

Presidency Issues Note for the Informal ECOFIN Working Session IV

Berlin, 31 August 2020

Rethinking Financial Markets in the Digital Age

Digitization clearly affects our lives and the economy. It is often said that data is the new oil, one of the key ingredients of the modern economy. After WWII coal and steel were the most important components and the founding members of the EU created the Coal and Steel Union. It is now time to call for a “*European Data Union*” and recreate the original spirit of the European integration: pooling the essential common and public resources, obtaining the size effect, regaining the ability to set standards without sacrificing efficiency.

Finance is all about information. Big data changes two important aspects of it. (i) *Information collection* is shifting from banks to payment networks and digital platforms. (ii) *Information processing* is significantly altered via new machine and deep learning algorithms. These new methods rely on large sets of diverse data.

The economic logic of big data links size, diversity, and innovation. It also leads to a self-reinforcing dynamic. Firms that control large data sets can offer better services and hence attract more customers, who, in turn, provide these firms more detailed data. This creates new asymmetries and natural monopolies. It also shifts the power of *standard setting* to firms that control large networks.

Importantly, big data creates potential segmentation between large, self-sustaining systems that segment the market. While platforms create previously impossible connections, they may tend towards monopolies or fractured markets stifling competition. From a platform owner’s perspective, it is desirable if customers use one platform for all of their activities. Private platform owners have an incentive to impose switching costs and reduce the interoperability across platforms. They also have an incentive to set different standards across platforms. This calls for a regulatory focus on interoperability and common standard setting.

Questions for discussion:

- Should European regulation try to prevent or slow down the shift from a banking centric financial system to a platform centric system?
- Modern global competition is to a large extent about technological sovereignty and standard setting. How are standards and sovereignty interrelated? Which continent will set the standards in the digital space, be it in finance or other economic areas? Should the standards be set by public sector or private companies? Can the public sector keep up with the innovation in the private space and should therefore primarily play a coordinating role?
- What is the trade-off between competition and stability? On the one hand, from an efficiency perspective one should encourage new platforms to enter the market in order to reduce existing transaction costs (due to current excessive market power) and ensure that Europe is not left behind in the data revolution. On the other hand, the transition can lead to disruptions and (at least temporarily) to financial instability.
- Will different privacy rules and data policies segment global financial markets, in U.S., China, and European anchored financial markets? How high are the costs of such a segmentation and new digital borders? Should the European data policy be designed in such a way that it also is attractive for other countries to join, including for countries in Asia and Africa?