AMITABH KANT

CEO, NITI Aayog
Views are personal

INDIA & FINANCIAL INCLUSION

From achiever to icon

India has been building on the momentum from JAM and DBT. The next phase will be about digital delivery that is sharpened by leveraging of consent-based data sharing

UNDISPUTEDLY, FINANCIAL INCLUSION is the bedrock of inclusive growth. It is crucial for empowering every citizen, streamlining the economic and social welfare agenda of the government, and mobilising resources for allocation. A formal economy with a mature financial system effectively facilitates avenues for domestic savings and productive investments while supporting both consumption and expenditure. The substantive network effects of financial inclusion have been a formidable component of the welfare paradigm in India since 2014. Consequently, there has been a relentless focus on universalising access to banking and financial services.

Over the years, the financial inclusion mission has taken strategic and multifaceted steps. It has pushed new and innovative products and services. Gone are the days when one had to go to a bank to open an account, it is now just now a click away. There have been curated efforts to make the banking system more robust, augment its reach, and change the outlook of service providers to acknowledge the potential opportunity of business models that leverage financial inclusion. These have extensively advanced the ease of living for citizens. Significant prominence has been given to acknowledge feedback from both citizens and service providers to iterate and innovate in financial services. Banking institutions now have verifiable information on their customers via mechanisms such as Aadhaar; citizens are more reliant on the formal banking system due to extensive information campaigns; the greater reach of business correspondents has augmented trust by in-person interaction; and technology has been leveraged to reduce transaction costs.

The journey started with the launch of Pradhan Mantri Jan-Dhan Yojana (PMJDY) in 2014. Powered by India Stack and the JAM trinity, today, nearly 400 million people benefit from it—with 63.6% account-holders in rural areas and 55.2% of them women. Its robust architecture made it the foundation of Covid relief. Direct benefit transfer (DBT) enabled the Centre to disburse over ₹31,000 crore as financial assistance to more than 332 million people within a couple of weeks into the lockdown. This paradigm facilitated DBT of ₹50 billion to 20 million construction workers; PM-KISAN transfers of ₹6,000 annually, with the latest transfer on December 25, 2020, of ₹18,000 crore to over 90 million farmers; transfer of increased wages from ₹182 to ₹202 per day under MGNREGA, benefitting 136 million families; and an *ex gratia* payment of ₹1,000 each to 30 million poor senior citizens, widows and *divyangs*. Impressively, ₹30,705 crore was credited into the accounts of women PMJDY account holders between April–June 2020. Finally, the latest iteration leveraging this architecture is the Svanidhi scheme, with which 13,56,600 loans up to ₹10,000 each have been disbursed to street vendors.

Unified Payment Interface (UPI), India's biggest payment success story, pushed the transition from financial inclusion to integration. It is being adopted in many nations to enable real-time and secure payments. It is no coincidence then that the Inclusive Finance India Report 2020 highlighted the phenomenal rise of ICT-based transactions—from 827 million transactions worth ₹1.6 trillion in 2016 to 3.2 trillion transactions worth ₹8.7 trillion in 2020. Today, UPI-led innovations are clocking in an astounding 2 billion transactions a month.

> NITI Aayog recently released the Data Empowerment and Protection Architecture (DEPA) report that makes the case for Indian citizens to share their financial data securely to help them access the optimum financial product. Together with other layers of India Stack, DEPA could do for India's data ecosystem what the internet did for communication: a Cambrian explosion of novel products and services

Focusing on easing the operative ecosystem of financial inclusion, the government approved the use of e-signatures and e-KYC in 2019. This was followed by the introduction of DigiLocker, an exemplary digital storage mechanism for receiving, storing, self-attesting and sharing documents. A transformative intervention was the introduction of 'video KYC' in 2020, allowing banks to remotely verify customer identity on live video. This mechanism is expected to facilitate 80% of the new-to-bank digital credit in 2021. Finally, Reserve Bank of India took a giant stride for easing banking operations by incentivizing greater use of the central KYC registry, wherein financial institutions, basis customer consent, can verify customers referring to the registry. Apart from reducing costs and duplicated efforts, this mechanism will allow for future unification of KYC data across financial services.

