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Digital payments and European sovereignty

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Summary

Digital payments are of great strategic importance, not only for the further development of efficient financial markets but also for a prosperous economy as a whole. The more digital the payment landscape becomes, the more important the role played by international, non-European players. As a consequence, innovative efforts have to speed up and pan-European solutions with European governance are needed to ensure a competitive, safe and sovereign payment landscape in Europe. Central bank digital currency (CBDC) is being discussed as a means of integrating our euro currency into the digital world. With or without CBDC, private sector service providers should continue to play an integral part in payments as face to the customer and for the delivery of a broader set of additional services.

What is at stake?

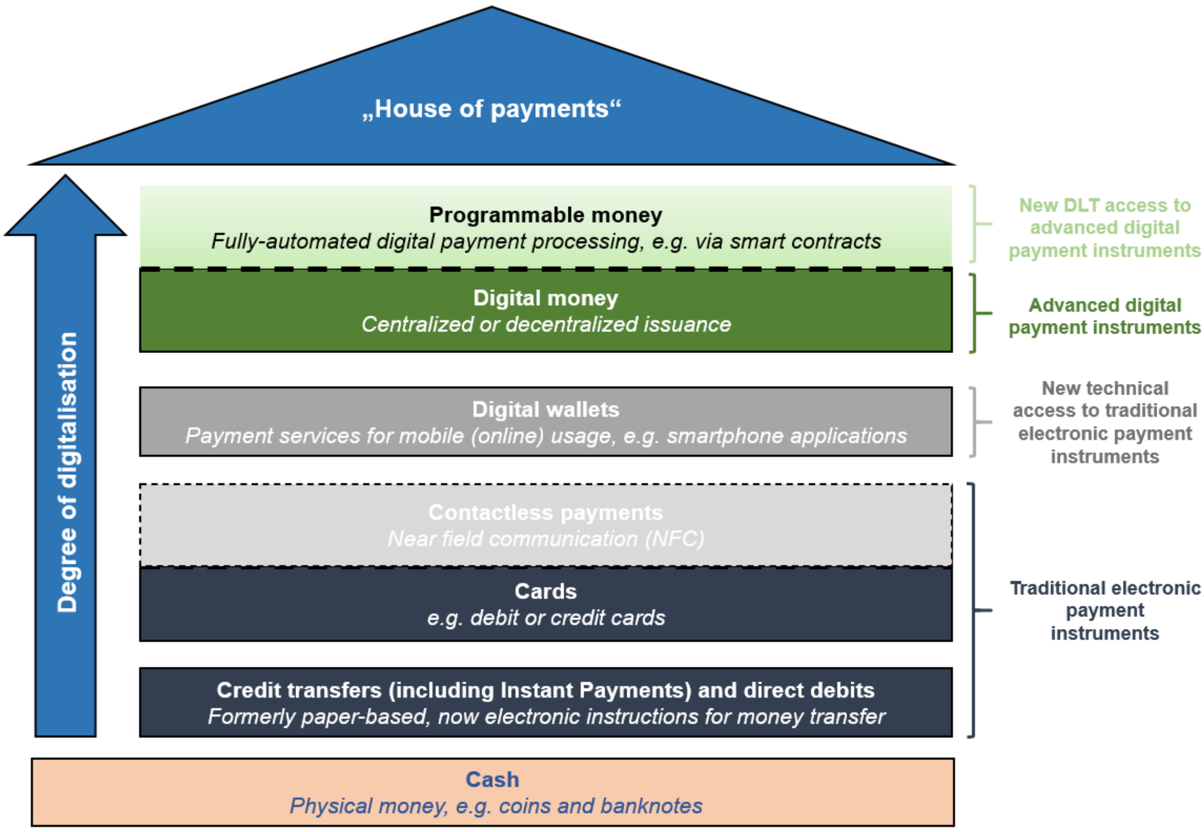
We have recently been seeing an acceleration in the pace of digitalisation. This shift has been turbocharged by the coronavirus pandemic. At the same time, payments are an integral part of our everyday lives and, in a wider sense, the "lifeblood" of the economy.

