The Big Picture – Cashless Economy

Presenting the Union Budget for 2019-20, the Finance Minister said that **2% tax deducted at source (TDS)** will be levied on **cash withdrawals exceeding Rs 1 crore in a year** from a bank account to discourage the practice of making business payments in cash.

Also, the government has said that businesses with an **annual turnover of over Rs 50 crore** can offer low-cost digital modes of payments and **no charges on** Merchant Discount Rate (MDR) will be imposed on them or their customers.

The **Reserve Bank of India and banks will absorb these costs** from the savings that will accrue to them on account of handling less cash as people move to these digital modes of payment.

Analysis of the Proposals Made in the Budget

- The TDS proposal is kind of a **preventive measure** i.e. it will not encourage one to withdraw money from the bank account for cash payment more than a crore in the year. There is no penal tax and its imposition implies that **one's transactions are under the scanner of the government**.
  - In the year 2005, the government introduced more or less same proposal i.e. **Banking Cash Transaction Tax (BCTT)**. The BCTT of 0.1% was introduced for withdrawal of cash on a single day of over Rs 25,000. The 2006 budget showed that only 350 crores had been collected by the banks for paying government on that account. The amount was not considered enough to continue with the implementation of the program.
- The second proposal of eliminating MDR can be a bit controversial.
  - This proposal will **incentivise merchants** to offer the option of digital payments including UPI, credit/debit cards, RTGS, NEFT to their customers.
  - It is based on the **number of transactions** rather than the value of transactions as in the case of TDS proposal.
  - A penalty of Rs. 5,000 a if the merchants do not offer digital modes of payments to their customers by a particular date makes it **binding to the merchants**.
- The boost to digitisation should not result in losses to anyone, expecting the banks and companies having a turnover of over Rs 50 crore to bear the cost of digitization is not fair. It is quite possible that such companies may witness a negative impact on their transactions.
- There is a **need to create incentives and disincentives structure** by which people automatically get encouraged to move towards more digital transactions.

Cashless Economy

- It is not that any economy can ever be completely cashless, cash will continue to play its role. Even in the developed countries, the prevalence of cash is not completely being eliminated.
- If one reduces the use of cash, **the compliance level** in various things gets better. For example, better recognition of economic activities, **more efficient collection of tax** etc.
- The GDP can get positively impacted by 0.5-0.6% due to digitization.
- However, using cash in small amounts has its own set of benefits. It offers security and protects the privacy of an individual. Also, it does not have an associated cyberthreat as in the case of digital transactions.

- Transition to cashless economy also has the burden of financial exclusion due to lack of digital literacy, especially in the case of **poor and elderly**.

The Government’s Initiatives for Digitizing the Economy

- The first move taken was the **demonetisation** in November 2016. At the time of demonetisation, India’s cash to GDP ratio was around 12%. After demonetisation, that ratio came down to around 9% of the GDP. But after that, it grew at a lower pace but steadily. The latest 2019 end figure shows that the ratio presently is around 11% of the GDP.
    - The proponents of the demonetisation argue that if it had not happened, further quick measures to encourage digital transactions like increase in the number of point of sale machines, **introduction of mobile wallets** like Paytm and PhonePe had not happened.
    - There were 18 trillion rupees approximately in circulation before the demonetisation, at the end of that fiscal it was around 13.5 million and presently, 20-21.5 trillion, less by 4.5 around trillion.
    - In the year 2013, the value of digital transactions was around 0.7 trillion, it is now 5 times i.e. 3.5 trillion. This can be the result of the 4.5 trillion rupees being less in circulation now.
    - Some see the **growth of digital transactions during demonetisation as a bit of compulsion** as there was not enough cash in the economy.
- **The** National Payments Corporation of India (NPCI) **created the Unified Payments Interface (UPI)** which is a payment platform in which funds can be transferred between the banks effortlessly. It created the **digital infrastructure for private players** to come and offer apps for payment services to the citizens. **PhonePe, Paytms, mobiquicks** are examples. The private players also helped in popularising the digitisation in the economy.
- The government and the private sector have also started using **Big Data techniques** for improving the financial services provided by them. Credit offerings are now being based on the transaction history of the consumers.

Way Forward

- The number of smartphones in the country is going to increase manyfold, now it is around 30%. As the percentage increases, the number of people using digital payments would also multiply.
    - Presently, 10% of the internet users in the world are in India and per month use of data in India is 9GB, that means that people are moving towards digitization.
    - Also, India needs to have a **consistent broadband network and power connection in order to include the rural consumers**. The government has already launched **Bharatnet** in this direction and background infrastructure for rural area is expanding slowly.
- According to the Nandan Nilekani panel, India can triple the transactions in the couple of years. To achieve that, it has given 73 **recommendations**, the government can consider the same. The recommendations include:
    - All the government transactions should be done using digital payments.
    - The government should facilitate payment of tolls, purchase of railway tickets, subsidy payments to farmers through a digital medium.
    - The government should create **cash-in cash-out machines (CICO)** instead of ATMS which are now becoming very bulky and difficult to build and maintain. CICO machines can operate with a sim card whereas ATMs require a broadband connection.
- India’s transition to a cashless economy needs more focus on behavioral change (as observed during demonetization). The government is moving in the right direction as supply of digital infrastructure will eventually create demand for digitalization. This can have a multiplier effect on the economy.
- Sweden and China are leading in digitization. In China, a reasonable amount of money is transacted through ‘Wechat’. Whatsapp is trying the same in India but is suffering due to data localisation **issues**. Such issues needs to be resolved soon.

The switch to digital economy should not be based on compulsions and should be left on the market forces. Incentivizing is better than imposing financial burden on either companies or banks. Also, the policy framing in this regard should be more inclined towards the consumer and less on the digital companies.

India’s demographic dividend offers hope to this transition. Private sector participation and rural inclusion should remain the focus areas while moving forward towards ‘Digital India’.