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Policy Brief

The Way Towards Achieving Interoperability and Digitizing of Payments by Government-to-People (G2P) and People-to-Government (P2G) in Ethiopia

Why is Interoperability and Digitizing G2P and P2G Payments Key to Nurturing an Inclusive Financial Sector?

Ethiopia lags behind neighboring countries in financial inclusion where account ownership in 2017 stood at less than 35% compared to a whopping 82% in Kenya and 50% in Rwanda. Among the adult population, only 26% save at formal financial institutions and only 11% borrowed from financial institutions.

The 2017 Findex data on Ethiopia stated that, 85% of surveyed unbanked adults reported that insufficient funds was their reason for not opening an account. The report further stated that there is a perception that financial services are not meant for the poor. Distance to a financial institutions, and lack of documentation were cited as the second and third barriers for financial inclusion by 20% and 11% of the respondents, respectively.

The concentration of commercial bank branches in the capital city and other major urban areas is also the major reason to so many of the population living outside of those areas excluded. Inability to get costs down while trying to reach excluded communities (mainly people living in rural and low-income areas) is cited as the main reason behind this gap. Therefore, the need for additional measures of access points, use cases and customized products to suit their needs is evident to increase financial inclusion.

Achieving interoperability is one key measure that will increase financial inclusion as it will create convenience, multiple use cases and more commission for financial institutions and agents. This will make financial services easily accessible and affordable to these communities while giving institutions an appealing business case that will yield productivity, profitability and scale.

Similarly, policies that will enable national level payments for G2P/P2G will usher in a new wave of citizens who can reap the benefits of participating in the formal financial sector.

A Closer Look: The Current Policy Landscape

Interoperability of Payment Systems

In Ethiopia, the policy base for the interoperability of systems emerges from the National Payment Systems proclamation (proclamation no. 718/ 2011). This proclamation led to the formation of the Ethiopian Automated Transfer System (EATS), a digital clearing and settlement platform which includes a real-time gross settlement (RTGS) and an Automated Clearing House (ACH). The RTGS is used for high value low volume transactions between payment platforms and the ACH is designed to be used for high volume low value transactions, including retail payments.

Even though the proclamation for the national payments system was in effect since 2011, innovation and growth of the digital payment space compared to other countries in East Africa has remained dull.

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Some of the challenges that have hampered the success of interoperability of payment systems are (1) the lack of suitable directives, (2) overlapping roles of institutions, (3) implementation obstacles, (4) limited skilled manpower and (5) lack of technological advancements.

However, in recent years, several changes have been made on the regulatory framework of the digital payment ecosystem. In 2020, the national bank released three regulations that replaced the 2012 Mobile and Agent banking directives. These are classified as the; Payments Instrument Issuers Directive, Payment System Operators Directive, and Use of Agents Directive. The directives allow non-financial institutions to be licensed and operate digital payment solutions in the country.

The main change in policy regarding interoperability is on the licensing and authorization of payment system operators. The new policy defines and clarifies the roles of operators in the payment ecosystem. The directive gives recognition to platforms that act as Switch, Automated Teller Machine, Point of Sale and Gateway operator. Hence, it is paving a promising pathway for the critical enabling policy environment for the sector.

Despite the improvement in the regulatory space, there is still yet to be a non-financial institution to be licensed as a payment system operator.

Policy Environment for the Digitization of G2P and P2G Payments

In Ethiopia, most of the population still relies on cash to pay utility bills and receive payments. In 2017, almost all (99%) adults pay utility bills with cash, compared to 12% of people in Kenya and 59% in the region as a whole. These P2G payments include payment from the public to government institutions such as fines, service charges, taxes, etc.

This means that there is a lot of work to be done to transition the country to the digital era and is one opportunity for the government to take a lead on. A promising way for the transformation is through G2P payment options. Government transfers to the public like any kinds of social benefits such as subsidies, unemployment benefits, or payments for educational or medical expenses are ways that can capture majority of the population and also support to financial inclusion.

Globally, 23% of adults reported receiving at least one payment from the government in the past year in the form of public sector wages, a public sector pension, or government transfers in 2017. Even though this type of payment digitization is extremely low in Ethiopia, there have been some examples of projects that partially and fully digitized payments that flow from the government to multiple individuals. A good example is the Productive Safety Net Program (PSNP), which uses digital means to pay millions of beneficiaries in low income and rural parts of Ethiopia.

Regarding the P2G transactions, a good example that has proven success of payment digitization in Ethiopia is the digital utility payment service that is available using CBE - Birr to pay for water and electric bills. The major policy documents that have affected P2G digitization are the: Digital Payments Proclamation and Directives, Ethiopian Government Procurement Policy and E-Tax policy documents. Although there are more work to be done, the current policy environment has made it more accessible and realistic over the past few years so that digital banking services are able to play a critical role in expanding coverage and aid financial inclusion.

Key Findings: Challenges and Opportunities

Investment and Innovation: Previous attempts to create full interoperability among Ethiopian Financial institutions have resulted in a limited success due to the required large investment and innovation needed to reach scale. There has been efforts by banks individually, bilaterally and multilaterally to create payment switches, which amounted to the creation of Eight Switches. However, none of them could meet the demands of customers as they couldn't achieve interoperability beyond debit cards to include Account to Account and online payments.

