DRIVERS OF EUROPEAN PAYMENTS INTEGRATION: INNOVATION AND COOPERATION

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Ladies and gentlemen,

First of all, I would like to thank the organizers of this conference for inviting me to speak in this beautiful location. The beauty of Ohrid and its lake is already well known to us in the Netherlands, mainly through the books of A. den Doolaard. There is even a monument to the Dutch author here in the city. While I was out jogging this morning I was able to admire the lake's beauty for myself. However, I'm not just here for the scenery, but also for this conference of course.

This event is already in its tenth year, which is reason to celebrate! It is the result of fruitful cooperation between the National Bank of the Republic of Macedonia, Banco de Portugal and De Nederlandsche Bank. Over the past decade, the conference has become a meeting place for central bank officials from the region and beyond.

It provides an ideal platform to exchange knowledge and experiences on a wide range of important issues affecting the payments industry. And the theme of this year's conference could not be timelier. I will start by reflecting on European integration and cooperation, before discussing two specific innovations in the payments industry.

European integration

So let's begin with the issue of **European integration**. It means, put simply, removing, or at least lowering, borders between countries for people, goods, services and capital. The basic idea is to enlarge markets. This results in increased competition, which generates economic growth and prosperity.

Now, you may know what some say about European integration: 'two steps forward, one step back.' However, this metaphor has been used to describe political integration in the EU. I do not believe it applies to economic integration. With the obvious exception of Brexit, economic integration in Europe is progressing at a constant rate – and it is undoubtedly very successful considering the steady growth in prosperity.

European economic integration can entail coordination or even unification of economic policies. A prime example of this is the EMU, which establishes a common monetary policy for the euro area. Even when policies are not aligned, economic integration is still possible. This can occur through for example harmonized technical standards and systems, like the Single Euro Payments Area, or SEPA. SEPA became operational in 2014. As a result, the fragmented national markets for euro payments became a single, European market. The project involved developing common financial instruments, standards, procedures and infrastructure, through cooperation in the payments sector.

Two drivers of integration

This conference's theme refers to two drivers of payments integration: innovation and cooperation. However, in my view, another important driver for integration is legislation and regulation. Perhaps it is even a precondition for integration, because reducing or removing national borders requires the legislator to take the necessary action. In the case of SEPA, for example, it was the European Commission which established the legal foundation through the SEPA Regulation, and other secondary regulations.

Cooperation is also vital for integration. The commercial and technical standards for payment instruments in SEPA were developed through close cooperation between European banks. Cooperation between central banks is of course also very useful. It involves developing effective policies and institutions, through for example staff training. This enables central banks to learn from each other. I am therefore delighted with the long-standing relationship between NBRM and DNB, and the resulting cooperation and knowledge transfer.

Integration and innovation

Now let me turn to the **relationship between integration and innovation.** Is innovation a driver for integration?
Yes, to some extent. If an innovation is easily accepted in various countries, replacing other, older technologies or instruments, international differences disappear. Internet and smartphone technology are great examples. They are relatively new and form the basis for common and new payment methods across Europe. I will come back to this in a minute.

Yet, I think that there is also a reverse causality. In plain English, integration is also a driver for innovation, at least in the eyes of economists. When borders are removed and trade increases, new ideas and new technologies emerge, enabling creative entrepreneurs to turn these into new products. For payments in particular, having the same standards boosts innovation, which produces network effects. The entry of a new merchant or consumer increases the value of the network for all participants. When many people use the same internet payment method, for example, more e-merchants will want to offer this to attract more customers. And when these customers find the payment method convenient, they will tell others. This word-of-mouth advertising leads to more use of that payment instrument. This creates economies of scale, lowering the cost of each transaction.

What I have just described, is economic theory, the ideal world. In reality, of course, integration and innovation are not as smooth. Integration, for example, may require compromise, and comes with adjustment costs.

There is a **silver lining**, though, as adjustment to new technologies also presents **opportunities** to renew the infrastructure and do away with legacy. Network effects and economies of scale may also result in concentration.
While concentration can offer efficiency benefits, there is a risk that the resulting market power will be misused.

Apart from the two-way causality, integration is not the only driver for innovations in payments. There are several other possible drivers. In 2012, the Bank for International Settlements (BIS) published an in-depth report on the matter.
It was based on an analysis of over 120 innovations reported by 30 central banks. The report distinguished a number of exogenous and endogenous factors that could serve as either a driver or barrier for retail payments innovations. The report revealed that the two main endogenous factors are cooperation and standardization, which we have already discussed.

