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How to make digital payments work

Tech companies should be given membership of the Reserve Bank's RTGS system, which should be operational 24x7

SNAKES & LADDERS

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Why did the demonetisation experiment work out poorly? One element lies in inadequacy of digital payments. India has the lowest use of digital payments in the world, as a consequence of a harmful policy framework. A payments revolution is required, similar to the telecom revolution of the late 1990s.

All of us are living the world of SMS, email, Google Chat, and WhatsApp. Imagine attaching a payload of money into any of these. As an example, we should be able to attach money on an email. Almost overnight, we would get big gains. Person-to-person payments would become as hassle-free as sending a text message, sending an email, chatting on Google Chat, or messaging using WhatsApp.

What impedes this? We in India have created an array of rules to block off technology companies from competing in payments. The payments industry should have firms like Google, Facebook (which owns WhatsApp), Airtel, Vodafone, etc. However, all these firms are blocked off from the field of payments in India.

In the 19th century, the field of payments was dominated by banks. Now that SMS, email, Google Chat and WhatsApp are here, a new world of payments is possible. We should see payments as a distinct industry: One that will be dominated by technology companies. Payments is the business of moving money. Banking is the business of giving assured returns on deposits, and is a distinct industry from payments.

Banks are, however, the incumbents in payments. They make money when consumers undertake payments using their bank balances, and they make money from "the float" when payments are slow. Banks are hence less than enthusiastic about the new world of payments. Technology companies that go through banks to get their work done tend to face reluctance or worse.

The solution to this lies in giving membership in RBI's Real Time Gross Settlement (RTGS) system to technology companies. Through this, payments would go from person to person without the involvement of banks. There is no financial risk introduced when RTGS membership is broadened.

RBI will need to simultaneously beef up the capabilities of its RTGS offerings. A key flaw is the hours of service. Public infrastructure must run 24 hours a day. Google and Facebook run 24 hours a day; there is no excuse for RTGS to be closed for half the day. When you say "IT" in a central bank, it means "inflation targeting" and not "information technology": It is difficult for RBI to run systems. RBI could contract out the operations of the RTGS system to a capable financial infrastructure institution, which is able to deliver high throughput, low user charges, and 24x7 operation.

Banks, the incumbents in payments, may hamper the new players. This requires interconnectivity regulation. The field of telecom shows the way. When a new player comes up (e.g. Jio), it is easy for the incumbents (e.g. Airtel) to block it off by refusing interconnection. Incumbents would be able to block competitors by refusing to allow calls to and from the new players. This is anti-competitive.

Hence, all over the world, telecom regulators perform the role of interconnectivity regulation. They define phone number formats, force incumbents to connect to new rivals, and monitor the market to block mischief by incumbents. We need such interconnectivity regulation in payments. It should not be possible for Facebook to block off a payment emanating from a Google customer; it should not be possible for SBI to block off a payment emanating from a Google customer. At present, we are mishandling these questions. Instead of requiring interconnectivity, RBI rules actually prevent it in many respects.

A class of institutions called "payments clearing houses" is required, where netting systems can run. At present, we have a monopoly (National Payments Corporation of India or NPCI), which is owned by banks. This arrangement is unfair to technology companies. This entry barrier needs to be opened up so that there are multiple competing clearing houses, which are run by technology companies and cater to the interests of technology companies. This is also an area which sits uneasily with banks: The best skills are found in technology companies and in financial infrastructure institutions.

Progress on payments periodically runs into concerns of law enforcement agencies. However, all electronic payments are more traceable than cash. As long as cash is legal tender, any electronic system is better for law enforcement agencies. The criminal justice establishment should be a votary of the shift to cashless, intermediated by technology companies.

In the digital payments world, there will be incomplete information with law enforcement agencies. This is better than the zero information that they possess when transactions are done in cash.

This is a moment in reform that is comparable to the late 1990s, where the NDA government opened up the telecom sector, broke the domination of the incumbent (DOT and its PSUs), created Trai, and opened up to new competition. This gave us the telecom revolution, and was one of the most important milestones in India's journey. In similar fashion, we need to now break the domination of the incumbents, and undertake a payments revolution.

For many years, the policy discourse on payments in India has been restricted to superficial changes. Technologists have treated the existing RBI-NPCI-banks framework as given and tried to plead for incremental changes. This approach has failed, as is evident in the aftermath of demonetisation.

A Ministry of Finance committee headed by Ratan Watal is, for the first time, working on deeper issues in payments reform including the drafting of a new legislative approach that would replace the existing 2007 law. This work may be the turning point in India's journey in this field.

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