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A LOOK INTO FINTECH'S ROLE IN DIGITAL TRANSFORMATION AND REGIONAL COOPERATION IN THE EU-MEDITERRANEAN AND NEIGHBOURING REGIONS

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Introduction

International development modalities have been a topic of criticism for practitioners and researchers in the field. The discussion about the effectiveness of development aid has not been conclusive: from having a negative impact on the financial systems, adding inflationary pressure to the economy and unintentionally supporting corrupt and undemocratic governments, to the importance of development aid in the countries' fiscal space and massive impact on education, rising poverty and health outcomes. This policy brief aims to discuss how international development actors, specifically international non-governmental organizations (INGOs), United Nations (UN) agencies, the European Union (EU) and regional cooperation agencies can capitalise on the existing development projects and programmes to shift the paradigm of development cooperation from the donor-receiver dynamics towards a more inclusive approach that caters for involving civil society, the private sector, state actors, and deepening regional integration. To demonstrate how stakeholders in development cooperation can work on shifting the paradigm in international development, the policy brief follows the thematic approach, which means it uses a thematic topic – financial technology (FinTech) in this case – to showcase how development modalities can utilise the existing opportunities and capitalise on them for establishing better norms in the field. The paper focuses on FinTech's role in digital

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transformation and argues that the focus on digital transformation can change the dynamics of international collaboration into the basis of peer-to-peer and knowledge sharing. Since it is a fairly new area for all countries, of course, there are disparities and differences on the level of digital transformation and technology adoption between developed, emerging and developing countries. The technology is available for everyone but it requires investment and collaboration. To illustrate this idea, the paper explores the two-way relationship between FinTech and digital transformation, and discusses how the risks accompanying the use of FinTech can provide a space for development cooperation. To provide a holistic picture of the overall impact on development outcomes, it also explores how FinTech can be used to address the developmental challenges of financial inclusion and international remittances.

Furthermore, the policy brief draws on examples from diverse regions to demonstrate how FinTech can foster regional cooperation. Although it would have been more beneficial to use examples exclusively from the Euro-Mediterranean region, the regional cooperation in FinTech and digital transformation is still an untapped area for the international community. However, the recommendations are still relevant for agencies and organisations working on deepening the cooperation between the EU, the Mediterranean and neighbouring regions, and they can adopt the policy recommendations with further specifications based on the goals and targets.

Addressing risk in FinTech: an opportunity for shifting the paradigm

Like many terminologies used in the international development sphere, FinTech can be applied in different settings to refer to diverse and narrow notions like crowdfunding and online banking. The paper uses the definition from the Financial Stability Board (FSB) to clarify this ambiguity, which defines FinTech as "technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions, and the provision of financial services." This broad definition will provide the space to discuss and indicate regulatory and technical policy recommendations that can be adopted for unilateral and multilateral development cooperation interventions.

FinTech has shifted the way money flows in the economy. Technologies like computing power and big data, along with wider access and advancement in Internet services, eased the way for FinTech to influence consumer and investor behaviour. Although the technological changes in financial services provide us with opportunities to strengthen financial inclusion, development and efficiency, they still pose a risk for consumers and investors in terms of cybersecurity and shift of business models. These risks challenge policy-makers since they require timely policy responses to be in line with the rapid advancement in FinTech, and the new policy options may contradict the traditional financial system's existing policies (Ehrentraud et al., 2020). Furthermore, these inherited risks related to FinTech can jeopardise the global financial system if the actions and policies are not globally and equally coherent, which illustrates the need for global cooperation and exchange of knowledge. This point is vital for changing the dynamics of development cooperation and deepening regional cooperation, which is easier to facilitate and can be the first step for global policy coherence in governing FinTech. Another demonstration of how addressing FinTech's risks can provide a space for development cooperation is the fact that the perils accompanying FinTech are linked directly to data generated by the different financial technologies. Although this data is the heart of innovation in the field and opens the door to further enhancement of financial services, it still poses different dangers for economic agents. Such risks can be looked at through their impact on consumers, investors and businesses.

