

**COUNTRY DIAGNOSTIC
EXECUTIVE SUMMARY**

Building from a Strong
Foundation: A Path Forward
for Digitizing Sub-national
Government Payments in Peru

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PERU

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PERU

Country Diagnostic

This Diagnostic Study shows that Peru has a powerful opportunity to drive financial inclusion and continue modernizing its economy through further reforms to support digitization of payments. These reforms would help overcome the challenges of a highly fragmented governmental structure at the sub-national level, and would build on Peru's recent improvements to its digital infrastructure. These improvements have supported a rapidly growing digital economy and contributed to Peru's impressive economic growth in recent years. Despite this, Peru still has a large shadow economy, and remaining disparities of economic opportunity across the country. The Diagnostic Study maps out the key barriers to a more inclusive digital ecosystem in Peru, and makes specific recommendations at the national and sub-national level so Peru can harness the power of digital payments to build on its recent economic achievements.

EXECUTIVE SUMMARY

Following significant economic growth and improving infrastructure over recent years, Peru is well positioned to reap major benefits – particularly greater financial inclusion – from greater digitization of payments.

To help Peru realize these benefits, and at the request of the Peruvian government, this study provides detailed analysis of government payment flows. It also offers specific and targeted policy recommendations about digitization initiatives that will deliver the greatest positive impact, relative to their cost and practicality.

This study has focused on sub-national government payments, and has been designed to complement a parallel study on national government payments, conducted by the Inter-American Development Bank, entitled “Proyecto Pagos Digitales de Gobierno para Promover la Inclusión Financiera” (Digital Government Payments Project to Promote Financial Inclusion).

KEY FINDINGS



Peru's higher level of GDP growth relative to neighboring countries makes it one of the countries in the region best positioned to achieve further economic growth improvements through digitization of payments.

A recent study by Moody's Analytics¹ examined the economic impact of electronic payments in 70 countries, with the results indicating that increased use of electronic payments leads to higher consumption, which in turn leads to increases in production, jobs, income, and GDP. On this basis, the relatively stronger economic position of Peru in the region should enable it to better capitalize on payment digitization because the country is better able to foster basic banking services and expand basic payment services.



The Peruvian Central Bank's payment statistics show that the volume and value of electronic payments are growing rapidly.

This progress is a credit to the government's proactive initiatives to expand Peru's digital and financial infrastructure and facilitate innovation to accelerate digital payments to drive financial inclusion. For example:

- Between 2011 and 2015, credit transfers grew by transaction volume and value, 85% and 82% respectively; and card payments grew by transactions volume and value, 62% and 90% respectively.
- While the most advanced infrastructure in Peru is concentrated in the most affluent and economically dynamic parts of the country, the reach of the country's infrastructure is expanding.
- By moving forward to establish card acceptance (POS) and access to cash (ATMs), Peru has substantially improved its payment infrastructure in recent years. The number of POS terminals in the country grew by 472% between 2010 and 2015. However, this growth is partly attributable to the lack of interoperability among POS terminals which results in merchants having to acquire multiple devices.
- A recently developed private initiative, Billetera Movil (BIM),² providing an interoperable shared mobile payments platform is a key strength of Peru's infrastructure, and can be substantially leveraged to drive further digitization of payments. The platform was launched in February and had higher than expected adoption rates, exceeding 70,000 registered users within one full month of its launch.³



Despite some progress toward digitization, electronic payments usage growth is from a small base of the population and there is a pervasive dependence on paper-based payments.

- Cash usage is particularly widespread for retail transactions. This could be in part because POS acceptance is not fully interoperable and, compared to other countries in the region, POS penetration in Peru still remains relatively low, generating barriers to the full adoption of electronic payments.
- Overall, check payments per value and volume fell by 14% and 7% respectively between 2011 and 2015. However, check penetration remains high, especially for high-value transactions⁴ driven by small and medium enterprise (SME) payers and G2B and G2P payments (e.g., procurement, tax refunds), both at a national and sub-national level.
- Card payments grew by value and volume by 90% and 62% respectively between 2011 and 2015. Payment cards are predominantly used to access funds through ATM withdrawals. Credit cards are mainly used for payment at POS, accounting for 72% of the total card POS payments value in 2015. Debit cards used for cash withdrawals account for 94% of the total card withdrawal transaction value in the same year.



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Peru's prioritization of digital payments to expand financial inclusion is key to tackling the country's financial exclusion, 70% of Peruvians do not have an account in a formal financial institution,⁵ and relatively large "shadow economy,"⁶ 49% of the country's GDP.⁷

Payments behaviors are strongly correlated to the shadow economy. In particular, high cash usage – and consequent low usage of digital payments – are often found in countries with large shadow economies, such as Peru. While cash is an enabler of shadow economies,⁸ it is also a necessary means of trade in countries with low levels of financial inclusion, reinforcing the need for the government's strong emphasis on expanding financial inclusion.

