

Introducing Card Payment Operations into Public Administration

Zagreb, December 2016



American Chamber of Commerce in Croatia *Američka gospodarska komora u Hrvatskoj*

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Introduction

Brief History and Development of Payment Cards

The history of payment cards begins in the 1950s, when Diners introduced its first charge card. It was followed by a significant expansion of payment card companies and their products.

The following events illustrate the course of the major developments related to payment card services worldwide:

- 1950 – Diners introduces the first charge card
- 1958 – American Express issues its first charge card
- 1958 – Bank of America introduces the first bank card (Bank Americard)
- 1965 – Eurocard established in Belgium
- 1967 – Interbank Card Association founded by American banks
- 1968 – Interbank Card Association (ICA) and Eurocard form an alliance
- 1974 – Eurocheque International founded
- 1977 – Bank Americard becomes Visa International
- 1979 – ICA becomes Mastercard International
- 1988 – MasterCard becomes shareholder of Eurocard International & EPSS
- 1992 – Eurocard, Eurocheque & EPSS merge into Europay International
- 2003 – Europay International dissolves in the merger with MasterCard International and becomes MasterCard International

Payment cards eliminate the risk of carrying cash and, being a universal means of payment, extend banking operating hours to 24 hours a day. Payment card products have basically become global currency, so widespread that Visa and MasterCard are today accepted at several dozen million points of sale for goods and services, in over 200 countries worldwide. Today, it is difficult to imagine everyday life without using payment cards.

With the development of the payment card market, payment card transactions have developed to be more than just transactions for purchasing goods and services via EFTPOS (Electronic Funds Transfer at Point of Sale) terminals or ATM transactions for cash withdrawal and deposit; today they also comprise transactions for the online purchase of goods and services, payment card direct debit transactions and standing orders, and cash withdrawals via EFTPOS terminals.

General Advantages of Card Payments

A credit card makes it easier for citizens to manage their monthly budgets by monitoring and adjusting their monthly spending by simply monitoring their monthly statements. Most cards provide a grace period of up to 50 days, without

charging additional fees or interest. A card can be used to cover short-term expenses until the following regular income payment, and it can be particularly useful for emergency payments or for covering larger unplanned expenses (such as car repairs, medical expenses, new household appliances, etc.).

Cards are accepted all over the world, even at locations that do not accept cash, since they offer the possibility of various shopping methods (e.g. phone orders or online shopping). Carrying a credit card is safer than carrying cash and it fully exonerates from the liability of unauthorized spending (after a card is reported lost or stolen, the cardholder is exonerated from liability for costs incurred from unauthorized use).

In addition to spending, the use of credit cards makes a cardholder eligible for numerous benefits depending on the issuer (benefits at points of sale, reward programs, etc.) and contracts for many additional products (direct debit, additional/joint cards, online balance monitoring, e-payment of invoices, etc.) can be concluded.

Situation in Croatia¹

The Republic of Croatia has fully harmonized its legislation with the European Union (EU) acquis in the field of payment operations.

The providers of payment services (hereinafter: the issuers) in the Republic of Croatia in 2015 were as follows:

- 26 credit institutions (banks) authorized by the Croatian National Bank (HNB) to issue payment cards;
- 2 electronic money institutions authorized by the HNB to issue payment cards.

Statistical data on the use of different types of payment cards show that 8.7 million cards are in use in the Republic of Croatia, 500 thousand of which pertain to legal persons.

The payment card is the most frequently used payment instrument in the Republic of Croatia, and the market of payment cards and payment card transactions is continuously growing and developing. In nine years, the number of national payment card transactions has grown by 72%, from 203.68 million in 2006 to 351 million in 2015. In the same period, the value of national payment card transactions has grown by 47%, from HRK 85,331.34 million to HRK 125,251.27 million.

The significant presence of cards in the Republic of Croatia is evident from the following data, valid as of 31 December 2015:

- Number of payment cards per citizen = 1.94
- Percentage of citizens with at least one payment card = 79%
- Number of credit cards per citizen = 0.42

¹ Statistical data source: *Croatian National Bank: Payment Cards and Payment Card Transactions, Year II*, July 2016

- Number of payment cards per payment card holder = 2.45
- Number of payment card transactions per citizen (per year) = 82
- Value of payment card transactions per citizen (per year) = HRK 29,231

Advantages of Card Payments for the Economy

Global trends indicate the increasing presence of cashless payments, which is in line with the general trend of digital transformation of global society and economy.