At the consumer level, FinTech's dangers are observed in data security risks, scamming, fraud and negative manipulation of consumer behaviours, which could have a long-term impact on consumers saving and investment patterns. The digitised data risks for consumers can occur worldwide, with the exchange of unauthorised data and manipulation of the policy gaps and divergences across countries. Investing in cybersecurity is a clear example of how development interventions can address the risks of FinTech on consumers. Although the impact of cybersecurity capacity development interventions is not very clear, there is hesitancy to define it as a developmental issue (CFR, 2018). Still, it can be more relevant to international development if dealt with under the umbrella of FinTech. Additionally, cybersecurity is an important pillar of digital transformation as a whole. For example, in 2015, the ASEAN Regional Forum established a Work Plan on Security of and in the Use of Information and Communication Technologies, which provided capacity-building for member states, a space for the exchange of knowledge and experiences among the members. Moreover, such cooperation can motivate other players to take part. In 2015 Microsoft became a pioneer in supporting international cybersecurity, with the "International Cybersecurity Norms for Reducing Conflict in an Internet-Dependent World" initiative. More private sector companies such as Apple, Amazon and IBM are also taking action for global cybersecurity. Similarly, the FinTech private sector can play a major role in advancing the adoption of their services by participating in addressing the risks associated with them and protecting their consumers.

When investigating the negative impact of FinTech on investment, we find that it relates to the systemic risk on the global financial systems. The adoption of FinTech is associated with the decentralisation of the financial industry out of the regulated banking systems, which can shake the stability of the financial systems. Although the systemic risks of Fintech on financial systems have not been observed (Franco et al., 2019), the impact still remains a possibility if not sufficiently regulated. The impact of systemic risks might directly affect monetary policy and the central payment systems' functions, which will challenge policy-makers' ability to monitor and manage these impacts, possibly creating a similar situation with the subprime mortgage, which were functioning in a blind spot for policy-makers, thereby making it impossible to follow and resulting in a worldwide financial crisis (Barefoot, 2020). A possible path to mitigate this systemic risk while advancing regional development cooperation is to adopt Regulatory Technology (RegTech) while stimulating innovation and protecting societies. RegTech refers to the use of technology in monitoring the compliance with and the impact of policies. Its importance stems from the existing policy trade-off in regulating FinTech, either through policy objectives to protect and secure the financial system or by giving a space for FinTech to play its role in advancing the system (Ehrentraud et al., 2020). Such a situation provides an opportunity for development interventions. Not only does it show the direct link between FinTech and digital transformation, but it also provides the space for regional cooperation through exchange of knowledge and regional policy coherence endeavours. RegTech is quite a new domain even for advanced economies. For example, in 2020, the value of the global RegTech market was nearly USD 6.68 billion and it is estimated to grow from 2022 to 2027 and reach USD 23.16 billion by 2026 (EMR, 2021). The growth in the RegTech market provides a great opportunity for the creation of a digital regional market, and regulators can facilitate the process by boosting the creation of simulations systems and sandboxes.

Furthermore, when it comes to risks for businesses, FinTech and digital transformation can in general affect the market competitiveness by disrupting the existing business models. Indeed, big businesses can leverage their economies of scale to adopt and integrate digital infrastructure in their business models. The disparities in the ability of businesses to adopt FinTech solutions can create another entry barrier for new businesses, thus decreasing the competitiveness in the industry and creating market monopolies. A way for development interventions to address the risks for businesses and turn them into opportunities can be by using FinTech to facilitate access to digital loans through crowdfunding or tokenisation. For example, specialised platforms that link investors and businesses in solar energy: We Share Solar facilitates crowdfunding for solar energy projects by investing in solar shares in the Netherlands;[1] and Citizenergy offers a cross-border investment in sustainable energy projects, with most of its funded campaigns in the EU and partly in Africa.[2] We Share Solar and Citizenergy are an example of how FinTech can be introduced for Small and Medium Enterprises (SMEs) through access to credit.

The space in development cooperation to invest in FinTech for digital transformation

Unlike the first and second industrial revolutions, the third and fourth are happening everywhere –not equally, of course –, which means that the countries that are lagging behind can take the opportunity to leapfrog the digital infrastructure and learn from the experiences of other countries. International development cooperation can play a big role in the exchange of experiences and collaboration between countries. In this way, FinTech can be a driver of regional and international development cooperation, not only by addressing the risks associated with FinTech but also by instrumentalising it to solve pressing development issues. A great example of this is the use of FinTech for increasing financial inclusion and improving the use of remittances for development finance.

