

Can plastic money replace cash?

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On the cards How to make them count A Roy Chowdhury

Given the level of indirect taxes, there's an incentive to evade them. The proposed tax breaks for using e-money may not help

The objective of the proposed policy on facilitation of electronic transactions is to replace cash transactions with e-transactions. These have several advantages, including macroeconomic effects and benefits to merchants and consumers.

Macroeconomic benefits include financial deepening, reduction of unaccounted income, increases in tax base, and reduction in currency with the public. Both merchants and consumers benefit from avoiding risks associated with handling cash, while the former gain from more purchases thanks to credit cards.

However, there are several issues that could block the success of this initiative and therefore need to be addressed upfront. Such issues include tax burden, compulsion of unpleasant disclosures, transaction costs, security, and potential debt burden.

The share of indirect taxes in the total tax revenue of the country is more than 66 per cent, mainly because of high rates and a large tax base where almost every product is taxed.

Indirect taxes do not differentiate between rich and poor. While direct tax can be designed on the basis of income structure, it is extremely difficult to implement the same strategy in the case of indirect taxes.

Therefore, there is always an incentive for consumers belonging to the stressed income groups to negotiate with merchants for a middle ground that allows them to avoid indirect taxes and obtain cash discounts. Given the large consumer base, merchants can negotiate effectively.

The trade-off

The impact of these taxes is much higher than the tax break proposed in the draft proposal. The success of implementing a cashless economy would depend on whether the benefits to merchants and consumers exceed the loss associated with disclosures on the true volume of transactions. Any move to forcefully expose consumers to e-transactions without taking care of the tax burden is likely to increase the cost of living, which may push economically stressed consumers further into poverty.

Thus, effective use of e-transaction by consumers is best brought about by a substantial shift in the tax structure of the economy. The burden of value added tax (VAT) or the proposed goods and services tax (GST) should be so low that there is minimum incentive for consumers to avoid it.

Globally, GST rates are in the range of about 10 per cent, against 27 per cent proposed in India. This is too high. Moreover, the tax structure itself needs to be changed such that direct taxes take the lead in revenue collection while GST is moderated below the global average.

While a reduction in indirect taxes would motivate consumers to use e-transactions, merchants who wish to avoid direct taxes may feel differently. At times these merchants also have to part with large sums as extortion or speed money to the officials concerned. Therefore, a corruption-free governance is another important requirement.

It is expected that e-transactions would be preferred by consumers than merchants, particularly if tax rates are reduced.

However, willing consumers can take advantage of e-transaction only if there is a law that compels all merchants to maintain the facility for e-payments. Therefore, a law to this effect will need to be promulgated so that plastic money

can be popularised to the extent required.

Avoiding pitfalls

There are many operational costs associated with ownership of payment terminals such as installation fee, cost of printing paper for transaction receipts and cancellation, rental fee, costs of broadband, transaction fee, and costs of opening and operating a business bank account. In addition, due to compatibility problems between payment terminals and transaction service providers, a merchant might be required to keep several types of payment terminals.

The impact of such costs is associated with scale of business. This would be negligible cost for large companies, but for small ones, it may be worthwhile to subsidise such equipment.

Transactions with plastic money have yet not proved to be completely free from fraud and forgery. With the expected large-scale application of e-transaction, security measures with respect to data protection, early detection, and punishment need to be put in place in order to address apprehensions of potential losses.

The effective use of plastic money requires a huge amount of restraint and planning on the part of the user, and this comes with experience. Many families have suffered due to the rampant use of credit cards.

The interest rates on outstanding credits are among the highest, even more than the informal cash market. Many card users abandon the use of cards due to these costs. Therefore, the risk of indebtedness has to be reduced to encourage participation in electronic transactions .

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