FIGHT AGAINST THE SHADOW ECONOMY

Policy solutions for increasing government revenues with electronic payments

A number of countries have stepped up their fight against the shadow economy by taking effective policy measures to stimulate electronic payments. In partnership with governments, and as a technology company constantly investing in innovation, Mastercard is supportive of the following policy solutions:

1. Electronic payment of wages/government transfers, pensions and social benefits to a bank account or a prepaid card
2. Threshold of business-to-consumer (B2C) cash payments
3. Cash register (“fiscalisation”)
4. Point of sale (POS) terminals
5. Incentives for consumers
6. Incentives for merchants

THE SHADOW ECONOMY IN EUROPE

The shadow economy or “non-observed economy” – a term used by the European Commission[1] – is a complex phenomenon that includes both illegal (e.g. drugs selling, money laundering, etc.) and otherwise legitimate economic activities (e.g. when a legally established business does not report a part of its revenues to avoid taxation.) A recent Ernst & Young (EY) study with the support of Mastercard distinguishes between the committed and the passive shadow economy:

- Committed shadow economy: there are two sides of the transaction e.g. a construction worker and his client agree that the renovation of a flat will be conducted in the shadow economy, i.e. without invoicing, and they will share the benefits (unpaid taxes).
- Passive shadow economy: there is only one side that benefits directly from the transaction e.g. a consumer pays for the service (for example in a restaurant) in cash. The seller does not register the transaction and does not pay VAT and income tax for the service.

The shadow economy has significant adverse economic and social implications. It contributes to a lower observable tax base, leading to reduced VAT and corporate income tax (CIT) for governments.

- The use of cash is probably one of the most important causes of the (passive) shadow economy.
- Studies show that there is a clear link between increased use of electronic payments and reduction in shadow economy activities.

THE USE OF CASH AND THE SHADOW ECONOMY

The committed shadow economy is hard to fight as the two sides of the transaction benefit. The passive shadow economy, which is far larger, can be fought by tackling its main cause, i.e. cash. Cash is easy to use and easier to hide from authorities. Consequently, transactions that are performed with cash are more likely to be unregistered. The total amount of VAT lost across the EU is estimated at €168 billion. The cash-driven shadow economy is a large contributor to this.

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Hence, increasing use of electronic payments will decrease the size of the shadow economy and lead to increase in the general government revenues. Unlike cash, electronic transactions are traceable and make it easier for tax offices and law enforcement to compare reported transactions towards received electronic transactions. If electronic transactions are incentivised, it will lead to an increase in the number of consumers wanting to pay electronically and/or the number of merchants accepting electronic transactions.

According to EY figures, doubling the use of electronic payments could lead to a reduction in the shadow economy of up to 3.7% of GDP.

Public policies leading to an increase in the popularity of non-cash payments (especially card payments) are relatively easy to implement. Over the last years, a number of countries have stepped up their fight against the shadow economy by taking effective policy measures to stimulate electronic payments.

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1 *European Commission, “European System of Accounts. ESA 2010”, 2013.*
2 *European Commission, “Study to quantify and analyse the VAT Gap in the EU Member States”, 2015.*

MASTERCARD'S PROPOSED POLICY SOLUTIONS TO FIGHT THE SHADOW ECONOMY AND INCREASE GOVERNMENT REVENUES

Transparency and traceability of payments are essential to help combat the shadow economy, recover lost revenues and contribute to a fairer society. Governments have the authority to adopt smart policy measures that increase electronic payments. But, governments are not alone. Financial institutions, as well as payment networks, can contribute by continuing to innovate and enhance convenience of payment methods, making this commercially attractive for merchants and public administrations, identifying opportunities for using prepaid cards instead of cash, maintaining the highest safety standards, and offering its knowledge to policy makers.

There are a number of different incentives which are used to promote electronic payments. Depending on market conditions and other factors such as culture, different incentives will have varying effects on increasing tax revenue.

1. Requirement of electronic payment of wages/ government transfers, pensions and social benefits to a bank account or alternatively a prepaid card: This simple and effective measure will allow the persons receiving the funds to pay for goods and services electronically via a payment card or bank transfer – thereby reducing the amount of cash in the system and incentivise merchants to accept electronic payments. The introduction of the EU Directive on basic payment accounts will ensure all people will have access to a payment accounts with basic features, such as a payment card, making sure people will not be financially excluded.

2. Threshold of business-to-consumer (B2C) cash payments: Many countries, for example Bulgaria, Greece and Italy, have put in place a threshold above which cash payments are not allowed or must be flagged to authorities. However, the threshold is often set at a relatively high level, which has a limited impact on reducing cash payments as they normally occur in lower value transactions. The correct level would be different between countries and depend on a number of factors, such as payment card usage, financial inclusion and payment infrastructure development.

3. Cash register ("fiscalisation"): A cash register records each individual transaction regardless of the means of payment. Placing cash registers should directly reduce the passive shadow economy.

4. Point of sale (POS) terminals: A POS terminal is a machine which enables card and/or other forms of electronic payments. Since the development of an acceptance network is an important determinant of the popularity of electronic payments, regulation should stimulate growth in the value of card payments, which in turn should reduce the size of the passive shadow economy.

5. Incentives for consumers: A tax relief/subsidy on electronic payments for consumers would make cash comparably more costly for the consumer and thus incentivise towards electronic payments. There are several ways of implementing such a programme, for instance through an immediate VAT discount or deferred income tax refund. The idea of receipt-based VAT lotteries, where consumers can win prizes with VAT receipt, would incentivise consumers to ask for receipts.

6. Incentives for merchants: If merchants receive an incentive (e.g. tax deduction, ad valorem, etc.), their costs related to the acceptance of card payments will decrease.

Mastercard is a committed partner to governments and law enforcement agencies in the fight against the shadow economy. As a technology company, constantly investing in innovation, we continually look for new and simple ways for consumers and businesses to connect – while maintaining the highest possible safety standards. We do not issue cards. We operate the world's fastest payments network to facilitate the processing of payment transactions. With our knowledge and experience, we are well placed to work together with government to move to a cashless society that will benefit economic growth. This is an achievable task.

ADDITIONAL INFORMATION

If you would like additional information on Mastercard's position or technical input, please contact:

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