FinTech and financial inclusion

International development actors investing in FinTech can advance digital transformation while also meeting other challenges posed by inequality in access to financial services and addressing market failures (e.g., reducing transaction costs), which will result in achieving inclusive economic growth. According to the Global Findex 2017 (Demirgüç-Kunt et al., 2018), around 1.7 billion adults are unbanked globally (see Figure 1), 56% of those are women, and almost all live in developing economies. However, it is important to note that nearly half of the unbanked adults live in seven economies (Bangladesh, China, India, Indonesia, Mexico, Nigeria, and Pakistan), which shows the level of heterogeneity among developing countries regarding the financial inclusion status and the needed policy response. On the other hand, bank account ownership in developing countries stands at 70%. In Figure 1 we can also see that the number of adults without a bank account is an issue in the Mediterranean region.

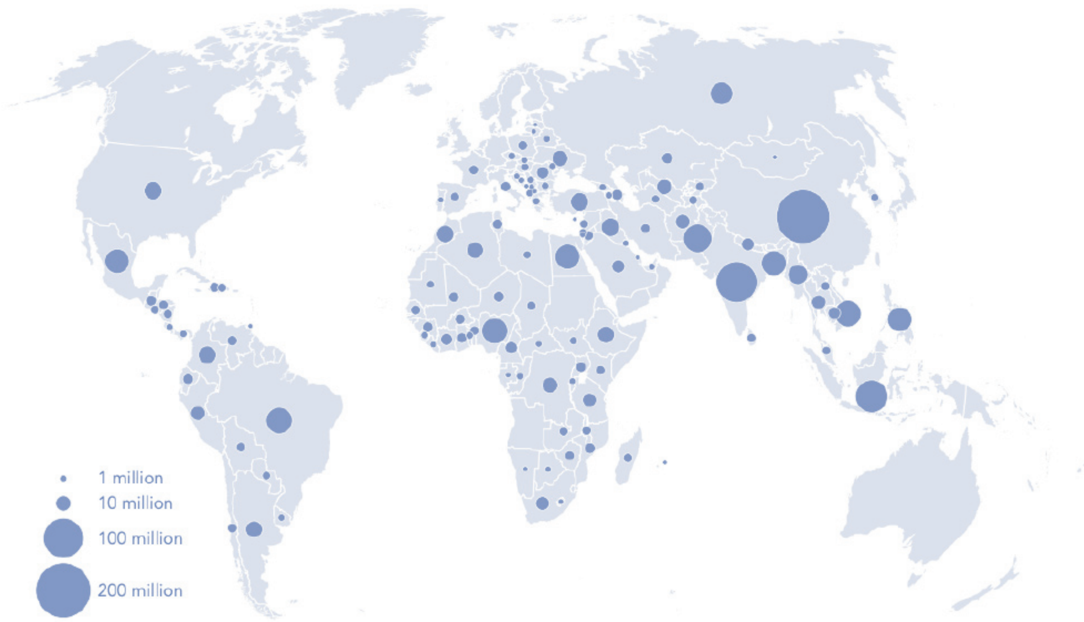
For FinTech to play its role in digital transformation, policy-makers and development cooperation agents should ensure the provision of digital and financial literacy and access to digital infrastructure. Figure 2 shows that Internet access is already relatively widespread worldwide, and the percentage change in access to the internet has been increasing worldwide (see Figure 3). These statistics are crucial for understanding the needed infrastructure for advancing FinTech and reaping its benefits for financial inclusion, and also indicate that development interventions that target FinTech can be beneficial because there is an existing infrastructure to support adoption and the intervention can work on expansion and advancing Internet access. For example, the EU recently announced its flagship infrastructure project the "Global Gateway", which aims to boost sustainable links worldwide, providing a great opportunity for investing in digital infrastructure, such as Internet access, and representing a valuable resource to strengthen the diplomatic ties in the EU-Mediterranean and neighbouring regions. For example, for the Mediterranean Partner

[1] Smart City Embassy.

[2] https://citizenergy.eu/projects

Countries (MPCs) of the European Development Bank, only 35% of the population over 15 own a bank account (excluding Israel) (*Financial Reforms in the Mediterranean,* 2018).