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The significant fragmentation among payment systems and high degree of autonomy over payments policy within all 1,838⁹ municipalities is a primary challenge to further progress.

- The governance structure and legal framework for payments is well articulated at the national level, with the Ministry of Economy and Finance and Central Bank playing a coordinating role and having comprehensive visibility of the country's payment processes. However, this governance structure is applicable to only a limited degree at sub-national level, as municipalities have a high degree of independence and discretion in their administrative decisions.¹⁰ This is particularly true when it comes to the application of consumer protection measures.
- Consequently, at the sub-national level, there is complexity and inefficiency of single municipalities' negotiating with banks, payment providers, and system integrators, and a lack of scale due to the degree of fragmentation.

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The adoption of basic digital financial products (e.g., card payments, mobile money) by individuals and businesses is a vital prerequisite to further digitization and financial inclusion.

As a result, the private sector, backed up by the government, can play a leading role in developing accessible digital financial products and a functional digital payments ecosystem. Without this ecosystem, payments made by governments to individuals and businesses tend to be quickly converted into cash, negating many of the financial inclusion and broader economic benefits of digital transactions.

RECOMMENDED INITIATIVES: SUB-NATIONAL LEVEL

Based on the above analysis of payment infrastructure and municipal payment flows, this study has identified five strategic initiatives at a sub-national level to be recommended to the Peruvian government for the purpose of supporting digitization of the selected sub-national payment flows.

Through a methodology that ranks the most potentially effective initiatives, more efficient and transparent Government-to-Business (G2B) procurement transactions, Person-to-Government (P2G), and Business-to-Government (B2G) local tax collections emerge as key recommendations. Specifically:

- 1) Develop an integrated and affordable technology solution across local government entities, providing single-access multi-channel capabilities for digital payments for government receipts (e.g., tax collections and procurement payments).
- 2) Provide accessible and low cost solution for municipalities / SATs to access multi-channel payment collection.
- 3) Integrate BIM for tax collection and procurement payments.
- 4) Automate monitoring and reconciliation of collections and spending of sub-national entities.
- 5) Migrate G2B check flows to digital payments by decreasing / eliminating check usage for procurement payments.

The Better Than Cash Alliance's analysis of sub-national payment flows has identified selected target flows for digitization at sub-national level. These are:

- 1) **P2G and B2G:** Impuesto predial (property tax) – these payment flows are worth S6,720m with 59% of payments from citizens and 94% of payments from companies taking place by cash and checks for a total value of S5,188m, 77% of the total, paid in cash and checks.
- 2) **P2G and B2G:** Arbitrios municipales (costs to municipalities that are recharged to taxpayers) – these payment flows are worth S6,447m with 65% of payments from citizens and 95% of payments from companies taking place by cash and checks for a total value of S5,404m, 84% of the total, paid in cash and checks.
- 3) **G2B:** Gastos (outbound payments to suppliers / procurement) – these payment flows are the larger and are worth S119,748m of which 19%, S22,752m, are paid by checks.

The total potential flow that could be addressed through electronic payments across the target flow amount to S33,334m with relevant benefits of cost efficiency for the government and positive impact in terms of financial inclusion.

RECOMMENDED INITIATIVES: NATIONAL LEVEL

While digital payments at the national level are the focus of the IDB study,¹¹ this study also assessed nine national-level initiatives in terms of their potential impact and practicality, and then applied a cost-benefit analysis to each initiative. As a result, this study recommends initiatives to accelerate the growth of BIM, and extend its applications to P2G and G2P payments. Indeed, throughout the research and analysis for this study, BIM emerged as a key asset for Peru in its efforts to digitize payments and drive financial inclusion.

Recognizing that public resources are often scarce, and reforms difficult, the aim of this study is to help guide Peru in its journey from cash to digital payments. By doing so, Peru can help drive improvements in living standards and economic opportunity, increase transparency, and bring more people into the formal economy, potentially expanding its revenue base. In doing so, Peru can also provide a positive example that other countries can learn from in their own journeys from cash to digital payments.



The Better Than Cash Alliance Research Series

Our case study and country diagnostic series seeks to highlight specific examples of shifts from cash to digital payments by governments, companies, and international organizations. Each case study and country diagnostic aims to provide insights for a wide audience on the factors that have helped or hindered the digitization process, and also present key results and benefits of the transition away from cash. We hope that readers will be able to adapt the lessons from these cases to their own contexts and local conditions.

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About The Better Than Cash Alliance

The Better Than Cash Alliance is a global partnership of governments, companies, and international organizations that accelerates the transition from cash to digital payments in order to reduce poverty and drive inclusive growth. Based at the United Nations Capital Development Fund (UNCDF), the Alliance has over 50 members, works closely with other global organizations, and is an implementing partner for the G20 Global Partnership for Financial Inclusion.