

The limited use of non-cash payments in Moldova: Diagnosis and policy options

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1. Potential benefits of greater use of non-cash payments

- Government
 - Fiscal: Higher tax revenues („de-shadowing“)
 - Central bank: lower cost of issuing and handling cash; enhanced transparency
- Business
 - Level playing field (fewer shadow transactions)
 - Lower transaction costs (especially for banks)
- Population
 - Significant time saving; less waiting in banks
 - Better monitoring/tracking over expenditure
- Thus: wide economic benefits of non-cash payments

2. Limited use of non-cash payments in Moldova: Findings

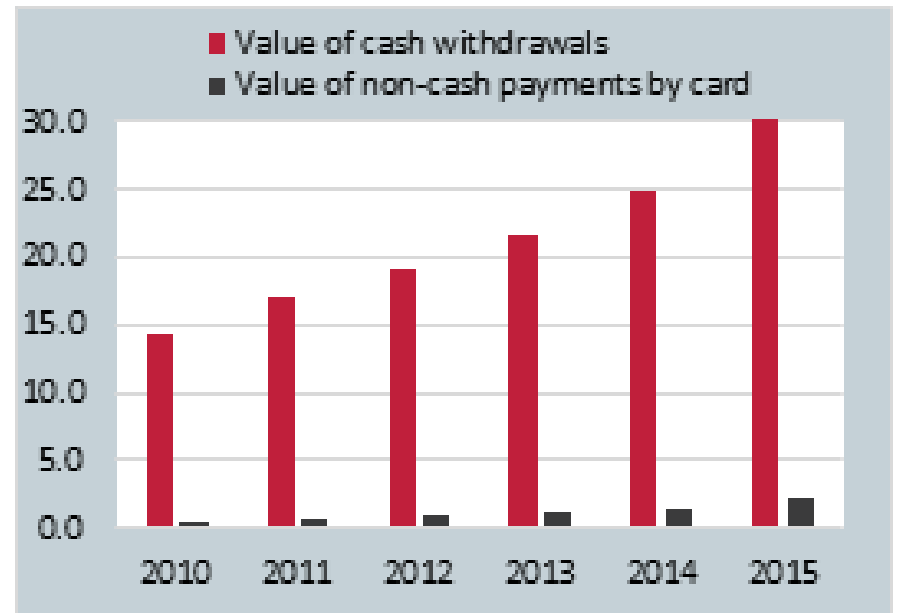
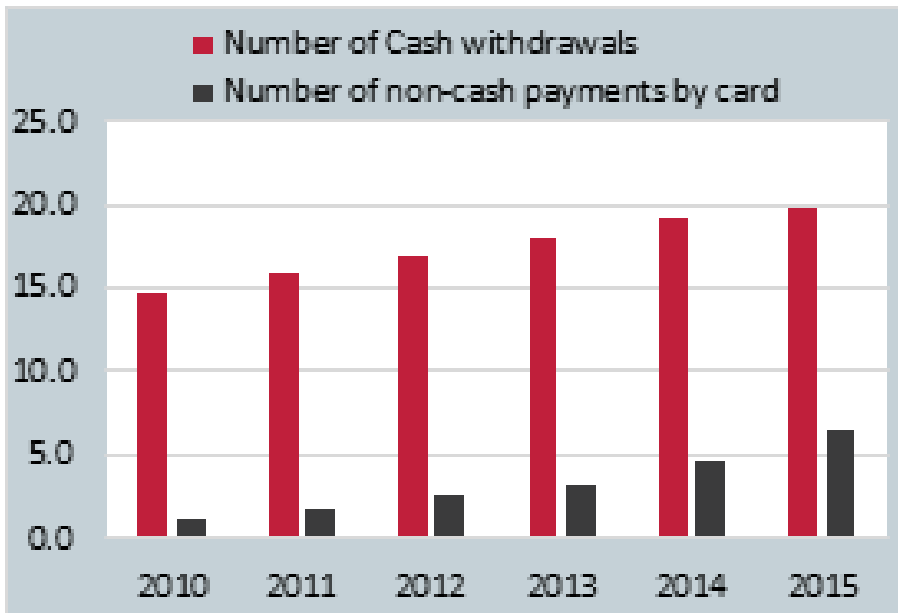
- Moldova lags behind most Central and East European countries in the use of non-cash payment instruments
- Interestingly, the infrastructure in Moldova is comparatively more developed than the limited use of non-cash instruments might suggest
- Card payments have grown faster than cash withdrawals since 2010, but started from a low base