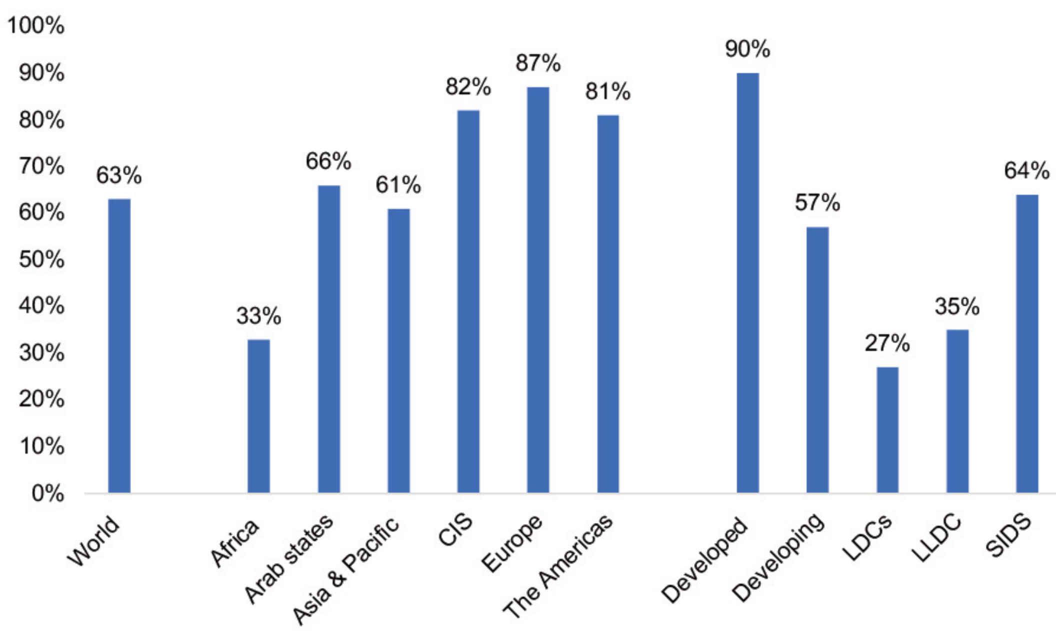
Figure 1. Adults without a bank account, 2017



Source: Demirgüç-Kunt et al. (2018)

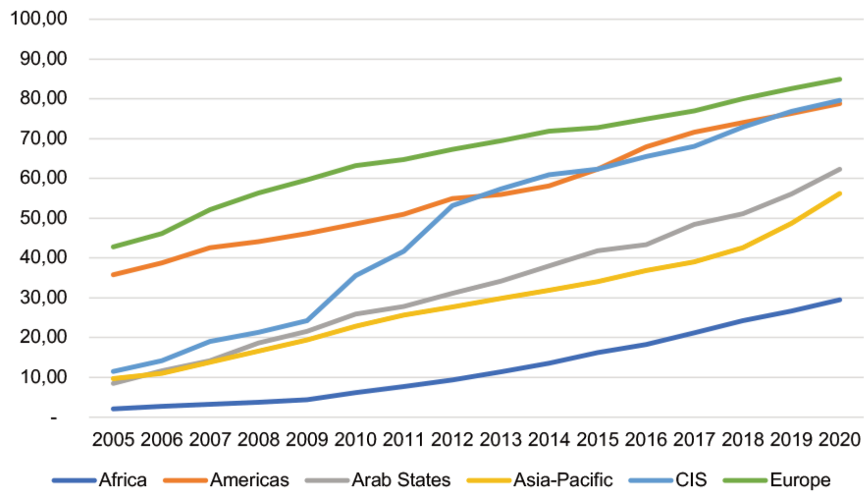
Note: Data is not shown for economies where the share of adults without an account is 5% or less.

Figure 2. Percentage of individuals using the Internet, 2021



Source: Compiled by the author using ITU regional and global Key ICT indicators (October 2021)

