Does Europe's payments strategy add up?

by Zach Meyers, 3 October 2023

The EU institutions are pushing multiple European payments champions to compete with Visa and Mastercard. But focusing on 'sovereignty' at all costs is no strategy for success.

EU residents have an impressive range of ways to pay for goods and services at home – including with cash, cards, smartphones, direct debits, bank transfers and instant payment apps. Yet the EU institutions have spent years fretting that most of these services do not work seamlessly across borders. The main way residents pay for goods and services across the whole bloc remains American payment networks like Visa and Mastercard. There is still no EU-wide payments champion, despite the EU's many efforts to foster one.

The EU is following China and the US in pursuing an active industrial strategy in strategic areas like chip-making and green technologies. But its industrial policy in payments has received much less attention, perhaps because it is driven more by regulation than by large subsidies. To keep the dream of a 'sovereign' European payments champion alive, the European Commission has recently launched a barrage of proposals for new rules. But these different ideas lack an overarching vision. The EU's strategy would work better if it worried less about sovereignty and thought more about what makes payment systems successful: fulfilling consumers' needs.

Historically, European banks have had little interest in managing the mechanics behind cross-border retail payments, or making the big investments necessary to support them. In a few countries, banking consortia rolled out some innovative and successful payment products – like Spain's Bizum, Sweden's Swish, Denmark's MobilePay, Norway's Vipps and the Netherlands' iDEAL. But these have largely remained national projects. After investing in their development, banks have mostly been unenthusiastic about recreating them so they work with other EU countries' systems, or trying to bridge the varying preferences of consumers in different member-states. Many banks largely treated payments as a compulsory side gig. Many gave up on operating domestic card systems in individual EU member-states, preferring to stick with international card brands that work everywhere. And European banks sold off their stakes in Visa and Mastercard. They are now normal members of the Visa and Mastercard networks,

which means they still get to keep a handy cut of fees from card transactions, while letting Visa and Mastercard do the heavy lifting of co-ordinating the card systems.

In response to this 'de-Europeanisation', the Commission has tried to open up the payments market. The central idea was to encourage financial technology firms ('fintechs') to enter the market. In 2009, the EU allowed fintechs to operate payment accounts across Europe without the rigmarole of becoming regulated banks. And in 2015, the EU mandated 'open banking': allowing consumers to use a fintech to transfer money from a consumer's bank account to a retailer, enabling cheap online payments without using card networks. Banks want consumers to use cards because they earn a cut of the card fees – conversely, fintechs want to offer this cheaper alternative. The Commission therefore hoped that open banking could result in a new EU-wide payment option. However, this remained elusive. Different countries, and sometimes different banks, rolled out open banking in inconsistent ways. More egregiously, some banks simply block cheap cross-border transfers. In response, the Commission now wants to standardise open banking across the EU – a costly and complex endeavour.

At the same time, the EU wants to cajole banks into playing a bigger role in retail payments. An EU-wide payment card to compete head on with Visa and Mastercard proved unviable. The EU institutions have therefore worked on improving EU-wide bank transfers and creating the capability for them to happen instantly anywhere across the EU. The European Central Bank (ECB) and the Commission believe these 'instant payments' could be an alternative to cards. After all, within their own country, many EU nationals can already use an instant payment service like Swish or iDEAL to transfer money to a friend or pay a retailer. With the ECB's backing, the European Payments Initiative (EPI) – a consortium of European banks across different member-states – wants to use the EU's new instant payment capability to build a similar type of service that works EU-wide. But, just as with open banking, the EU strategy has so far encountered big hurdles. Only 62 per cent of European banks participate in the EU's instant payment scheme, and many banks that offer the service charge high fees for it. That means it can still take days to pay someone in another EU member-state. The Commission now wants to regulate this problem away, by forcing banks to join the EU-wide instant payment scheme and offer it to consumers cheaply.

If these two big projects were not enough, the Commission and ECB are pushing yet another EU-wide means of payment: the digital euro. As I have explained before, the digital euro would be a digital version of cash. Unlike today's electronic payments, it would be 'minted' and backed by the ECB just like cash is, rather than a claim on the bank that operates the account (like all electronic funds held by individuals today). In June, the Commission announced yet more payments reforms to help boost any future digital euro. The reforms could lead to many retailers being forced to accept digital euros (even though retailers in many EU countries do not accept central bank money today, and instead go cashless), and would require most banks to offer the digital euro to their customers. The EU is separately pushing a 'digital wallet' which would help consumers easily prove their identity to make digital euro payments. And it is using antitrust and the Digital Markets Act to help ensure each of the payment systems supported by the Commission can more easily run on smartphones, in competition with services like ApplePay.

