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CASH TO CASHLESS PEOPLE

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INTRODUCTION

Worldwide there is tremendous interest among policy makers, academicians and commercial enterprises to explore the possibility of moving towards a cashless economy. However, cash still continues to remain the predominant form of transaction. In Europe, it accounted for 78% of Euro 388 billion retail payments in 2008, or nearly Euro 301 billion transactions. In 2008, the total cost of distributing, managing, handling, processing and recycling of cash and that of accepting cash payments was Euro 84 billion or, 0.60% of Europe's GDP. Although it is expected that there will be a significant increase in the use of cashless payments and a general decline in the number of cash payments in Europe by 2014, cash will still remain the continent's main retail payment mode. These European figures are significant. Between 2000 and 2008, such payments grew by160% or at a compounded annual growth rate (CAGR) of 6.2%. In comparison, for the same period, retail cashless payments in the USA increased at a CAGR of 4.5% to USD102 billion. However, the extent to which economies have moved towards cashless depends crucially on the need for it.

DIRECT BENEFITS

High maintenance costs: The cost of maintaining currency in India is enormous. According to the Reserve Bank of India, the provisional estimates of the amount of currency in circulation (as of June 2010) stands at INR 8,64,333 Crores out of which only 5% of the currency is with the bank, implying that almost the entire volume of currency is transacted every day. Over the period April 2006-June 2010, currency has shown a yearly growth rate of 17%. It is estimated that, for 2009-10, RBI incurred an annual cost of INR 2,800 Crores to just print the currency notes. This is 0.4% of the total currency in circulation. This cost does not include the cost of storage, transportation, security, detection of counterfeits etc. To the printing cost, if we were to add the cost of storage and maintaining these currencies through ATMs alone, the cost of printing and distributing cash constitutes about 0.2% of India's GDP. Given the growth rate in the volume of currency, the cost of printing and disbursing will soon become enormous. In the face of this, a moderate growth of cashless transactions by 5% a year will save more than Rs 500 Crores annually. Therefore, there is a direct benefit (in terms of cost savings) of moving towards cashless transactions in India. However, it is the indirect benefits that are perhaps much more important for India, especially given its objective of inclusive growth.

INDIRECT BENEFITS

There are three distinct yet important indirect benefits from promoting cashless transactions in India. These are:

(a) It will promote financial inclusion;

(b) It will keep records of financial transactions; and

(c) It will lower transaction costs involving any two parties engaged in a financial transaction.

While the last observation is in general true for any economy, the first two are particularly relevant for India.

Gangopadhyay (2009), shows that more than half the Indian population is not financially included. Overall 525 of the households have a bank account, thee relevant percentages are 67% in urban areas and 40% in rural areas. There are about 6.3 bank branches for every 100,000 people in India, less than 3 branches per 100 square kilometres. For rural India, the numbers are 3.5 branches per 100,000 people and less than 1 branch per 100 square kilometres. In particular, 45 per cent of the rural, 28 per cent of the urban and 38 per cent of all households in India, admit that access and availability are the main factors determining their choice of a particular bank. While it is necessary for financial inclusion that every household should have access to bank, mere physical access to a bank is, of course, not sufficient. This is particularly important given that more than 90% of the workforce in India is in the unorganised sector, and physically accessing banks would mean huge opportunity costs for them (measured in terms of daily earnings). A cashless payment system will reduce this cost tremendously. An enabling system that promotes cashless transactions would, therefore, be the natural extension of the existing policies directed towards financial inclusion.

According to Reserve Bank of India (provisional estimates), the amount of currency in circulation (as of April 2011) stands at INR 9,70,309 Crores out of which only 5% of the currency is with the bank, implying that almost the entire volume of currency is transacted every day (see table 2.1). This is a growth of 50% in little over two years! Naturally, this implies a huge cost of printing and maintaining paper currency. How well is the banking infrastructure equipped to go cashless? What are the instruments that have potential for highest growth among all electronic payment systems? What are the cities that need targeting on a priority basis? These are some of the questions we answer in this section.

The banking sector in India has 171 banks (as reported by RBI in 2009). Out of these 166 are scheduled commercial banks while 5 are non-scheduled commercial banks.

Where does the banking system stand as far as cashless transactions go? In tables 2.2 -2.4 we present the total volume of electronic payment systems (EPS). The instruments considered under EPS are ECS (electronic clearing systems), NEFT (electronic fund transfer systems) and credit and debit cards. Note that credit and debit cards still make up the bulk with 55% of total EPS transactions. The amount (in Rupees) of EPS has increased 25 times in the eight years (2003-04 to 2010-11). This is a fantastic growth. However it is not uniform across all the instruments. While ECS (debit) has grown more than 30 times and NEFT by more than 50 times, Credit Card and Debit Card growths have been modest and are only around 5 times. From a collective share of 43% of total EPS in 2003-04, the collective share now stands at less than 10% for credit and debit cards put together. In table 2.4, we present the average amount per transaction. The current average amount per electronic transaction is Rs 14,403. NEFT (an interbank transfer instrument) has the highest average amount per transaction and is close to Rs 71,000. The average amount per transaction for credit and debit cards stands at Rs 2848 and Rs 1632 respectively. Clearly the above numbers suggest that households are not averse to EPS if it involves interbank transactions but are reasonably averse to using debit and credit cards. The possible factors that explain such low usage of these cards are—higher transaction costs, lower transaction amounts, and transaction security. These are the factors that were brought to light in our household survey. The growth figures for credit and debit cards are particularly worrisome. The growth rates have been extremely modest whether we consider the number of transactions or the amount of transactions. What is of particular interest is the fact that amount per transaction has also grown extremely slowly for credit and debit cards. Therefore, if the current trend continues, a mere push for increasing the number of cards will not guarantee a substantial growth in either, (a) number of transactions (b) amount of transactions.

REFERENCES

1. See EPC (European Payments Council) newsletter
2. Iceland is ranked #1 in terms of proportion of cashless transaction to total transactions in retail sectors. Less than one sixth of retail transactions are in cash.
3. 1 crore=100,00,000=10 million

4. Ashish Das, and Rakhi Agarwal (2010), "Cashless Payment System in India- A Roadmap", Technical report, IIT Bombay,
5. Gangopadhyay, Shubhashis (2009), "How can Technology Facilitate Financial Inclusion in India? A Discussion Paper", Review of Market Integration, 1(2): 223-256.
6. For an overall policy framework to enable financial inclusion, see reports by BCG and TCS.
7. These calculations are done without considering RTGS (Real Time Gross Settlement) which by itself comprises the highest volume in terms of Rupees. This is because, RTGS are applicable for transactions exceeding a minimum value. Therefore, very few households make transactions through RTGS. Amount transacted through RTGS is usually 30 times that of NEFT.