Potholes on the digital payment superhighway

GS III: Indian Economy and issues relating to Planning, Mobilization of Resources, Growth, Development and Employment.

Context: Digital payments have found strong ground, especially in India, increasingly relegating all other modes of payments to the background. Because of the versatility and ease of settling financial transactions, the growth of digital payments is going to be phenomenal, supported by banks and Fin-Tech, or financial technology, companies. However there are some issues, the article talks about the lack of level playing field between Rupay and other card payment service providers like Visa and Mastercard. Also, there are threats to the not-profit character of NPCI.

Payment Innovation Steered by the RBI

1. There is a long and interesting history behind the evolution of digital payments in India, piloted by the Reserve Bank of India (RBI).
2. A major thrust toward large value payments were effected through the Real Time Gross Settlement System, or RTGS, launched by the RBI in March 2004.
3. The large value payments on stock trading, government bond trading and other customer payments were covered under the RTGS, providing finality of settlement, thereby reducing huge risks such as the Harshad Mehta scam; besides this, it substantially reduced the time taken for settlements.
4. The RBI introduced National Electronic Funds Transfer or NEFT, and bulk debits and credits to support retail payments around the same time. Now, NEFT is available round the clock and RTGS will follow from December 2020 — only a few countries have achieved this.
5. In the corporate and capital market transactions the Securities and Exchange Board of India (SEBI), the market regulator, is contemplating a T+1 settlement (T is for transaction date) because the underlying consideration of

the sale proceeds of the shares gets exchanged very fast under the payments system. This is expected to attract more international capital into the Indian market, in turn, broadening and deepening the financial market.

An umbrella system: NPCI

The sterling contribution of this robust payment system, especially retail payments, was reinforced with the setting up of the National Payments Corporation of India (NPCI) by 10 lead banks at the instance of the RBI in 2009. The idea of the NPCI as a not-for-profit company has appeared as an attractive proposition as payments is basically a public good. The setting up of such an umbrella organisation to build a superhighway for digital payments had a strong appeal.

Indicators of success

The NPCI's success against deeply entranced formidable international players, supported by innovative technology, viz. Unified Payments Interface (UPI) and Immediate Payment Service (IMPS), is well recognised by central banks in many other countries. The Bank for International Settlement's endorsement of the NPCI model in 2019 is a major accolade. If the NPCI has gained such a rare distinction in just 10 years of its successful and path-breaking journey, we should be proud to preserve this precious jewel.

Caution

There is a demand from some quarters that the NPCI should be converted into a for-profit company to withstand competition. The shareholders of the NPCI can have windfall gains too. But this will be a retrograde step with huge potential for loss of consumer surplus along with other strategic implications. Instead, like the RBI providing free use of the RTGS and other products, the strategy should be to assist the NPCI financially, either by the RBI or the government, to provide retail payment services at a reduced price (in certain priority areas). This may also help support the expansion of the payment system network and infrastructure in rural and semi-urban areas in partnership with Fin-Tech companies and banks.

On merchant discount rate: No level playing field

In Budget 2020-21, the government prescribed zero Merchant Discount Rate (MDR), the rate merchants pay to scheme providers, for RuPay and UPI, both NPCI products, to popularise digital payments benefitting both customers and merchants.

For reasons unknown, the government left out other providers of digital payment products from this MDR prescription, which is unjustified and had adverse effects. Taking advantage of this dichotomy, many issuing banks switched to mainly Visa and Master cards for monetary gains. As customers were induced by such supplier banks, it created a kind of indirect market segmentation and cartel formation, though there is hardly any quality difference in payment products. It is hoped that the government will take corrective action in the next Budget to ensure a level playing field and to relieve the NPCI from such policy-induced market imperfection.

Settle the pricing for Digital Payments

The ideal pricing for digital payments products should be based on an analysis of producer surplus, consumer surplus (i.e. gain or loss of utility due to pricing) and social welfare for which we need cost-volume-price data. A factor which needs to be reckoned is the float funds digital payments allow (cash withdrawal is a drain on the banking system), which is a source of sizeable income for banks. The RBI will do well to study and arrive at a rational structure of pricing including MDR, given that the digital payment system is like a national superhighway, for which the government has a crucial role to play in protecting consumers against exploitation. This can run into a huge amount when digital payments become all-pervasive.

It is not the intention to deny a fair amount of return to payment service providers including Fin-Tech companies. But It should not be at the cost of a huge loss of consumer surplus. Ideally, it should be a case of win-win for all.

Prelims:

1. Basics of RTGS, NEFT, IMPS, MDR and NPCI.
2. Important Changes were made in NEFT in December 2019.

Mains:

1. Contribution of RBI in establishing a flourishing digital payments system in India
2. Benefits of Digital payments to banks, economy, government and consumers.
3. Why is there a demand for a payment regulator independent of RBI?