Trying to give new sovereign payment options a 'regulatory helping hand' is understandable. New payments systems face formidable co-ordination challenges. They require banks to make large new investments, retailers to acquire new devices, and – most importantly – consumers must also see the service as compelling. But many of the EU's objectives, like improving its sovereignty and providing alternative payment methods to improve resilience, could be achieved with just one new system. It is therefore surprising that the Commission's retail payment strategy says very little about why multiple

initiatives are being pushed at the same time. Is the EU's goal simply to create as many European alternatives to US payment options as possible, in the hope that at least one of them sticks? Is there a risk that the systems compete with each other, so that none of them gets enough scale to succeed? Or is there an underlying strategy?

One justification for the EU's approach might be to give consumers more choices. That could make sense. If the EU champions only one solution, it will become politically expensive to abandon – even if it fails to deliver. But if the EU pursues multiple initiatives, and only one of them gets traction with consumers, policymakers may find it easier to abandon the failures. But the EU's strategy does not seem likely to deliver that outcome.

First, the EU's motivations are lofty-sounding abstract goals like 'sovereignty' and 'resilience', rather than more concrete objectives – such as filling gaps where the market is not delivering good outcomes for consumers. Abstract goals are a distraction. The most important factor in a system's success is whether consumers actually want to use it. Just take these examples:

★ Card-issuing banks are no fans of how ApplePay is priced. Apple extracts high fees from these banks: the Swiss competition commission estimated that Apple took up to 44 per cent of the card issuing bank's payment revenue in Switzerland, for example. Yet banks pay these fees because they have little choice – if they do not offer ApplePay, many young, wealthy and tech-savvy consumers will take their business elsewhere.

★ Similarly, retailers grumble about many bank-run instant payment services like Sweden's Swish. These services can be relatively unattractive to retailers, since they charge high fees. Swish's fixed-fee model is especially expensive for low-value transactions. But consumers love Swish: so retailers use it to accept payments or risk losing sales.

If the EU initiatives focused on being attractive to consumers, the EU would have to do far less work imposing regulations to cajole banks and retailers to participate in them. The EU would then be more likely to produce at least one 'winner' out of its initiatives.

Second, pursuing a portfolio of initiatives makes sense only if the cost of pursuing each initiative is proportionate. But the EU has already done much of the heavy lifting: open banking and instant payments systems are already available today. Taking the next step of mandating that banks adopt these initiatives, and making them work universally, is far more costly – and it will require duplicating investments recently made at a national level. The initiatives may require new standards to be developed, banks to build new IT systems and infrastructure, retailers to buy new payment acceptance devices, and many different companies to change or update their operating processes. Consumers will bear many of these costs. The opportunity cost is high, too: many banks and fintechs will have to divert their resources towards delivering the Commission's goals, rather than experimenting and developing their own innovations which consumers might prefer.

Third, imposing these costs may prove unnecessary. Open banking and instant payments are already growing across EU member-state boundaries in response to consumer demand. For example, the Nordic countries have produced P27, an initiative that enables instant payments across multiple countries. And several firms specialise in helping other fintechs bridge the different national implementations of open banking, so they can offer services across different EU member-states. It is no surprise consumer demand

for these services has come from the most tech-savvy parts of the EU like the Nordics, where consumers already use digital payments. This suggests the Commission and member-states would be better off helping all consumers get comfortable using digital payments, and narrowing the widely different consumer preferences that exist across Europe, rather than pushing solutions before demand exists.

Fourth, there is a risk that a sovereignty-first approach will lead to the EU's own payment systems trying to compete head-on with US card systems. To do this, they will probably need the sophisticated functionality which cards have today. Work is already starting on building some of these functions, such as protections against fraud. However, it is unlikely EU solutions will be able to compete one-for-one with the innovation capabilities of global firms. And if they did, consumers would not enjoy the benefit of having a range of different ways to pay in different situations. The EU systems should therefore try to offer something new and different. Cheap instant transfers, or digital euro payments, could act primarily as a digital equivalent for cash: useful for small low-risk payments, like buying a cup of coffee or a newspaper, but not the best option for large online payments. Card payments with sophisticated fraud detection and refund rights are more expensive for retailers to accept: but they could still be useful for higher-risk purchases, like spending thousands of euros buying a package holiday online. The EU institutions have so far been coy about explaining how their different payment initiatives would position themselves in the market – preferring to talk up each initiative's possibilities rather than being clear about the trade-offs.

The EU's previous initiatives have unlocked a range of new payment options – enabling banks, retailers and fintechs to invest in new services to fulfil unmet consumer demands. But its barrage of new regulatory initiatives have significant costs and less clear-cut benefits. The EU's payments plans have important lessons for industrial policy generally. The EU should focuses on providing support to enable new payment options, on empowering consumers, and on protecting a level playing field so that markets can respond to consumers. Then, it could then quickly ditch ideas that do not work out, instead of forcing businesses to keep spending indefinitely on projects that add little to Europe's resilience and provide nothing new for consumers.

The CER's members include Visa, and various technology companies and banks. The views expressed here, however, are solely the author's, and should not be taken to represent the views of those companies.

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