Indicators of non-cash transactions and related infrastructure: Moldova and selected transition economies, 2014 (MDA: 2015)

| | Croatia | Lithuania | Hungary | Czech Rep. | Poland | Bulgaria | Romania | Ukraine | Moldova |
|--|---------|-----------|---------|------------|--------|----------|---------|---------|---------|
| Credit transfers per inhabitant | 68.5 | 60.3 | 55.4 | 54.3 | 51.4 | 26.6 | 10.1 | - | 4.6 |
| Direct debits per inhabitant | 4.7 | 4.8 | 6.7 | 13.5 | 0.6 | 0.8 | 0.5 | - | 0.02 |
| Card payments per inhabitant | 51.4 | 58.6 | 36.4 | 46.0 | 48.7 | 9.0 | 11.5 | 19.7 | 1.8 |
| Cash withdrawals at ATM per inhabitant | 23.3 | 22.8 | 10.8 | 17.2 | 19.7 | 12.6 | 11.0 | 15.6 | 5.6 |
| ATM terminals per 1 million inhabitants | 992 | 438 | 494 | 421 | 533 | 777 | 577 | 744 | 273 |
| POS terminals per 1 million inhabitants (thousands) | 23.0 | 13.4 | 10.6 | 9.6 | 10.4 | 10.5 | 6.5 | 4.6 | 3.4 |
| Cash in circulation (percent of M1) | 19.3 | 11.2 | 33.0 | 15.4 | 21.4 | 32.7 | 33.6 | 65.0 | 66.0 |
| Cash in circulation (percent of GDP) | 5.6 | 3.7 | 11.0 | 10.1 | 7.5 | 12.2 | 5.6 | 17.7 | 15.6 |

Source: National Bank of Moldova, European Central Bank, National Bank of Ukraine.

Card payments in Moldova, 2010-2015*



Source: National Bank of Moldova, *Cards issued and used in Moldova

3. Causes for the limited use of non-cash payments: Stakeholder perspectives

Why do we not see more use of non-cash payments?

Approach: Focus on different stakeholder groups

- Consumers
- Merchants
- Real economy

Consumers – „Old habits die hard?“

- Many consumers pay by cash even when non-cash payment methods are easily available (e.g. withdraw money from ATM to pay utility bill at bank cash counter)
- There is much room for non-cash payments to grow without consumers having to make hard choices about regularizing informal payments, etc.
 - For example: in 2015, non-cash payments were MDL 2.1 bn, but non-food retail turnover was MDL 35 bn
- Moldovans travelling abroad as well as Moldovan migrants visiting Moldova pay more by non-cash methods ... incentives seem to matter

Consumers and merchants: Cost of non-cash payment services

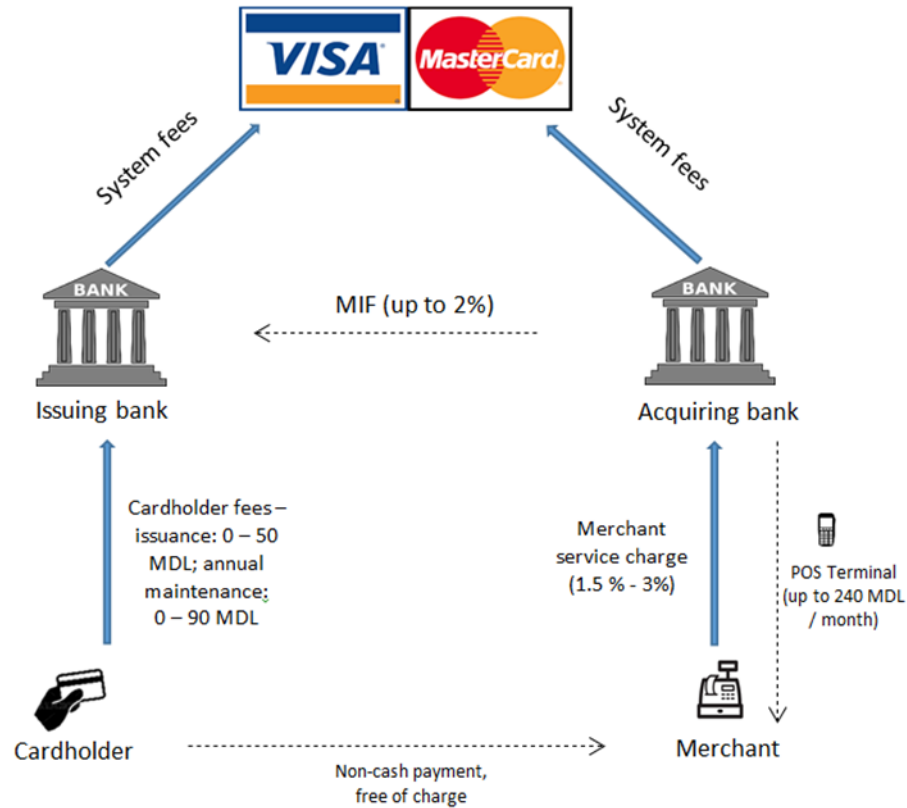
- Bank fees for non-cash payments are substantial for consumers (e.g. ATM cash withdrawal vs. bank transfer, especially to a different bank)
- Merchant service charges for payments through POS terminals are high by international standards, mostly due to high multilateral interchange fees
- Similar fees in the EU were capped as a result of intervention by Competition Commissioner
- While cost structures in Moldova may be different (economies of scale may not be realized), there is room for a fee reduction

