GERMAN COUNCIL of Economic Experts

PRESS RELEASE

More opportunity than risk: digital innovation in the financial sector offers lower costs and new products

- How private households access financial services has changed dramatically in recent years: The majority of bank branches have been closed over the last decade, but Germany lags behind many of its European peers in terms of the digitalisation of the financial market.

- The market entry of digital financial services providers will most likely reduce the cost of financial intermediation and improve the convenience of products.

- Regulatory sandboxes for fintech companies could promote financial innovation, and clients would benefit from open-banking rules simplifying a transfer of their financial information to alternative providers at their own request.

- The envisioned digital euro promises to provide a cost-effective and secure alternative for private payments, especially in the digital space, and can help establish a pan-European payment infrastructure.

Wiesbaden, 13.11.2024 – New players, so-called fintech companies and big techs, are entering the financial services market and are accelerating its digital transformation. These developments will benefit customers. Digital innovation will likely be driven by these new players and promises lower costs of financial intermediation and new products that improve convenience for users.

“We should, first of all, consider the opportunities digital finance offers rather than focusing only on possible risks. For the foreseeable future, the risks for financial stability in Germany that could arise from digital finance and new market participants are low,” explains council member Ulrike Malmendier. “Economic policy should aim at fostering digital innovation in the financial sector.” At the same time, it is important to keep an eye on systemic risks and protect consumers in the digital space, particularly when it comes to data protection.

How private households access financial services in Germany has changed drastically. Around two thirds of all bank branches have closed during the past 25 years. At the same time, Germany is still below average in Europe when it comes to the investment in digital technologies in the financial sector and may thus forego potential innovations and efficiency gains.

Digital euro could reshape the payment market

Europe still lacks a shared infrastructure for cross-border card payments, and transaction fees are high – especially for digital payments. The digital euro promises to become a cost-effective alternative to private credit cards and e-payment solutions and may thus strengthen competition in the European payments market.

With the digital euro, the ECB can set industry standards and help solve the coordination problem of private providers as it will be setting up a pan-European payment infrastructure that is independent of the major international card providers. The digital central bank currency would also ensure that all economic agents have access to public money even if cash becomes significantly less important. Finally, it can protect the euro area against – extreme, but unlikely – tail risks. One such risk would be a private digital parallel currency replacing the official currency so that monetary policy could no longer ensure price stability.

"Some critics claim that the digital euro will undermine traditional banks and cause large-scale outflows of customer deposits. In our opinion, this is very unlikely with the envisioned design," says Ulrike Malmendier.

Foster innovation in the financial sector

Customers benefit from the digital transformation in the private financial sector. More efficient business processes and the use of digital data lower the cost of financial services. New products such as mobile payments, the digital "buy now, pay later" option in e-commerce, or securities trading by neo-brokers offer greater convenience. Economic policy should therefore facilitate digital innovation in the financial sector. Temporary regulatory sandboxes and easier access to individual financial data could support this goal and reduce competitive disadvantages, especially for new fintech companies.

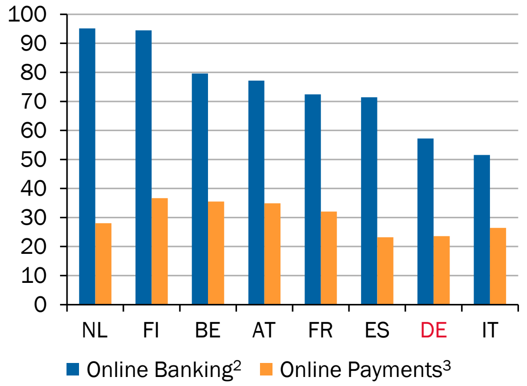
Regulatory sandboxes allow testing new products and business models. At the same time, supervisory authorities may gain experience with the new providers, review the existing regulatory framework and develop it further.

Open banking regulations enable new financial service providers to access individual financial data from banks at a customer's request, allowing them to offer competitive pricing. As such, open-banking regulations should help reduce the competitive disadvantage of new fintechs relative to banks and big techs.

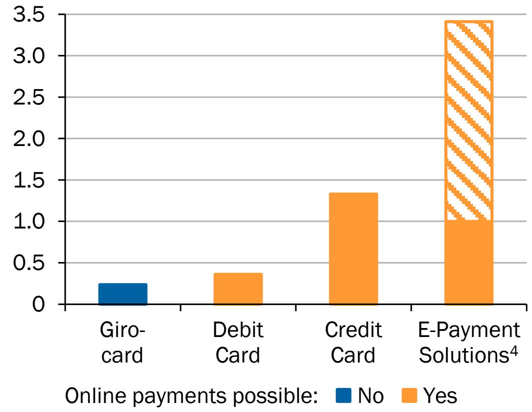
The regulation and supervision of big techs with significant activities in the financial sector have been focussed on individual services, but there is no comprehensive regulation of the group as a whole. This approach to regulation does not adequately account for the risks posed by big techs. It would make sense to group all financial activities in a separate holding company, which would then be subject to prudential liquidity and solvency requirements just as banks are.

Costs and benefits of digital financial services

Use of digital financial services varies by country[1]



Transaction costs are particularly high for digital payments



1 – NL-Netherlands, FI-Finland, BE-Belgium, AT-Austria, FR-France, ES-Spain, DE-Germany, IT-Italy. 2 – Number of people, who have used the internet for online-banking, data from 2023. 3 – Share of online payments relative to total (non-recurring) payments, data for 2022. 4 – For online e-payment solutions we use PayPal as an example. The standard listed merchant fees are considered an upper bound. Berg et al. (2024) give an example of average merchant costs of 1 % for an e-commerce company selling furniture.

Sources: Berg et al. (2024), Cabinakova et al. (2019), ECB, European Commission (2016), Eurostat, PayPal, own calculations

The German Council of Economic Experts (GCEE) provides support to policymakers and the general public on questions and matters of economic policy. It was founded as an independent body in 1963 and currently consists of the council members: Professor Dr. Veronika Grimm, Prof. Dr. mult. Dr. h.c. Ulrike Malmendier, Professor Dr. Dr. h.c. Monika Schnitzer (chair), Professor Dr. Achim Truger, Professor Dr. Martin Werding. By publishing regular reports, the GCEE aims to help the general public and decision-makers in politics, business and society to form a reasoned opinion on economic policy developments in Germany.

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