



DRIVING ECONOMIC INTEGRATION THROUGH PAYMENTS MODERNIZATION IN THE WESTERN BALKANS

Introduction

Payments are part of everyday life. Payment systems are key elements of an economic and financial activity – they are the nerve system of the economy. In purchasing goods at the supermarket, receiving a salary or pension, paying for goods or services for business activity or sending money to a friend or family member, we all use a payment system. Being able to transfer value safely, efficiently and effectively is fundamental to the operation of any economy. As a result, payments are seamlessly integrated in daily life.

The way we make payments has evolved with consumer preferences and innovation in the supply of payment services. From new payment platforms and solutions, to updated regulations addressing payment effectiveness and security, to — maybe most significantly — higher expectations from merchants and consumers are transforming the old systems. With changes in technology and consumer preferences, new forms of payments emerged – ranging from payments over the phone to digital wallets. Consumers and businesses now have access to a range of payment methods that are fast, convenient, secure, and available 24/7.

Given the key role of payments in facilitating interactions in the economy, an effective payments system can help drive inclusive economic growth, attract foreign investment, and be the essential building block of digital economy. Payments underpin everyday commerce between consumers and businesses and enable governments to raise revenue and fund essential services. Digital payments can provide individuals and households with convenient and affordable channels through which to pay and be paid, as well as to save and borrow. Moreover, they can be more accessible for lower-income and rural households as well as for women and youth—the segments of the population that are often underserved. In addition, payments provide the link through which economies interact with the global marketplace. With so many payments made daily, even relatively small inefficiencies could potentially have significant implications for the broader economy.

Modernizing payment system in the Western Balkans

The EU supports and works with all the Western Balkan economies towards the modernization of their payments systems to bring them closer to EU standards and to the fulfilment of all the conditions for the integration into the Single Euro Payments Area (SEPA). These efforts are supported by the Regional Cooperation Council (RCC) and CEFTA Secretariat.

As part of EU membership goals, the Western Balkans Six (WB6) have already achieved important milestones in modernizing payments. They have adopted legislation consistent with the EU standards and developed retail payments infrastructures with the objective of enhancing cross-border payments within the WB6 and with the EU. Despite progress, challenges still exist, and progress across the region has varied.

One of the critical objectives of the WB6 is to reduce the costs of regional payments by integrating in SEPA. There is a growing momentum towards payment systems modernization in the WB6. The payment landscape in the WB6 is hampered by multiple challenges, such as the lack of modern infrastructure, limited access to financial services, non-comprehensive regulatory frameworks, insufficient AML/CFT

The benefits of joining SEPA and modernizing payment systems are numerous, and go beyond convenience, speed, and safety.

- **Supporting business and trade.** Digital payments can help businesses save on transaction fees, which for micro and small businesses trading between WB6 economies can be as high as six times those incurred in by their peers in the EU. The reduced costs can make these enterprises more competitive and help them grow, and the greater and more accurate amount of information channeled by digital payments can help them simplify their reconciliation processes. Fast payments, which transfer money in real-time to the beneficiary, can also mitigate the problem of late payments.
- **Facilitating remittances.** Modern payment systems offer migrants accessible and low-cost solutions to send and receive remittances through formal channels. They can help reduce the cost of remittances to the targets identified by the United Nations, which for the WB6 would mean unlocking about half a billion EUR savings in the costs of remittances. The total remittance inflow in the WB6 totaled EUR 12 billion in 2022 and they account for a sizeable portion of the GDP in each economy. Despite their importance, sending remittances to the WB6 economies cost 6.71% (of the total transaction amount) at the end of 2022, more than double the global target of 3 percent. Sending remittances between WB6 economies is 32 percent more expensive than sending remittances to the region from other parts of the world. Finally, fast payments can bring even more value to remittances, reaching beneficiaries (often vulnerable people) immediately and providing more transparency on costs and terms of service.
- **Reducing the informal economy.** Digitalization and Innovation makes accepting payments easier and cheaper, especially in comparison to cash. Moreover, digital payments are traceable and transparent, and therefore facilitate tax collection activities and contribute to reducing corruption and crime. Research shows that an increase in the share of digital payments at the expense of cash by 10% leads to a reduction of about 2% in the size of shadow economy.
- **Driving financial inclusion.** Transaction accounts (i.e., accounts that can be used to make or receive payments) often operate as a gateway for individuals and businesses to access other financial services, even if they do not have a relationship with a bank. For example, the payment account information is used by a financial institution to assess the creditworthiness of a client and grant a loan. Facilitating access to finance, digital payments can contribute to closing gaps such as the gender and urban-rural ones, hence reducing inequality. In WB6, where only 76% of adults have a transaction account (compared to 99% in the euro area), digital payments can help reduce cost and proximity gaps and open access to finance for an estimated 1.9M people.

The World Bank Support

The Payment Modernization Project, implemented by the World Bank and funded by the European Commission (EC) supports payment modernization efforts within the region by providing technical assistance. The Project is aligned with the objectives that underpin the development of the Common Regional Market (CRM) Action Plan and the Economic Investment Plan for the region and facilitates the economic integration within the region and with the EU.

The objective of the Project is to support the authorities in strengthening their payment systems, the linkages within the WB6 and linkages of the Western Balkans payment systems as a region with the EU to enable cost-efficient cross-border payments. The lack of efficient and interoperable payments infrastructures to process cross-border payments within WB6 as well as with EU hinders deeper economic integration and stresses the importance of reforms regarding payment systems modernization.

The activities of the World Bank are centered around assisting authorities are based on three pillars:

- Adopting EU payment regulations and other requirements to achieve SEPA readiness ensure that WB6 payment systems are safe, secure.
- Modernizing payment infrastructures by developing domestic fast payment systems (FPS) and embedding new services, integrating with open banking and preparing the future connection to TARGET Instant Payment Settlement (TIPS) for cross-border fast payments.
- Implementing other foundational reforms related to payments and financial inclusion. These reforms could include the creation of a regional Know Your Customer (KYC) registry, the harmonization of the licensing framework for non-bank payment service providers, the development of financial education strategies, and the enhancement of cybersecurity capabilities in the WB6.

The World Bank stands ready to commit financial support to the WB6 in modernization of payment systems infrastructure. Effective role of the financial sector and its responsiveness and relevance to the needs of enterprises, entrepreneurs, and society is critical. Modernization of payment systems directly supports this objective. Seeking economic integration within WB6 and with the EU would create the obvious benefits. It can also be viewed as a preparation of the Western Balkan economies for the EU Single Market. The conditions are ripe, and this is a unique opportunity for the region to move towards the joint goal of cost efficient domestic and cross-border payments, particularly via SEPA and ultimately TIPS integration. The World Bank remains committed, both technically - by utilizing its expertise and experience from supporting payment systems reforms in over 120 countries - and financially, to assist WB6 in reaching these objectives.