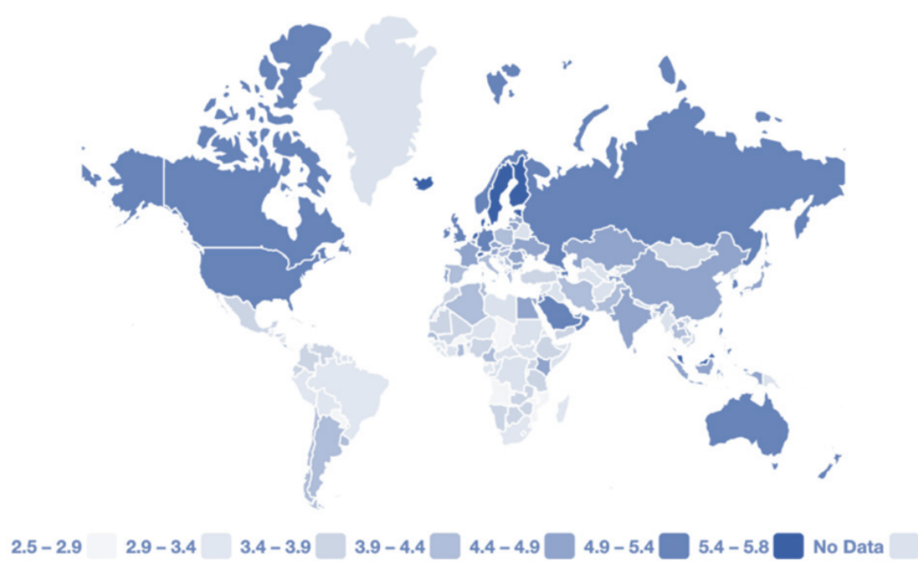
Figure 3. Individuals using the Internet (per 100 inhabitants)



Source: Compiled by the author using ITU regional and global Key ICT indicators (2021)

Another relevant factor that provides an access point for development cooperation actors is investing in advancing the population's digital skills. Figure 4 illustrates the digital skills gap globally, and especially in the sub-Saharan Africa region, some parts of the Middle East and North Africa (MENA) countries and the Southern Mediterranean. There are many existing development programmes and funding opportunities that present a space for knowledge sharing and capacities for building partnerships, such as the EU4Digital programme in the Eastern Neighbourhood region, which provides an excellent illustration of how capitalising on digital skills can deepen regional cooperation by supporting measurement of digital skills through the development of a common methodology aligned with EU practices for the Eastern Neighbourhood region. It also demonstrates a way of making international development cooperation more inclusive by involving civil society and private sector actors in supporting the establishment of national coalitions, and improving digital skills of SMEs through the development of a common Digital Competence Framework for SMEs and microbusinesses in the eastern partner countries. The experiences of such projects can be extended for knowledge and skills exchange on a regional level, and expansion to other regions.

Figure 4. Digital skills among the population

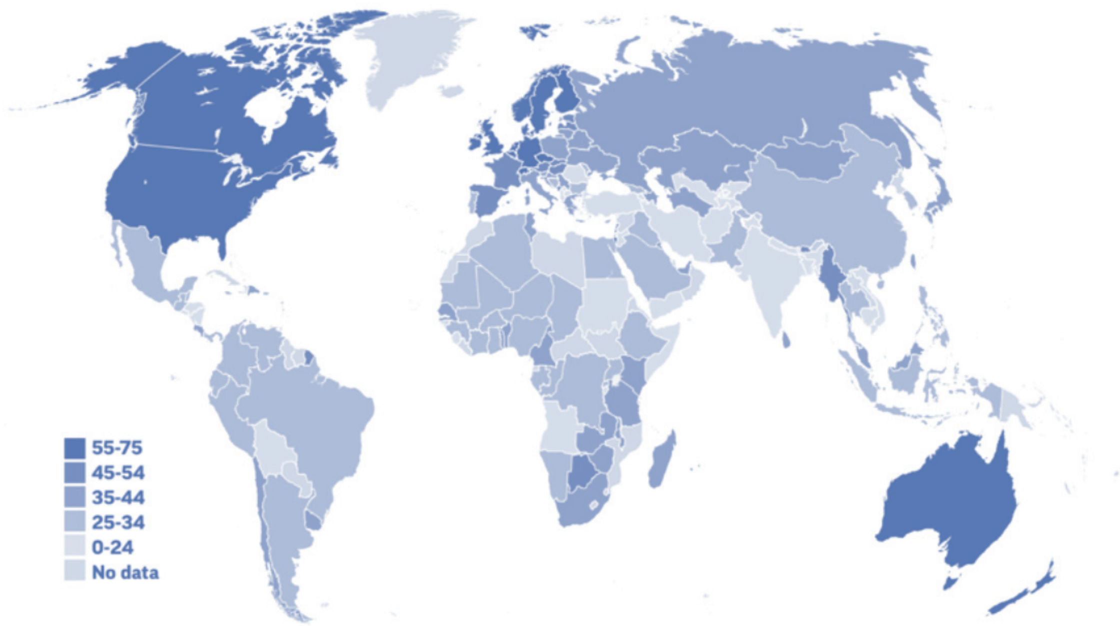


Source: World Bank, World Economic Forum Global Competitiveness Index (2019)