Thus, digital payments are of great strategic importance, not only for the further development of efficient financial markets but also for a prosperous economy as a whole. At the same time, digitalisation is not a domestic development but a global phenomenon, with a handful of international players playing key roles, for instance by operating large platforms with broad ranges of services and strong customer bases. The political conclusion that needs to be drawn from these two premises is as follows:

We have to speed up our innovative efforts and we must do so in a way that safeguards the contestability, competiveness, safety and sovereignty of the European payments market – which serves 450 million consumers and processes 150 billion cashless payments in the EU each year.[1]

Different levels of digitalisation: the "house of payments"

Distinguishing between digital and non-digital payments is not a trivial matter, since the majority of payments nowadays are already conducted electronically. To illustrate the differences, the idea of a "house of payments" – a multilevel structure that is undergoing never-ending construction – is introduced and further explained in the following.



[1] ECB payments statistics for 2019 (online: https://sdw.ecb.europa.eu/reports.do?node=1000004051).

The ground floor of this house consists of cash payments, which have been a widely accepted, easy-to-use, and quite resilient means of payment for centuries. Any account holdings at private banks – the "building blocks" for payments at higher levels – can be withdrawn and converted into cash holdings. Cash payments are by no means digital payments, which start on the first floor.

The first floor is home to the traditional payment instruments – credit transfers and direct debits. These have also functioned for decades on the basis of electronic data processing, but are not necessarily initiated by an action carried out online. For a very long time, a paper-based instruction to transfer money directly from one account to another had to be transposed into a digital dataset to be executed electronically. The same holds true for direct debits, which have to be initiated by the payee. Nowadays, the process is carried out completely online in most cases since it is initiated either by the payer via online banking or via the online transfer of a digital mandate for a direct debit from the payer to the payee. Credit transfers and direct debits have also built a bridge into the digital world. They are often used in e-commerce. In fact, payment on receipt of invoice was the payment method used for 30% of all e-commerce purchases in Germany last year, and the direct debit in its classic form was used for nearly 18% of all online shopping transactions.[2]

The second floor of the house of payments is where we find card payments. These may be part of a direct interaction between the payer and payee at the physical point of sale and are initiated digitally. This holds true for all kinds of debit cards (including the German girocard) as well as for credit cards. However, in online shopping, only cards from international schemes can be used in Germany. This brings us to a mezzanine floor between the second and third storeys: contactless card payments are more digital than traditional card payments since they rely on extremely user-friendly near field communication technology. Contactless card payments have enjoyed a massive surge in popularity in Germany during the pandemic, but had already been booming beforehand, with the number of card payments in Germany nearly doubling between 2014 and 2019.[3]

The third floor is where we find payment services that were introduced specifically for online usage. Here, it is important that the user perceives these to be purely digital, by being fully integrated into smartphones or digital wallets. Of course, in technical terms, these might simply be an additional, highly convenient layer on top of other payment instruments such as credit transfers, direct debits and card payments.

The fourth floor, meanwhile, is where programmable payment methods – payments initiated by smart contracts in a blockchain-based environment – become available. However, this floor currently is "under construction", as many of these kinds of payments see a need for new forms of money, in particular tokenised digital money.

International players and European sovereignty

If we now look at the house of payments from the angle of European sovereignty, it is worth analysing the providers of these various kinds of payment services. On floor one, we operate almost entirely on the basis of European rules. Credit transfers and direct debits denominated in euro are SEPA payment instruments, with rulebooks drawn up by the European payments industry. In addition, the infrastructure on which these services operate is owned mainly by European banks or, in some cases, by European central banks. However, meanwhile there are also global equity funds involved in the consolidation process that is taking place among technical service providers in the payments business.

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[2] EHI Study on Online Payment 2021.

[3] Deutsche Bundesbank annual payments statistics.

On the second floor, in Germany we have the popular domestic girocard scheme. At the European level, however, transactions made with international card schemes on payment cards issued in the European Union accounted for nearly 68% of all card payments in 2016.[4] On the third floor, we see even fewer European players. In the field of smartphone payments, many of the successful actors are US BigTech firms. Apple Pay, in particular, has managed to become an important fixture in the European market.

