

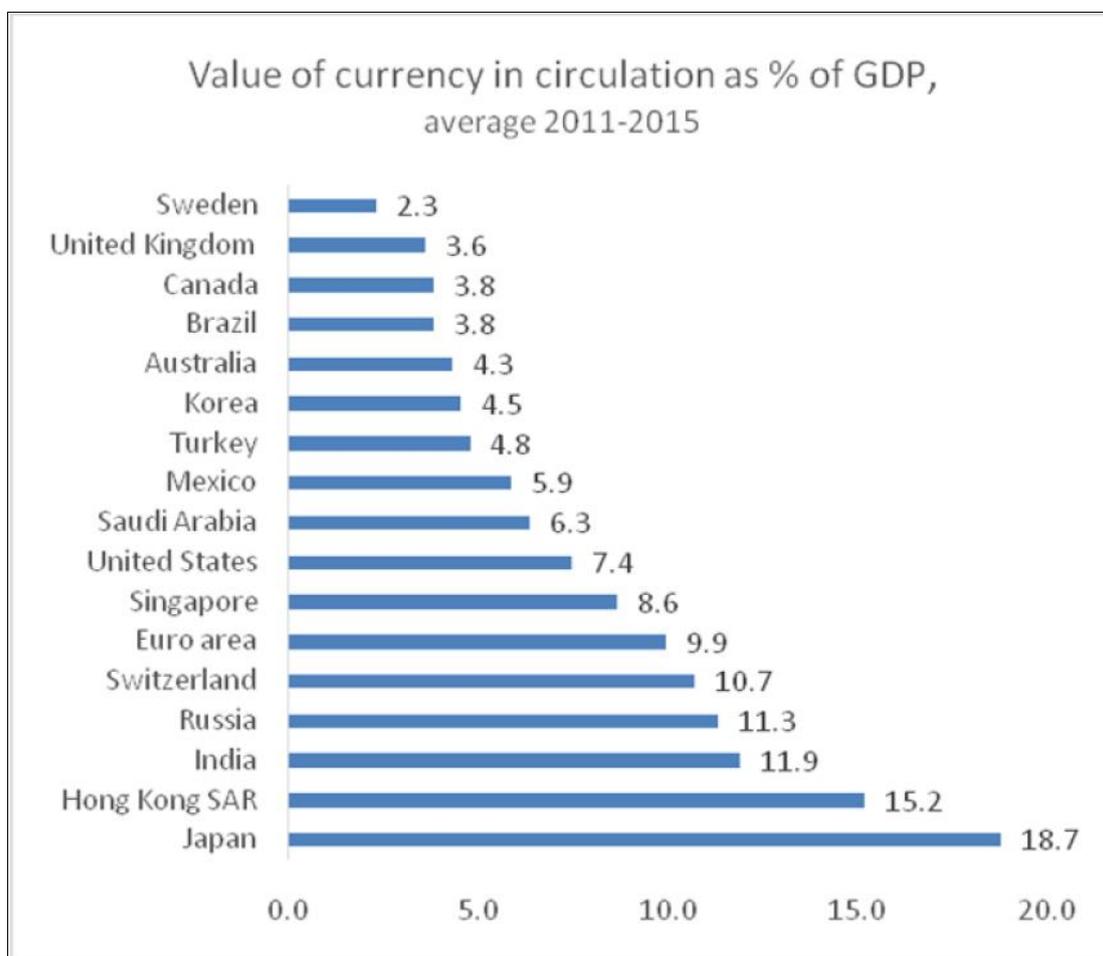
The Growth of Digital Payments*

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For the government and its supporters, pushing towards cashless or less-cash transactions seems to have become the silver bullet to deliver solutions to all sorts of problems, from fighting corruption, to ending poverty, to modernising society, even to ensuring sustainable development. There is a basic confusion in this perception, which mixes up the effects of strategies to increase production and provide quality employment, with the effects of a change in the manner in which transactions are conducted and settled.

To begin with, it is wrong to presume that currency use declines as countries grow richer or reach more advanced stages of development. As Chart 1 shows, there is really no relation between per capita income and the value of currency in circulation, or between levels of corruption and cash in circulation.