The Single Euro Payments Area (SEPA), established in 2012, substantially simplified the electronic transfer of money between Eurozone member states. SEPA enables citizens, enterprises and public institutions to make payments in EUR under the same conditions, rights and obligations, which lead to card payments becoming as simple as cash payments. Debit card payments are now possible when shopping in another Eurozone member state, which is particularly important for the new generation of customers who use cards more frequently.

Technology has improved card payment security standards, and this process has become even faster with the advent of contactless technology. E-wallet technology will add fresh impetus to the growing volume of card transactions, and with other improvements such as the growth of e-commerce and the Internet of Things, it will inevitably reduce the share of cash transactions.

A decrease in cash payment transactions automatically contributes to the transparency of the system, enables quality monitoring via the available services and big data processing for the purpose of analysis or planning and, consequently, the establishment of new controlled mechanisms.

Advantages of Card Payments for Enterprises

Card payments offer many advantages both to enterprises and to citizens. They help small and medium-sized enterprises that do not have a credit history obtain small loans by way of revolving or credit cards, and they may provide a much needed financial reserve in the event of overdue receivables or lower monthly sales. The key benefit is that cards provide quicker access to funds (making purchases or withdrawing cash) in comparison to other means of payment (e.g. bank checks).

In addition to issuing monthly statements, card companies offer online account management tools and an annual credit report to business users. This helps accounting departments organize accounts and monitor employee spending, and facilitates referencing during audits and for tax payment purposes.

It should also be said that by meeting its obligations incurred from payment card transactions responsibly, i.e. by paying invoices (or at least the minimum required amount) by their due date, a company can build a positive credit rating and thereby qualify more easily for loans with lower interest rates in the future.

Economic Effects of Card Payments

The use of cash money is a great burden for a country's budget. A 2013 research conducted at the Steinbeis University in Berlin² suggests that Germany generates losses of EUR 13 billion due to the use of cash money. If we divide that amount by industry, the strongest effects are felt by the retail industry that loses approximately EUR 7 billion per year, the private bank sector which loses EUR 4.5 billion, while citizens lose EUR 1.5 billion.

If we compare the cost of cash and card transactions, only transactions under EUR 6 are cheaper when cash is used, and it would therefore be preferable to use cards as a means of payment for all transactions whose value exceeds EUR 6.

It is known that cash is the preferred means of payment in the grey economy, and that card payments are an important element in combating the grey economy. The Steinbeis University research also shows that banning cash, i.e. creating a cashless society, would result in savings of EUR 35 billion in the German public sector. Card use would be the most effective in reducing illegal employment and tax fraud. The introduction of some of the measures proposed by the payment card industry would result in a GDP increase of 1%.

According to the study by AT Kearny entitled "The Shadow Economy in Croatia"³, the grey economy in Croatia amounts to 28% of the GDP. The study proposes electronic payments (including card payments) as one of the solutions, and it indicates their benefits:

- For governments:
 - automatic reduction of grey economy;
 - additional tax revenues;
 - stimulation of economic growth.
- For citizens:
 - safer funds for education, infrastructure, and social welfare payments;
 - safer payment of wages at the workplace;
 - lower possibility of wage reductions due to cash payments of lower amounts to illegal workers.
- For companies:
 - conducting business in compliance with laws and regulations;
 - lower cost of cash management;
 - higher number of customers/users due to advantages offered by electronic payments (e.g. loyalty schemes).
- For the financial sector:
 - reduced cost of providing cash;
 - higher revenues from new systems of payment and value-added services;
 - stronger relationships with clients.

² Research Center for Financial Services, Steinbeis University Berlin, "Cost of Cash: Status quo and development prospects in Germany", May 2014, downloaded at: <http://mastercardcenter.org/wp-content/uploads/2015/01/Cost-of-Cash-Status-Quo-and-Development-Prospect-in-Germany-January-2013.pdf>

³ AT Kearney, "The Shadow Economy in Croatia", 2014

Electronic/card payment measures that have proven to be successful in other countries as methods for supporting sustainable economic development include the following:

- Electronic payment of wages, transfers of state funds, pensions, and welfare payments into a bank account or a prepaid card;
- “Procure to Pay” electronic products for public procurement payments;
- Innovative solutions for public transport services (contactless cards);
- Setting a threshold for B2C cash payments (a business provides a service to a person who is not a business);
- Expansion of the POS terminal network;
- Tax incentives for merchants;
- Incentives for consumers (e.g. tax lotteries).

Card Payments in the Public Sector

Digital payment solutions provide the state with immediate insight into invoiced public services, and into the ratio of payments versus invoiced public services. Card payments offer higher security of payments for public services and provide the option of resolving payment issues in real time, which increases the level of transparency. Transparency and cost control are important for balanced economic development, for combating tax evasion more effectively and consequently for a more just society.