Similarly, in online payment services, PayPal is a very important player, with a German e-commerce market share of about 25%.[5] However, with Sweden's Klarna, there is a non-traditional European payment service provider in e-commerce which offers online payment services such as "Sofortüberweisung". Based on their current market capitalisation, providers like Klarna and Adyen have overtaken the biggest German bank, which illustrates the strong dynamic in the market structure and where the market sees developments going in the future.

To sum up, the more digital the landscape becomes, the more important the role played by international players. In addition, the BigTech firms are running platform-based digital ecosystems into which payment services are increasingly being integrated as a key component. This is the backdrop against which the "Libra coin" (now: Diem) was formally announced by a consortium of around thirty firms, including Facebook, in June 2019. While platform-based services are convenient and potentially more inclusive, from a platform provider's perspective, it is commercially lucrative to integrate a convenient payment service into a platform to make using it even more appealing.

The European dimension will be key

When discussing European sovereignty, it is not meant to protect the European market from external competitors. After all, openness to global competition is crucial if the European payments market is to foster efficiency and innovation. However, it must be ensured that the markets remain contestable und competitive and that European players remain relevant so that we do not end up in a situation in which we are completely dependent on non-European players.

This is why there is, first and foremost, a need for a pan-European payment solution that is governed at the European level. It needs to be useable at the physical point of sale as well as in e-commerce and between individuals. This is what the European Commission and the Eurosystem called for in their respective retail payment strategies. This is a task for market players, since it is their business that is at stake. While it is not easy to reconcile different interests at the domestic or European level, simply carrying on as hitherto is not a sustainable strategy in a rapidly growing digital world.

Second, future payments will be embedded in broader digital ecosystems. We are on the cusp of building a complete digital universe in which people with electronic identities will interact with public administrations and private companies almost exclusively online, including, to some extent, for education and work. To design this new world in Europe properly, we have to speed up our efforts to foster cooperation in network industries such as payments, try to build walkways with other important "houses" such as e-identity, and develop fair and transparent rules outlining how these houses are to interact with each other. With that in mind, the prospect of a European digital identity wallet, as announced by the Commission in June, looks promising. In the end, the idea is to aim for an open, innovative and seamless digital ecosystem – a lively town with many actors and efficient connections – rather than ending with a "super app" of one or a few providers dominating the digital universe of the future.

[4] ECB, "Card payments in Europe – current landscape and future prospects: a Eurosystem perspective"

[5] EHI Study on Online Payment 2021.

Third, we are considering how our currency can be integrated into this new digital universe. Unlike crypto-assets, “real money” in digital form is well suited for that, either in the form of tokenised commercial bank money or central bank digital currency (CBDC).

Many central banks around the world are currently considering this option, and some, like in the Bahamas, have already introduced a CBDC. For the Eurosystem, we will decide in the near future whether to press ahead with a formal project built around the analysis conducted so far. In this context, we need to be clear about what we would like to achieve: form follows function. For instance, CBDC does not necessarily equate with distributed ledger technology, depending on the objectives we are aiming for. One potential benefit CBDC could offers over existing payment products is that it could support programmable payments. In that respect, we also need to consider quick wins like trigger solutions, which combine processing in DLT-based infrastructures with payments in conventional systems. We have to bear in mind not just the retail space but wholesale payments with regard to the settlement of securities in electronic form as well.

With or without CBDC, the private sector will remain important. Private sector service providers should continue to play an important role in payments, as face to the customer, but also as providers of tailor-made payments solutions and a broad range of banking-like services. In order to achieve our vision, cooperation is key. So let us all work together to ensure that our house of payments – and perhaps our village, country and continent – can also brave the storm of digitalisation.

About the author

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Burkhard Balz has served on the Executive Board of the Deutsche Bundesbank since September 2018 and is responsible for the Directorate General Payments and Settlement Systems and the Directorate General Economic Education, University and International Central Bank Dialogue. He is a member of the Eurosystem High-Level Task Force on central bank digital currency. Mr Balz is also a Member of the Committee on Payments and Market Infrastructures of the Bank for International Settlements.

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