Chart 1: There's no relation between development and cash use



Source: Bank for International Settlements Statistics, www.bis.org

It is true that countries like Sweden, which makes extensive use of digital payments, have lower proportions of cash in circulation relative to money GDP. But rich

economies like Hong Kong SAR and Japan have very high ratios, much higher than that of India. In fact, India's average ratio over the previous five years, at 11.9 per cent of GDP, is not much higher than countries in the Eurozone or Switzerland. Meanwhile developing countries like Brazil and Turkey, known for high levels of corruption, have much lower ratios.

The conflation of currency with corruption and lack of development is therefore wrong. It stems from a lack of recognition that corruption and tax evasion can easily occur through transfer of other assets, and using electronic means.

Despite this, the Modi regime has pushed through with its cashless drive, through a combination of coercion and incentives. It is a strange obsession when the essential infrastructure and banking access that is required is still not in place in the country. It is well known that around one third of the adult population still does not have access to banks, with women disproportionately excluded; bank branches are not in easy physical reach of nearly half the rural population; around 30 per cent of people still lack the identification that renders banking access feasible; and those identification systems, especially Aadhaar, are themselves highly problematic and prone to significant error.

In addition, the obvious constraints are barely mentioned, such as the lack of continuous supply of electricity; inadequacy of available bandwidth and connectivity for smooth e-transactions; shortage of point of sale machines and associated telecom infrastructure for secure payments; the fact that only a small minority of the population have smart phones (around 17 per cent) or use the internet regularly (27 per cent).

Some of these constraints are sought to be dealt with by new mobile apps like BHIM, just launched by the Prime Minister. But these try to bypass these problems by essentially putting consumers at greater risk of fraud and misuse. Already India has one of the weakest cyber security systems in the world. In October 2016 there was a major hack of credit and debit cards that affected around 3.2 million cards of 17 major banks in the country, that led to freezing of these card accounts. Now that new systems like BHIM are being introduced that lack even the basic security feature of two-factor identification that is seen as essential in most countries, the potential for fraud and abuse is growing exponentially, and will disproportionately affect India's poor.

In this context, consider what the cash shortage has already achieved in terms of pushing people into digital payments. Chart 2 shows that e-banking transactions online fell slightly in volume terms in November but increased again in December, but the value of these transactions declined. This probably reflects the overall compression of demand in the economy in the wake of demonetisation, a feature that will continue into the coming months.

What is interesting about mobile banking (Chart 3) is that there was a sharp increase in values in November 2016 compared to the previous month and this moderated in December – but volumes of transactions actually declined. This could reflect a shift to prepaid instruments (like PayTM and others that have benefited hugely from the demonetisation and the implicit endorsement of the Prime Minister himself).

Indeed, Chart 4 shows that there were huge increases in pre-paid instruments even over the course of these two months. E-wallet companies are reported to be increasing their subscribers at the rate of 1 million per day.