The three key exogenous factors are, not surprisingly, technological developments, regulation, which we have also dealt with, and user behavior and user demand. The report suggested that user demand may even be the most important driver for innovation, since it forms the basis for a valid business case for suppliers. It is ultimately the users, normal people and businesses, who determine an innovation's success.

What is then role of central banks in payments innovation? This role is, in my view, two or threefold.
Central banks can monitor and assess the relevant developments. It is also up to them to give some guidance to markets, explain what their policy objectives are, and help foster public awareness of specific issues, like security. And last but not least, they can also facilitate new developments, particularly if changes are needed in settlement procedures, which is their natural domain.

Trends in retail payments
Although the BIS paper was published five years ago, I think its findings are still highly relevant, and indicate what we can expect in terms of retail payments innovation. The report identified a number of **trends**.
First, the market is dynamic, so although there are many new developments in payments, only a few survive. Second, most innovations are developed for the domestic market, and not many have international reach. Similar types and categories of innovations were reported in many countries, although the exact functionalities differed according to domestic market conditions. This is striking, in view of today's theme.

Again, it implies that the relation between integration and innovation is not so clear. Other trends were an increased focus on higher processing speed, and a greater role for non-banks.

Specific recent examples
Let me illustrate this by discussing the two most significant innovations in European payments right now, PSD2 and instant payments. **PSD2**, the revised EU Payment Services Directive, is an example of legislation intended to increase competition and stimulate innovations in the European payment market, while harmonizing market conditions and encouraging a level playing field.

The most important element of PSD2 concerns payment account access. That is: consumers, when making an online payment, have the right to make use of new service providers. Banks are obliged to grant these service providers access to their accounts. In exchange, the payments initiation service providers, and account information service providers will be regulated and supervised. They will therefore need to fulfill various prudential requirements, as well as requirements in the field of data protection.

The strategic importance of PSD2 can hardly be overestimated. It is potentially enormous. PSD2 is not only legislation that banks must comply with. It also provides banks and the new service providers with opportunities to develop new products, by working together. Open Banking, as it is called, unleashes third party creativity. Banks' online interfaces become platforms for new services. Interestingly, we are still not sure what many of these services will be. In view of this outlook, DNB supports the objectives of PSD2. It promises to a deliver a breakthrough in banking and in payment services in Europe.

Another trend is **instant payments**. This means that when the payer initiates a transaction, the payee's account is credited and the payer receives confirmation, all within a matter of seconds. It implies immediate or close-to-immediate interbank clearing of the transaction. Instant payment services must be available continuously, 24/7/365.
Quite a few countries already have instant payments. In the euro area, it should become available by the end of this year due to the efforts of the Euro Retail Payments Board (ERPB), chaired by Yves Mersch. I am sure that Yves will discuss this subject later.

The clearest benefit of instant payments is that the end-user is able to quickly complete time-sensitive payments, wherever and whenever necessary. Corporate customers will receive funds faster, which makes a substantial difference in terms of cash flow and liquidity management.

Another advantage is the finality of instant payments, which is particularly useful in e-commerce and other situations where goods or services are only delivered against the payment. Clearly, instant payments will become an alternative for cash, which also offers finality, and for credit cards in an online environment. More strategically, instant payments are reason to develop a new payment infrastructure. This may provide the basis for service enhancements and value-added services. The combination of instant payments and PSD2 also offers new opportunities. New services will be offered online, by banks and non-banks, and payments will be settled in a few seconds, which is what consumers and retailers expect in today's increasingly digital word. Traditional obstacles in terms of time and space are gradually being removed.
Payment markets will become fully integrated!

Conclusions

I want to end with this positive outlook in mind. Payment integration clearly contributes to greater efficiency and economic growth. Which is why we must continue our efforts. Rather than the previous metaphor on European integration, I prefer what Jacques Delors said: '*Europe is like a bicycle. If it doesn't move forward, it will fall over*'. I find this perspective much more appealing, not only because I'm Dutch and we cycle everywhere. It shows that economic integration needs momentum. Moreover, innovation needs to be stimulated by other means than just striving for integration. Legislation and regulation can be helpful, central banks can provide guidance, like the ERPB did with instant payments. They can also stimulate cooperation between market participants and public authorities, which can further innovation. This brings us back to the overarching theme of the conference.

I hope that today's program and the panel discussion will shed new light on the various issues in payments and payment innovations. I would like to encourage you to use this opportunity to actively participate in exchanging views. I wish all of you another day of lively and productive discussions! So let's make the organizers proud, and ensure this tenth edition is one of the most memorable conferences of the year.