Governments have the authority to adopt advanced measures designed to further enable electronic payments in the public sector. However, financial institutions and the payment card industry can contribute by further innovating and advancing practical methods of payment, and by offering their knowledge and expertise to state institutions.

Examples of Foreign Best Practice⁴

Since card payments are already a dominant method of payment for citizens and companies, many countries have also recognized the advantages of introducing card payments into the business operations of their administrations. In this document we present a brief overview of several successful examples.

Great Britain

The plans for the future of e-government in Great Britain are presented in the 2010 ICT strategy, the objectives of which are to improve the productivity and efficiency of ICT services through the re-use and exchange of information and services, greater flexibility of procurement and delivery of ICT solutions, and the establishment of an interoperating framework through common and open standards.

The British government also introduced the Government Procurement Card, a payment card which brought about greater transparency, improved efficiency and better cost control through the implementation of electronic solutions. The card enables a simple end-to-end process for public procurement through integrated e-payment solutions.

Significant improvements have also been made in public transport. Prepaid Oyster cards were considered to be a very expensive solution for London public transport, but the association between one of the largest card companies and the City of London enabled the introduction of contactless card payments and digital wallet payments, thereby speeding up the system and increasing user spending.

Italy

The annual revenues of the Italian tax system amount to EUR 90 billion. In the past, payment instruments were limited to cash, local debit card or Italian post office card transaction programs, while tax offices were poorly equipped with older generations of POS terminals.

⁴ Information provided by MasterCard Europe

In 2012, the Italian government set three principal objectives related to tax collection: expanding the collection network, improving user experience, and facilitating tax collection by promoting electronic payments. Approximately 70 thousand locations and 110 thousand POS terminals, many of which are contactless, were introduced.

Small merchants and kiosks, as well as public administration offices, are now equipped with POS terminals, and postmen are provided with mobile POS terminals (mPOS) which enable payments from private residences, and small and medium-sized enterprises. The tax collection process is now much more efficient and effective, and millions of Italian citizens are able to make faster payments.

Romania

The Romanian government recognized the advantages of electronic payments in combating grey economy, which is estimated at 28% of the national GDP, in comparison with the European average of 18.5%. In order to improve efficiency and collection levels, the Ministry of Finance requested a license for the direct collection of taxes and public service payments through one of the largest card companies in Romania. It is estimated that such cooperation will increase the amount of taxes collected by EUR 14 billion in a 5 to 7 year time period.

Russia

The Russian strategy "Information Society 2011-20" allocates over EUR 2.3 billion to the objective of connecting the entire country through universally accepted ICT services. It is estimated that the Russian government annually loses approximately 1.1% of its GDP due to cash transactions. Costs include the issuing, distribution, and storage of cash money, cash transactions including security, and the cost of counterfeit bills. It is estimated that a 10% reduction of cash use would increase the Russian GDP by 1.5%.

The Republic of Tatarstan has decided to introduce a regional multi-use card for citizens, to be used for public transport, healthcare, identification and loyalty programs. The card provides citizens with open access to the state Internet portal on which they can use the "one-click" service for paying bills for public services. The card also offers parking and tourism services, and services designed for families (excursions, museum admissions, etc.). It is also important for the integration of healthcare services since it includes scheduled appointments, prescription lists, an overview of medication usage and administration, and it safeguards the holder's vital healthcare information.

Card Payments in Croatian Public Administration

We believe that card payments should be introduced into Croatian public administration since the data referred to above indicate a substantial presence of payment card use by citizens and businesses.

The Croatian market shows a high level of maturity and an inclination towards cashless payments and finance management by using the advantages of card payments, such as installment payment plans. Croatia also has a developed infrastructure for accepting payment cards, with 103,000 POS terminals and 4,000 ATMs in 2015.

On the other hand, transactions related to public administration, bar some exceptions, are limited to cash payments and bank transfers. This denies citizens and businesses the advantages of card payments, and public administration denies itself the greater collectability that card companies offer, as well as the efficiency and transparency of the broader spectrum of electronic transactions.

Recommendations for Introducing Card Payments into Croatian Public Administration

The American Chamber of Commerce in Croatia (AmCham) believes that card payments should be available for any type of payment made to public administration bodies. However, we propose three areas in which to start with the introduction of card payments.

E-Citizens

The e-Citizens system is a project of the Government of the Republic of Croatia, established with the aim of modernizing, simplifying and accelerating communication between citizens and public administration, and increasing public sector transparency in the provision of public services. E-Citizens currently offers a series of services that are free for citizens, such as obtaining birth, marriage or citizenship certificates etc.; however, services which require the payment of fees are currently not available.