Average fees for consumers in 2015

| Operation type | Minimum | Maximum | Average |
|---|-------------------------|-------------------------------------|---------------|
| Account opening | 0 MDL | 50 MDL | 3.2MDL |
| Account closing | 0 MDL | 50 MDL | 3.MDL |
| Account handling | 0 MDL | 7 MDL / month | |
| Fees for payment transaction, within the same bank | 1 MDL per transaction | 4 MDL per transaction | |
| Fees for payment transaction, within different bank | 2 MDL | 10 MDL | |
| Fees through money transfer systems | 1.5 EUR per transaction | 56 EUR ¹ per transaction | |
| Card issuance | 0 MDL | 40 MDL | 17.9 MDL |
| Annual debit card maintenance | 36 MDL | 90 MDL | 64 MDL / year |
| Internet banking | 0 MDL | 100 MDL / month | |
| ATM cash withdrawals | 0 MDL | 1 MDL per transaction | |
| ATM cash withdrawals from other banks | 1 MDL | 1,5 % min 1 EUR per transaction | |
| The maximum daily withdrawal | 4000 MDL | unlimited | |
| Payment by card within POS | 0 MDL | | |

Source: compiled from web-sites of commercial banks in Moldova

Current fees for merchants



System fees: based on number of cards issued, connections to processing systems, extent of use of network
 MIF: multilateral exchange fee – app. 1.2-2%, depending on business type, transaction method, card type

Source: own compilation from commercial bank websites.

Merchants and real economy: Informal payments

Increase of non-cash payments faces several challenges

- Main challenge: Prevalence of informal (cash-based) activities, especially envelope wages, in some sectors of economy
- **Agriculture:** small average payments to farmers, limited access to financial services → cash often most efficient means of payment
- **Construction:** many cash payments in foreign exchange to minimize risk for the purchase of imported building materials
- **Retail and wholesale trade; hotels and restaurants:** widespread use of cash, although card payments through POS terminals would be a natural alternative

Widespread shadow economic activity in some sectors

Informal economic activities by sectors, Moldova, 2014
(informal relative to formal value added/ employment, percent)

| | Value added | | Employment |
|------------------------------|---|-------------|-------------|
| | Household production for own consumption: included | excluded | |
| Agriculture, etc. | 58.8 | 15.0 | 353.1 |
| Industry | 16.9 | 13.4 | 6.6 |
| Construction | 40.5 | 37.5 | 151.5 |
| Retail and wholesale trade | 26.3 | 26.3 | 18.6 |
| Hotels and restaurants | 39.8 | 39.8 | /b |
| Transport and communications | 18.2 | 18.2 | 13.4 |
| Public administration, etc. | /a | /a | 0.3 |
| Other services | 20.4 | 9.2 | 15.3 |
| Total (all sectors) | 27.5 | 16.2 | 48.2 |

/a Included with other services.

/b Included with Hotels and restaurants

Source: National Bureau of Statistics

4. An international perspective: Policies for increasing non-cash payments in Uruguay

Base document: “Law on Financial Inclusion” (Law 19210, April 2014)

Main driving force: Ministry of Economy and Finance

Implementation

- To a large extent through the payments system
- Crucial role of Central Bank of Uruguay (BCU, www.bcu.gub.uy)

Information sources

- Law 19210 and related decrees
- Interviews with relevant experts from BCU in July 2016
- Website for initiative: <http://inclusionfinanciera.mef.gub.uy/>

Uruguay: Main measures to increase non-cash payments

1. Fiscal incentive: VAT discount (see next slide)
2. Mandatory electronic payment of wages
 - Ca. 500.000 employees were paid in cash
 - Exemption of mandatory payment for rural workers
3. Mandatory electronic payment for rents > ca. USD 350 (per month)
4. Transactions over a certain limit (depending on type of transaction) only via electronic payment
5. Fiscal incentives (tax exemptions and subsidies for small shops) for installing POS-terminals; but POS is not mandatory
6. New: Issuing institutions of electronic money, card free of charge