FinTech and remittances

Another important aspect for development cooperation is the connection between FinTech and remittances. In low- and middle-income countries, remittances are considered the most important financial flow, with a projection exceeding USD 470 billion in 2021 (UNCDF, 2021). The movement of remittances to these countries is characterised as expensive, inconvenient and inefficient, with a 7% transaction fee. It comes as no surprise that remittances bypass formal banking channels, resulting in the loss of billions outside the banking system. Interestingly, in developing countries and especially in sub-Saharan Africa, 21% of adults have mobile money accounts, showing the growing role of FinTech in financial inclusion and remittances. On the other hand, the financial literacy rate is also a factor in FinTech adoption for remittances. The level of financial literacy varies between regions (see Figure 5). Advancing access to digital payment and financial literacy is a way to maximise remittances and enhance FinTech adoption. An example of how investment in FinTech for advancing remittances has enhanced regional cooperation is the "Know your Customer"[3] facility, which is a regional cooperation project between the South Pacific central banks to advance remittances in the region, including the use of FinTech.

Figure 5. Global variations in financial literacy (% of adults who are financially literate)



Source: S&P Global FinLit Survey

Policy response for addressing FinTech risks and reaping its benefits

Digital technologies, business and society are inseparable in FinTech-related policies. Policy-makers will have to provide an enabling environment for the changes accompanying digitalisation, which could be done by providing institutional and regulatory frameworks to ensure that they are addressing the risks that follow digitalisation processes and at the same time reaping the benefits of the transformation towards achieving equitable and inclusive growth. The following recommendations are intended to boost the partnership between national policy-makers and development cooperation agents in the Euro-Mediterranean and neighbouring regions, based on the experiences from other regional cooperation.

[3] https://www.rba.gov.au/media-releases/2020/mr-20-31.html

Mitigate risks of FinTech: regulatory recommendations

With the risks of FinTech, policy-makers will find themselves trading off between safety and efficiency. A partnership between development agents and policy-makers is essential for developing regulatory sandboxes to provide more flexibility in regulating FinTech activities. Additionally, experiences of countries more advanced in RegTech are very important for peer-to-peer learning. This recommendation is important to make FinTech regulations more global and coherent.

In addition, development projects should focus on facilitating the regional exchange of cybersecurity between countries with similar infrastructure and demographics to protect consumers and producers.

Then regional data protection and cybersecurity specialists should contribute to building governments' capacity in cyber protection regulations and create a platform for specialists to exchange knowledge and develop global skills.

Finally, as a first step towards regional data and cyber protection policies, cross-jurisdiction collaboration should focus on fostering partnerships to provide a controlled environment for the development of FinTech solutions through accelerator labs and sandboxes for testing and scaling.

Regional cooperation

The Euro-Mediterranean region can create a regional digital market to make it a connection point for neighbouring regions, ease the market access for Micro, Small and Medium Enterprises (MSMEs), integrate them into the regional supply chain, and promote regional integration e-commerce.

Projects should be funded and developed to enhance regional mobile operators and FinTech companies in access to digital loans by engaging regional mobile cash transfer to lower the cost of remittances.

Furthermore, regulatory conferences should be created to support South-South cooperation in knowledge sharing and peer-to-peer learning on technology regulation and funding-shared digital infrastructure projects.

Infrastructure

Development cash transfer and social support projects should work with the government to digitise payments and include the poorest segment of the population in the financial system.

In addition, public finance management (PFM) development interventions can support FinTech in tax generation and compliance; this will increase the public resources and contribute to the overall digitalisation of the economy.

Moreover, funding should be provided for projects which facilitate access for hard digital infrastructure and encourage regional public-private partnerships (PPP) to further focus on digital infrastructure.

Finally, designing development projects could strengthen digital and financial literacy by working with regional civil society actors to reach the most vulnerable groups.

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