

Motes and beams

When the designers of the euro got together in the early to mid 1990s, much thought was given to the manner in which large valued payments between Europe's central banks could be made. It was realized that the arrangements which existed at the time were unsuited to the potentially enormous, and very short term movements which would begin to take place.

At first, there was much discussion to keep access to the transfer mechanism – TARGET – just to central bank business. But pressure from a few areas- notably the Bank of England ensured that the system was sufficiently open to allow payments from commercial banks to be effected over TARGET using the local central bank as an access point. Initial concerns regarding volume were also dispelled when it turned out that the carrier for TARGET was SWIFT, and that the full bandwidth of SWIFT was available for intra-European transactions.

Of course, cross-border payment systems for large valued transactions have been in place for many years, and have worked efficiently and cost-effectively for a long time.

The same cannot be said of small valued transactions. While it is possible – and reasonably inexpensive – have a SWIFT transfer carried out for a retail or commercial transaction, the charge will normally be of the order of GBP 25 for the transfer. It is interesting that while this transfer can be effected in real time, it normally still takes several days for the recipient to obtain good value. But then we're used to 'float' aren't we?

But the majority of financial transactions which go through a bank are of a size which makes then payment of GBP 25 a significant cost relative to the size of the payment. After all, if you had to pay GBP 25 for every cheque issues or cleared, you wouldn't use many cheques for small amounts.

But that is one of the only two ways of carrying out a cross border retail payment within today's European banking 'system'. The other way is to write a Eurocheque (thus giving us yet another annoying dual reference for the term 'euro') which can be written in any currency and cleared through local banks.

But the Eurocheque system (which I have used many times and found very convenient) is extremely labour intensive, and is due to be phased out in the next few years. So by 2002, we may find it harder to make retail sized cross border payments than in 1995!

So while the euro was being devised, the vast majority of the effort went into a system which could, in principle, have been handled by a decent e-mail system and a couple of old-fashioned bank clerks, and the real issue – cross border retail payments, was completely ignored.

The outcome has been that the 'benefits' of the euro, in terms of price transparency and lower transaction costs have been completely negated. Far from making consumers look elsewhere for goods to buy, we have, in effect, imposed another barrier by making the high cost of payment a component of buying decisions.

However, there is another method of payment – namely by credit card (though not, presumably debit card) – which may have a profound effect on buying patterns. The Visa, MasterCard and Amex networks already work well for cross border, low value transactions, and will, presumably continue to gain ever more business as the banks are relegated to the role of regional players. And it is these which could provide the joker in the pack when it comes to solutions to the pan-European banking riddle.

There are three basic solutions to the cross border payment problem:

- 1) To **create a pan-European clearing network** which operates at low cost so that the cost of paying a French debt from a French account is much the same as settling the same debt from an account domiciled in Germany. This view is liked by individuals within the Commission in Brussels but seems doomed for several reasons:

- a) It would require harmonization of cheque and other payment methods. Information provided on (say) a German payment instrument would need to contain sufficient information for it to be routed to a French (or Spanish, Italian, Dutch etc. account) As one speaker at GroupEuro put it, we would need to change 99% of today's transactions and systems, to accommodate 1%.
 - b) It would be very expensive both to develop such a system and for the banks which would need to modify their systems in order to be able to communicate. The banks have had the full cost of systems modification imposed on them already, and in 'in' countries have already *lost* significant revenue from the introduction of the euro. Furthermore, allowing 'foreign' payments to mix at low or no cost with local payments would undoubtedly increase the likelihood of competition from banks of other member states. And since most European banks are a byword for inefficiency and local unions will undoubtedly resist any improvements it is hard to see any support for this approach at all.
- 2) To **create internal cross border clearing within associated or merged banks**. There were plenty of stories in 1998 that this was exactly what ABN Amro was doing. In one regard, Citibank is already there. The principle here is that building a branch network in another country is undesirable, unlikely to succeed and a great way of losing money. So therefore the best way is to use a network which is already there. Introduction of an automated internal routing system could be used to ensure that the required information arrives at the right place and the right paying bank. This would all tend to be in line with the development of European banking and provided that labour laws can be overcome, might actually lead to better customer services. However, this will be a long drawn out and difficult conversion, and no-one should hold their breath.
 - 3) To **use an existing pan-European retail payment system for all types of payment**. Although it goes against the grain to suggest that only minimal development should take place, there is a perfectly adequate network already in place, and with a minor revision of use, it would be possible to effect low cost payments almost immediately. This would, however, amount to rendering the banks in their traditional roles, redundant except as depositories for cash balances. The networks which the credit card companies already have in place allow for fast, cheap transfer of funds, and indeed are designed for low value, low cost, high volume business.

The only real problem is that the owners of Visa and MasterCard are the same organizations which stand to lose from them taking up just this activity, namely the banks.

We await developments with interest. For while all of the pre-euro activity concentrated on the mote represented by inter-central bank issues the beam of retail payments was ignored.