Thus: Sticks and carrots; balanced approach

Uruguay: Fiscal incentives - VAT discount

Discount of VAT rate by instrument and time

| | Debit card & electronic payments | Credit card |
|---------------------------|----------------------------------|-------------|
| First year (Aug14-Jul15) | 4% | 2% |
| Second year (Aug15-Jul16) | 3% | 1% |
| From third year (Aug 16) | 2% | 0% |

Note: Standard VAT rate is 22%

- Discount only for payments of total amount by final consumers
- Discount conducted automatically/ immediately
- Stronger incentives for debit cards; goal is not to promote credit
- Phased approach: Strong incentive in the first year, less afterwards
- Discount only for payments of less than ca. USD 400
- Restaurants: 9% VAT discount dating from 2006 (Law 17934)

Automatic discount: Illustration

Cash payment

| | |
|------------------|------------|
| Net price | 100 |
| VAT (22%) | 22 |
| Gross price | 122 |

Non-cash payment (4% VAT discount)

| | |
|-------------------|------------|
| Net price | 100 |
| VAT (22%) | 22 |
| VAT discount (4%) | -4 |
| Gross price | 118 |

- Non-cash payment: All 4 positions appear on card payment voucher
- Easy to understand and to monitor for consumers

Automatic VAT discount: Restaurant bill (9% discount)

Invoice



Gross price
(VAT 22%)

VAT 22%

Card payment voucher



Gross price
(VAT 22%)

VAT discount
\$50.53 (9%)

Gross price
(VAT 13%)

Net price
\$561.48

Uruguay: Impact of policy measures

Debit cards and checks

- Within 2 years use of debit cards increased by 6 times
- Number of debit cards increased to 3 m (ca. population Uruguay)
- Decline of use of checks
- However: Deferred checks still widely used (credit function)

Thus: Change of payments patterns; “old habits” can be changed

POS-terminals

- Within 3 years: Three-fold increase of POS

Uruguay: Fiscal cost of VAT discount

Fiscal impact

- Original plan: Full recovery of VAT revenues by 2018
- Current prediction: Full recovery of VAT revenues already in 2017

Thus: De-shadowing faster than expected

View of consumers

- Consumers are the direct beneficiaries of VAT reduction
- Before: Reduction 23% to 22%, but gross prices hardly changed...
- Anecdotal evidence: People now spend much less time in banks and support government policy on non-cash payments; popular measure

5. Discussion of policy measures in Moldova

Approach: Balanced mix of regulatory measures (“sticks”) and fiscal incentives (“carrots”)

Precondition: Trust in banking sector is reestablished

Regulatory measures for discussion

1. Sustained efforts at financial education
2. Cap on merchant service charges/ multilateral interchange fees
3. Mandatory electronic payment of wages
Possible exemption: payments to rural workers
4. Make electronic payment mandatory above certain thresholds (which may differ for different types of transactions)
5. Lower turnover threshold: compulsory provision of POS terminal

Fiscal incentives – for discussion

1. VAT discount for electronic payments
 - Level of discount
 - Time framework, transitory vs. permanent
 - Debit vs. credit card
 - Additional discount for sectors prone to shadow activities

2. Fiscal incentives for small shops for installing POS-terminals

Financial inclusion and access to banking

- Mandatory measures have to be accompanied by an improved and affordable access to banking
- This applies especially to low-income population

Discussion of possible measures

1. Right to basic banking: require banks to offer basic bank accounts free of charge
2. Promotion/ facilitation of direct banking services
3. Consolidate role of new electronic payment providers

Thus: Measures to increase use of non-cash payments are closely linked with better financial inclusion.

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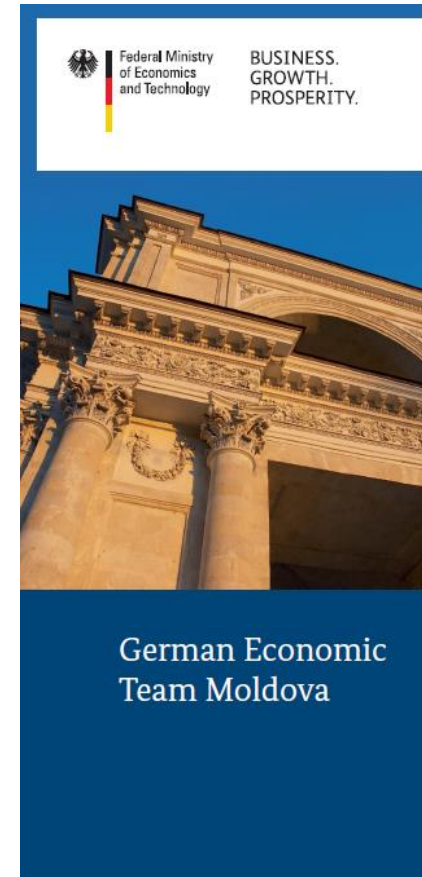
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