The introduction of card payments, the basic method of payment for any online business, would allow the provision of a wider spectrum of services such as:

- ID card, passport or driving license renewal;
- Overview of all tax liabilities, enabling immediate settlement of outstanding debts, with the option of payment in installments;
- Payment for public utility services, with the option of payment in installments (public utility companies already offer citizens and companies the option of paying by payment card at their offices or by way of standing orders);
- Purchase of e-stamp duties for online payments for public services (already planned, but not in use).

Card payments enable standing orders to be contracted for settling regular commitments, allowing a more secure collection for the service provider. They also reduce the administrative burden of the public administration with a reduced number of citizens coming to public administration offices in person, and the cost of cash transactions where cash is still used.

Public administration simultaneously reduces its administrative requirements for citizens, thereby providing a better and more transparent service.

Public Procurement

An efficient and transparent public procurement system is one of the key prerequisites for attracting foreign investments and improving economic competitiveness.

Although numerous changes designed to facilitate participation in public procurement procedures have recently come into force, substantial shortcomings still remain. Previous efforts were more focused on invitations to tender, rather than on the execution of signed public procurement contracts, although winning tenderers are also encountering various problems in respect to the latter.

We believe that if the ordering party (public institution/body) made its payments under the procurement contract by card, more regular payments and better ex-post cost control would be achieved. This would significantly increase payment security and the level of transparency in the public procurement system.

In 2013, public procurement costs in Croatia amounted to between EUR 4.3 and 6.5 billion, which is equivalent to 10-15% of the GDP. Cards can have a significant role in distributing these amounts in the public procurement process in a more transparent, reliable and efficient manner.

Purchase and Pay solutions offered by card companies can be integrated with the procurement systems of public entities. Such solutions enable immediate electronic payment of invoices, foster participation of small and medium-sized enterprises in public procurement procedures, and increase the efficiency, transparency and reliability of public procurement systems.

The advantages of introducing card payments into the public procurement system for public administration include:

- Real-time integration with public procurement and finance systems of state institutions and companies;
- Integrated controls for internal public procurement;
- Increased efficiency of processes due to automatic payments and less time required for invoice processing;
- Improved data storage capacity to help with accounting;
- Incentive for enterprises to adopt electronic invoicing.

The benefits for public administration are even greater in the context of budgetary pressure at the European level, with the imperative of efficient management of public funds. There is substantial independent evidence which shows that card payment programs in public procurement systems worldwide have provided tangible financial benefits:

- Less time is required for purchase orders/requisitions, coordinating accounts, approvals, payments, queries, data entry, etc.;
- Transaction costs of purchasing by card are significantly lower than the costs of manual/paper procedures;
- The majority of clients (60%) who have switched over to card payment programs are able to secure discounts from suppliers.

As a first step, we propose to enable card payments for low-value public procurement.

Payment of Taxes and Fees

Although we have listed some proposals in the chapter on the e-Citizens system, tax liabilities should also be payable by cards outside the e-Citizens system. That especially pertains to providing citizens and legal persons with the option of paying higher amounts in several installments.

The examples from Italy (which ensured a broader distribution of POS terminals) and Romania (where taxes are or will be payable by payment card) referred to above illustrate the advantages of this approach.

Examples of liabilities which, due to their potentially high amount, involve a non-payment risk include:

- Real estate tax;
- Annual motor vehicle tax;
- Rental tax;
- Lump-sum payment for municipal services, e.g. for water or electricity in newly constructed buildings.

Enabling card payments for the aforementioned and other taxes would increase the level of voluntary and prompt tax payments because payments would be simple and with an installment plan pose a smaller short-term burden.

Conclusion

Even though card payments are commonly used by citizens and business entities, such payments are still not used for public administration services in Croatia (bar some exceptions such as paying traffic fines).

Card payments are often perceived as an expense, while public administration practice in developed countries indicates long-term advantages of using card payments for the provision of public services:

- Efficiency – reducing administrative burden through digitalization and providing a better service to citizens and business entities;
- Transparency – electronic control of transactions and easier management of cash flows within a public system;
- Greater collectability – prompt payments by card companies and easier management of funds by the payers through payments in installments;
- Savings of public funds through greater collectability and reduced costs of cash transactions;
- Better planning and management of public finances since payment card operations enable immediate insight into invoiced public services paid by card.

Although we cannot accurately estimate potential gains in savings, greater collectability and general improvement in efficiency, experience from other countries clearly shows that card payments could be an important instrument for the reform of Croatian public administration (in parallel with digitalization) as a service for citizens and business entities, and could therefore be a stimulus of further economic growth.

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