

# Fiscal policy consequences of digitisation and demonetisation in India

# Outline

- Initiatives to encourage digitisation
- Status of digitisation
- Efforts to reap fiscal benefits of digitisation
- Consequences of demonetisation
- A framework for analysing fiscal policy responses to digitisation

# *Steps to enable digitisation...*

- **Key initiatives to accelerate digitisation**
  - Aadhaar (unique ID): 1.13 billion issued
  - Financial inclusion: 280 mn accounts in 2.5 years
- **Regulatory reforms**
  - New business models to enable use of technology for banking and payments
  - Liberalisation of telecom industry
- **Recent steps**
  - Lowered the maximum value for cash transactions
  - Lowered the limits on political donations in cash
  - Incentives for making electronic payments: service tax waiver; transaction charges waiver by govt agencies.

*...have yielded significant results....*

- **Mobile and internet usage in last ten years**
  - Mobile tele-density increased ten times
  - Broadband connections increased hundred fold
- **Use of electronic instruments for store of value and payments in last five years**
  - Sevenfold increase in use of retail electronic payment instruments
  - Several new categories of innovative instruments

## *.....but much work remains...*

- World Economic Forum's Networked Readiness Index (2016)
  - India ranked 91<sup>st</sup> among 139 countries.
  - Ranked well on affordability of digital services (8<sup>th</sup>)
  - Needs much improvement on: business & innovation environment (110<sup>th</sup>); Infra (114<sup>th</sup>); Skills (101<sup>st</sup>); Individual usage (120<sup>th</sup>); etc.
- The presence of retail transaction infrastructure among the lowest in the world
- Surveys find that most people have never used digital transaction methods

## *...and certain concerns need to be addressed.*

- A comprehensive legal framework to protect the privacy of users of digital services
- Improvements in redress, enforcement and adjudication systems
- Overcoming the “digital divide:”
  - 55,669 out of 5,97,608 villages have no mobile network
  - Several states have much lower tele-density, while some states drive up the national average (four large states have tele-density of less than 70)

# *Digitisation can have significant fiscal consequences*

- Six potential pathways for fiscal policy benefits
  1. Digitisation of **government payments** to individuals
  2. Electronic platforms for **public procurement**
  3. Efficiencies in **collection of non-tax revenues** (eg. User charges)
  4. Efficiency in **tax collection**
  5. Improvements in **tax intelligence and enforcement**
  6. Improved efficiency through **e-governance**
- Challenge: profit-shifting

# *Government has begun paying and procuring electronically...*

- **Government payments to individuals:**
  - Direct Benefit Transfer programme to cover all cash transfers to individuals. About USD 24 bn transferred
  - Portals for processing under schemes: eg. National Scholarship Portal (NSP)
  - Linking databases for policy decisions: eg. use of tax information to exclude from subsidies
- **Electronic platforms for public procurement**
  - Mandated e-procurement for procurements with estimated value of more than USD 3000 (approx.)
  - Government e-Marketplace: single window for online procurement of common use Goods & Services



# *...collecting electronically...*

- **Collection of non-tax revenues:**
  - Some depts leading change: 50 percent passenger and 95 percent freight ticketing in railways is online
  - PayGov India: a platform for online payments by govt.
  - Much work remains on this front
- **Tax collection:**
  - Most filing mandated to be electronic
  - Most taxes collected electronically
  - Goods and Services Tax Network (GSTN): a non-profit organisation to maintain a single portal for stakeholders.
- **Tax intelligence and enforcement:** systems to gather and analyse information about suspicious transactions

# *...and governing electronically*

- **E-governance initiatives:**

- management of public finances substantially automated through implementation of PFMS
- digitisation of land records is underway.
- platform for digital issuance and verification of documents
- network of 2,50,000 Community Service Centres (CSCs) at village level to deliver various citizen centric services.

*...while trying to manage negative  
fiscal consequences*

- **Taxation challenges in digital economy:** equalization levy on payments to non-residents for certain specified services.

# *...but little empirical research has been conducted*

- Muralidharan et al (2016) conducted evaluation of biometrically-authenticated payments infrastructure for employment and pension programs in one state:
  - the system delivered a faster, more predictable, and less corrupt payments process
  - investment was cost-effective - just time savings to beneficiaries covered the cost of the intervention. Also significant reduction in the “leakage” of funds
- Central government claims the DBT programme led to cumulative savings of Rs. 0.5 trillion between 2014 -15 and 2016-17.

# *The demonetisation decision had certain stated objectives...*

- Impose losses on those holding black money in cash form
- Improve tax intelligence and enforcement to enhance tax to GDP ratio
- Push digitisation of the economy by creating a strong incentive to use electronic instruments
- Disrupt terror and criminal activities conducted by using cash

# *...the fiscal impact of the decision remains unclear*

- **Short term impact on tax base:** RBI estimates impact of demonetisation on growth estimated to be (-)0.33 percent for 2016-17, with some sectors (eg. Automobiles, FMCG, cement, construction) more affected. No accurate estimate yet of the impact on informal sector
- **Impact on government securities:** adverse impact on interest expenditure was counteracted using monetary policy instruments
- **Impact on bank credit:** no acceleration of credit growth
- **Impact on unaccounted wealth:** only USD 350 mn tax penalties collected so far under the amnesty scheme. Full impact can only be measured with a lag

# *...and so does its impact on digitisation*

- Card payments and mobile banking payments peaked in December, but have fallen in January and February (see table below)
- Payments using prepaid instruments fell in February
- Even accounting for fewer days in February, the drop is significant
- The steady state impact of demonetisation on digitisation remains to be seen

# *Need to distinguish between different fiscal policy responses*

1. Involve direct interaction with citizens, residents and private organisations
  - 1.1. Create a mandate for the citizens/residents
    - 1.1.1. impose the mandate on low or middle income citizens/residents
    - 1.1.2. impose mandate on businesses and better-off citizens/residents.
  - 1.2. Create a digital option while leaving the non-digital option available.
2. Only meant to improve government's own internal processes.



# *...with a view to identify risks and responses*

Who does the scheme deal with?	Is the digital method mandated?	Mandate on whom?	Examples
Government to person/enterprise	Mandated	Low income individuals	Direct benefit transfer
		Middle or higher income individuals and enterprises	E-procurement; electronic tax payment; e-filing of taxes; etc.
	Not mandated	NA	Land record digitisation; community service centres
Government to government	NA	NA	PFMS

# Conclusion

- India has made strides towards digitisation, but still has much work ahead
- The impact of demonetisation on tax base and on digitisation remains unclear
- Many potential fiscal benefits of digitisation
- Government has launched initiatives to ensure fiscal benefits of digitisation
- Risks of false exclusion and other mistakes, especially in schemes that create mandate on low income individuals
- A gradualist approach may be better for such schemes
- Need for conducting more research and use of evidence to design fiscal policy responses to digitisation