Chart 2: E-banking volumes have gone up

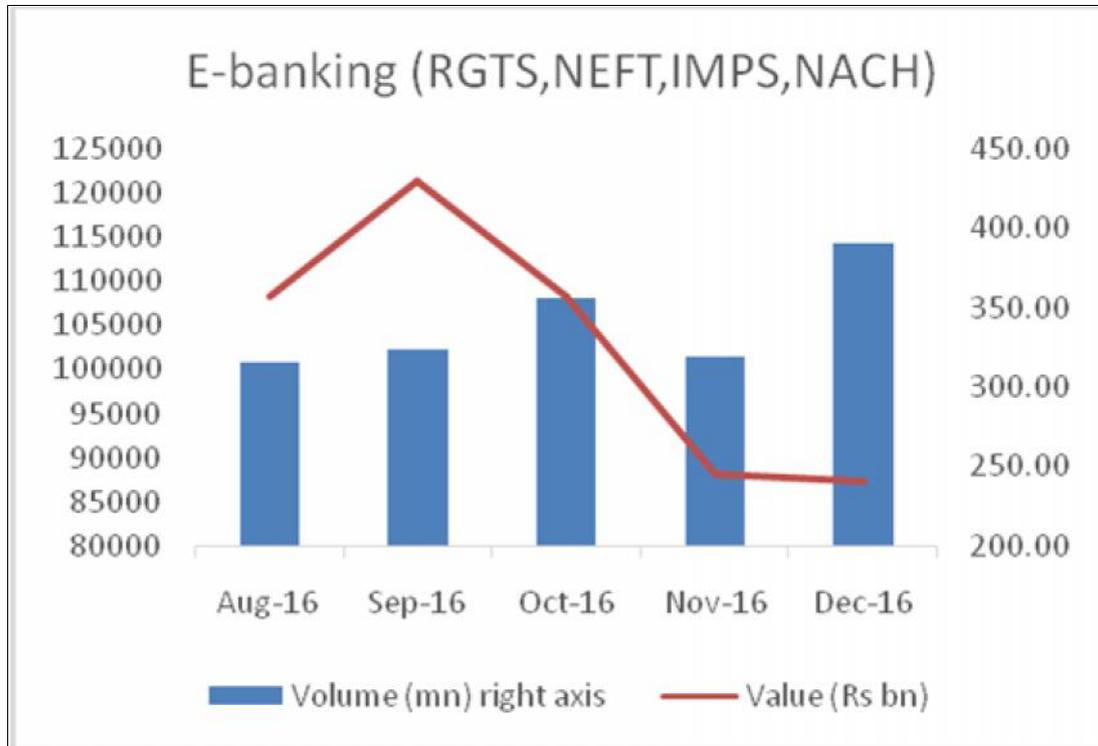


Chart 3: But mobile banking volumes fell

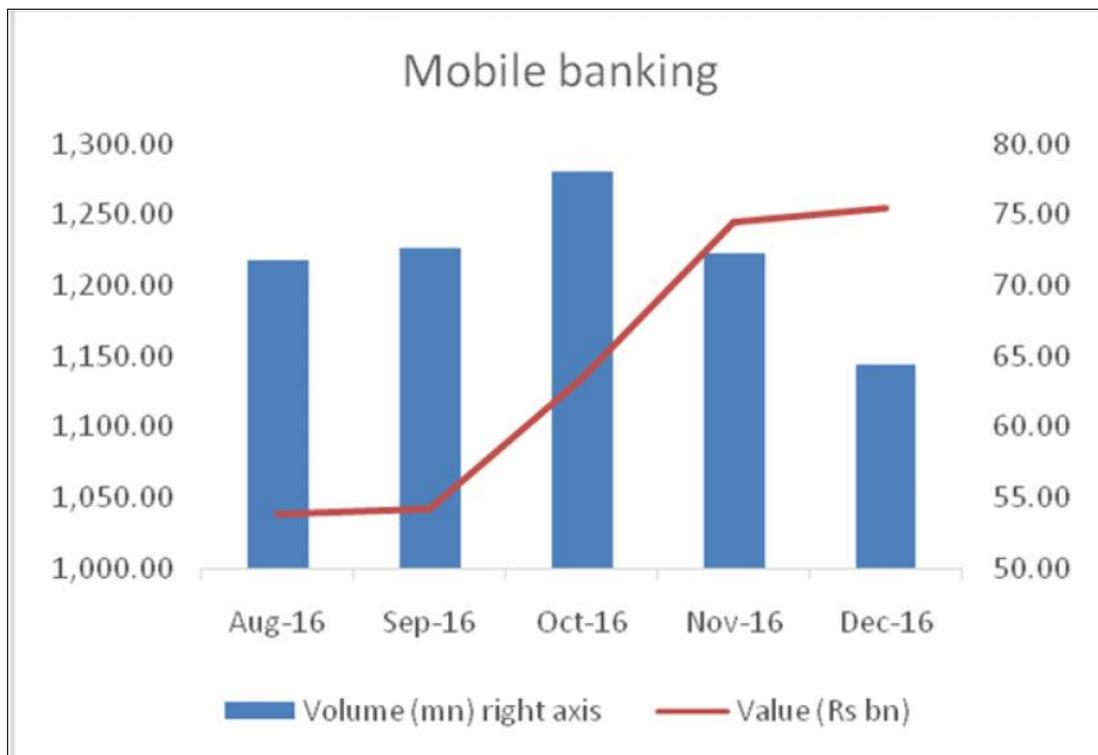
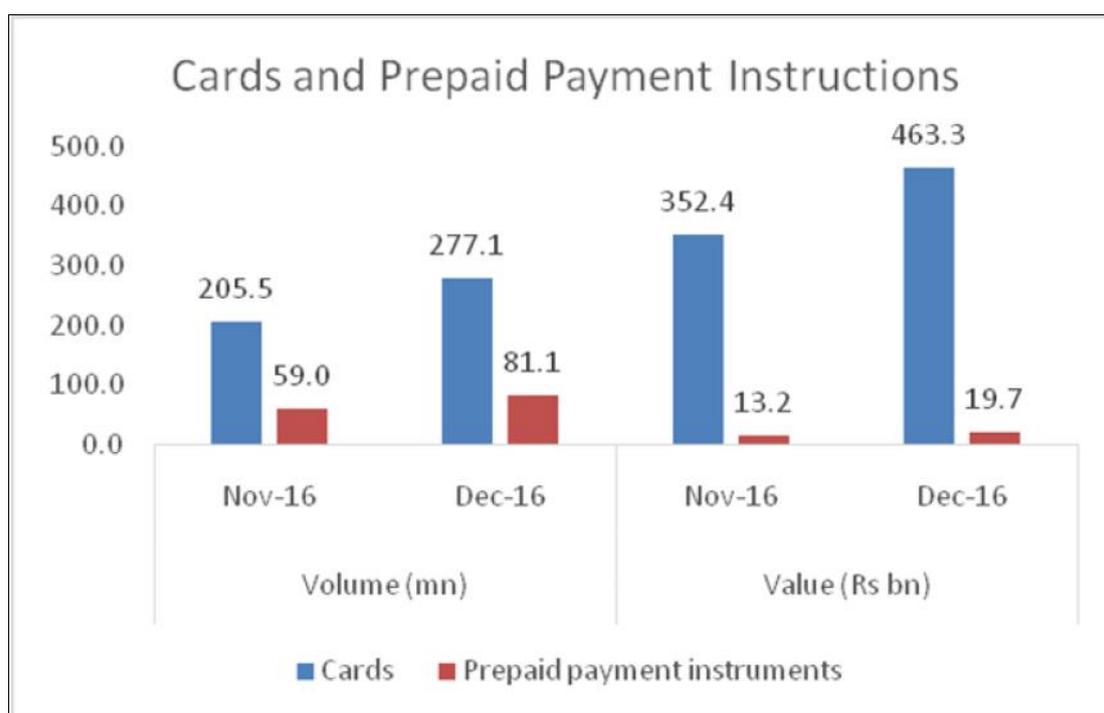


Chart 4: And cards and prepaid instruments surged



The costs of digital payment ultimately are borne by consumers, even when they are apparently charged to producers or vendors. Charges can range from 0.1 per cent to as much as 4 per cent of the value of the transaction. Since the poor typically make many small purchases, and cannot afford to buy or store purchases made in bulk, they would suffer more from this and end up paying a non-negligible amount for the transaction alone. This is a significant transfer of income from India's poor to add to profits of fintech companies.

And what is worse is that they are still open to exploitation by the corrupt. A recent case from Kukarkheda panchayat in Bhim block of Rajsamand district in Rajasthan shows that digital methods are just as susceptible to corrupt practices. A ration dealer temporarily seeded his own Aadhaar into ration cards of 80 families to illegally withdraw their rations, and then de-seeded the number. This was only discovered much later when it was found that many transactions had occurred in the middle of the night.

If this can happen in this supposedly "fool proof" system, consider the vastly greater possibilities for misuse when important personal details are automatically revealed to private players through the most basic everyday transactions.

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