Mobile Network Operators (MNOs) role and responsibility: MNOs around the world play an important role in the scaling of digital payment services to the poor and underserved communities in remote areas. Since MNOs are crucial to the Digital Financial Service (DFS) ecosystem, they cannot be allowed to play favorites or discourage one service on their network. In Ethiopia, two new MNOs are expected to start operations soon and Ethio Telecom is soon to launched a mobile money service. Therefore, all payment schemes and services should be equally accessible through the internet, SMS and USSD of all MNOs.

Use cases and bias: To encourage people to put their money in accounts and wallets, they must be able to earn and pay expenses digitally to and from their preferred payment schemes. If this is not enabled, people will prefer holding onto cash instead of saving at financial institutions. One of the main reasons for not owning a digital account in Ethiopia is lack of or limited use cases so this can significantly increase financial inclusion if taken as a priority.

Unique ID: One of the other challenges to financial inclusion in the developing world is the lack of verifiable unique identification for all parts of the population. Without fulfilling the minimum know your customer (KYC) requirements of financial institutions, the chance of using financial services is low. According to Findex 2017, lack of documentation was cited by 11% of unbanked adults surveyed in Ethiopia, as the reason for not using FIs. So, again a close attention to crafting policies to make this a reality will contribute massively to addressing this challenge.

On the bright side, the changing of policy in the digital payments ecosystem in the last few years has warranted a massive opportunity to increase interoperability of platforms. In addition, the government's push for e-governance and the current response to Covid-19 has also introduced further opportunities for the scaling of G2P and P2G payments in Ethiopia.

The Way Forward: A Promising Policy Framework

A Policy Framework to Achieve Interoperability

Foreign investment and operators: Due to large investment and innovation needed to reach scale in interoperability and agent network, relying on local resources alone will not be enough. Engaging foreign investment and operators can accelerate the process of achieving interoperability and provide the country with the necessary knowledge-transfer, state-of-the-art technology and support on implementation. This was evident in Tanzania's foreign-led MNO platform where significant increase in interoperable payments was witnessed after foreign mobile money operators were allowed to engage in the interoperability initiative.

Thus, Ethiopia should allow limited or full investment and foreign operators of Payment System Operator and agent network Business to leverage their experience, investment and innovation.

Regulating MNOs: Policies regulating telecom operators should be drafted to provide equal ground for payment service players and mitigate bias that may be created by ownership of payment services by MNOs. This was seen in India, where United Payment Interface (UPI) can use the phone number of individuals from any telecom operator to complete transactions.

A policy framework that can govern multiple MNOs with interest in payment services to operate fairly should be introduced in Ethiopia. With policy guidelines, MNOs cannot give advantage to their own services at the cost of others. India required all MNOs to be integrated to the UPI, which allows transactions from any mobile network towards any payment scheme without any barrier. This should also be considered in Ethiopia as a way to ensure seamless operations and ultimately expand access.

A Policy Framework to Support the Digitization of G2P and P2G Payments

Government offices accepting and making payments digitally from and to any payment scheme: Enabling digital payments will promote and expand e-government initiatives. All government service providers should accept digital payments as proof of payment and provide multiple digital payment options to the public. This has been learned from the best practice and success from India's UPI and BHiM interfaces and the Rwanda IREMBO project.

Ethiopia should introduce a policy framework that can replicate the IremboGov success as the government plans for digitization of services, payment options should be available for customers to interact with. By law, government offices must provide all channels for clients to pay and receive payment which forces citizens to enroll in banking services and transition into using the formal financial sector.

Policy framework supporting the implementation of a Digital Unique ID: To create equal access to accounts for the poor and underserved, the enforcement of a unique digital ID system is needed so it can be used to fulfill KYC and ease G2P payment digitization. India's UPI has also leveraged the unique digital ID system called Aadhaar to support the digitization of payment processes.

A policy framework that supports the creation and implementation of a unique ID system is essential to make sure governments and other services reach underserved communities.

Policy Implications

The efforts to bring interoperability and large scale digital G2P and P2G payments has not produced desired results thus far. Despite the introduction of favorable policies in 2020, there has not yet been any new local entities given licenses as payment system operators. Implementing the policy recommendations will flourish interoperability and scale the digitization of G2P and P2G payments.

However, it should be noted that the participation of foreign companies or investment could negatively impact Ethiopian owned businesses that are in the mentioned services or those planning to join the market. There is also a wrong assertion that allowing foreign participation in the Payment System Operator business is opening the financial sector to foreigners. This recommendation only proposes the participation of foreign companies in facilitating the exchange of funds from one regulated payment instrument issuer to another.

Ultimately, the wide usage of digital payments may lead to higher cases of payment fraud and money laundering. This should be expected and considered by policy makers for further investigation throughout the process in order to protect consumers.

Note:

This document is an extraction and summary of key findings from a formal study conducted by Precise Consult International. Both primary and secondary data were used. While the former were collected via key informant interviews and focus group discussions, the latter were collected from different organizations as well as from internet resources. In addition, the study employed descriptive data analysis techniques and benchmarking of best-practice lessons for Ethiopia.

All data that were used in this brief are referred in detail in the full research document which can be found by visiting www.preciseethiopia.com or by email request to info@preciseethiopia.com.

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