioning of a digital euro-system, computations were made for both the ‘mixed’ situations, in which money is created for 50% by private banks (the usual money creation) and 50% by the ECB (digital euro), and the situation in which all the new money (100%) is created as digital euro’s by the ECB. In both cases, it was assumed the digital euro would have been introduced in 2010, shortly after the 2008 crisis. The results for the case of 100% digital euro are shown in the figures by the red dotted lines. Indeed, there will be no more crises, while inflation will remain stable at the intended 2% inflation target. The amount of money (digital euro’s) to be created by the ECB to achieve the 2% inflation with economic growth of about 1%, is now in the order of 3% of the money supply, which in the Eurozone happens to corresponds roughly to 3% of GDP. Because the (free) market for money is now functioning again, interest rates will go to a slightly higher, but stable level between 4 and 5%.
Of course, if the digital euro were to be introduced at a lower level (a fraction of the total 'money'; 50 % in the computations), the positive effects would be proportionately smaller, but remain significant.
In order to further investigate the increased stability and robustness of the fully countercyclical money system (100 % digital euro), additional calculations have been carried out under the assumption that external, unavoidable circumstances will cause a contraction in economic volume. This might result from increasing raw material prices, environmental (climate) requirements or other disruptions. Even if the volume of installed productive capital were to fall by tens of per cent, the stability of the system would be maintained.

Implications

In concrete terms, the transition to a public digital euro system would imply the following:

- The Maastricht Treaty (Article 104) is to be amended such that the ECB will become a constitutional, independent 'monetary authority' that directs the amount of ('real') money in the Eurozone in order to achieve price stability (at 2% target inflation). Inflation is determined by many factors, but to a large extent to the amount of money in circulation. Controlling the amount of money thus is relevant.
- Private banks become brokers in the financial markets, mediating between the supply and demand of (existing) digital euros (CBDCs). The risks taken in the private sector are entirely borne by the private sector itself, as is the case for all other, non-public social activities. Because the market will do its work, the enormous complexity of the current system will largely disappear and financial supervision can also be simplified.
- Every citizen and every business has an account with the ECB, with digital euros on it. The money is real, so 100% guaranteed; a deposit guarantee scheme is no longer necessary. Those who want a higher return than 0% on savings can invest or lend their CBDC money to a (private) bank or financial institution, which will on-lend the money, including additional fees, to mortgage borrowers.

Additional, specific advantages and disadvantages

- In all cases, the introduction of the digital euro contributes significantly to the stability of the financial system. In the case of a (hypothetical) 100% digital euro, the system has changed from pro-cyclical-unstable to countercyclical-robust. But significant improvements in stability are also achieved at lower implementation levels. This can be understood as an operational, limited and legal formalisation of the previous ECB-QE programme, which had to restore stability by public intervention.
- Taxes for European citizens will be structurally lower, because if price stability is maintained, about 3% of GDP (> 7% of the government budget) can or must be brought into circulation annually as new money in the form of government spending, which then does not have to be paid for from taxes (in the Eurozone up to over € 500 billion / per year in case of 100% CBDC). In addition, an accelerated repayment of government debt is possible by repaying debts on the basis of newly created (ECB) money, without this having inflationary effects.
- The government's ability to provide direction will be enhanced by allowing the new money to be directed to sectors that are seen as the most relevant at that time from an economic, social or price stability (inflation control) perspective.
- Greater financial stability and service make greater economic stability possible, which in turn leads to greater political stability and thus to a reduction in social discontent and populism.
- Under the current circumstances, the money (3% of GDP) to be created could be spent structurally on the already policy-decided increase in defence spending from 2% to 5% of GDP. Austerity and/or tax increases and/or Eurobonds loans would then not be necessary and major political and military coordination problems would be avoided.

The often mentioned, additional disadvantages can be easily overcome:

- Feared shortages of credit for new social and economic initiatives can be avoided if desired by lending part of the publicly created money (if necessary at low interest rates) to the private banking sector, which can lend the money to companies for a fee.
- From the point of view of national sovereignty and strategic autonomy, countries/political parties may object to the creation of money in the inevitable form of CBDCs at the European level. This can be overcome by channelling newly created money directly to the individual countries, based on an agreed socio-economic criterion.

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