Indians have been rapidly accessing and adopting digital services in the last six years. The lower socio-economic strata is becoming data-wealthy before becoming economically wealthier. Small shop owners, farmers, traders, MSME entrepreneurs, rural self-help groups, and gig economy workers are increasingly generating a digital transaction history that could be used to inform and build trust with financial institutions. The next phase of financial inclusion will be driven by leveraging this data pool. Consent-based data-sharing would be the key enabler for effectively using this data. This will further integrate the marginalised, with access to a bouquet of formal financial products of credit, insurance, pension, etc.

NITI Aayog recently released the Data Empowerment and Protection Architecture (DEPA) report that makes the case for Indian citizens to share their financial data securely to help them access the optimum financial product. Together with other layers of India Stack, DEPA could do for India's data ecosystem what the internet did for communication: a Cambrian explosion of novel products and services. Going forward, breaking data silos and monopolies holds the potential for indigenous fintech companies to compete on product design, analytics, and value creation.

India has before it an opportunity to build next-generation financial services and contribute $865 billion to the economy by 2030. Building on the heels of digital financial inclusion, a three As framework will help advance this movement to greater heights:

Adequacy: Adequate availability of financial services through the formal system, covering savings, credit, remittance, insurance, etc. will foster more inclusive growth in India.

Acceptability: Great products create unquestionable trust. Long lists of complex terms and conditions, arcane language disguising hidden fees and charges, confusing user interfaces, are all hindrances in gaining a customer's trust. Consumer experience should lead to reuse and advocacy. To achieve that, we need to accelerate financial literacy. This is also critical to the success of the fintech experience. Digital products bring the benefit of measurement and predictability, enabling a fair, transparent, consistent and rewarding experience. This must be utilised.

Advocacy: With the government propelling fintech innovation via regulator sandboxes set up by RBI, SEBI, PFRDA and IRDAI, there is a growing emphasis on outcome-oriented advocacy. Fintech innovators should grab this opportunity and make best use of favourable innovation reforms.

A well-designed pool of financial products has been instrumental in bringing individuals out of poverty traps and into the umbrella of financial inclusion. It has enabled increased prosperity through savings and investment, greater security and resilience to income or health shocks through insurance, and propelled new aspirations through credit for entrepreneurship.

India is writing an unparalleled story of this age. The coming years will show how India scaled, sustained and specialised in building a financial inclusion architecture for one-seventh of humanity.

DFI will be no panacea

ASHISH KAPUR

Certified treasury manager, credit and relationship banking veteran of BNP Paribas, FirstRand, Global Trust and L&T Infra Finance (LTFS)

Managing risks before operations and structuring bankable projects are the real issues, not funding challenges

MANY DEVELOPMENT FINANCE institutions (DFIs) since Independence have failed due to inadequate focus on cost-effective liabilities and elevated construction-risks making projects unbankable.

While a sustainable, low cost-liability profile is a DFI's primary challenge, banks with ready access to retail liabilities face asset liability (ALM) mismatches in financing projects. Our inability to manage the risk before a project reaches commercial operations date and incapability to structure bankable projects is the real issue requiring a solution.

By postulating a new financing entity as the panacea for all our infrastructure woes, I am afraid we are only barking up the wrong tree!

Commentators tom-toming the new DFI cite its low funding cost as a cure for the low pace of infrastructure development. There are two fundamental problems with this argument.

Firstly, how low is really low. The primary funding source for PSU banks are the current and savings account (CASA) balances. Considering interest free CA, 3% SB coupon, deposits across tenors and their percentage contribution, the average cost of demand and time liabilities works out to about 3.5%.

Agreed, banks have a 40% commitment to priority sector lending (PSL), 18% SLR and 3% CRR obligation. Doing a simple math, critics argue that out of every ₹100 raised, banks can lend/make money from only ₹39 (100-40-18-3). Alas! That's unacceptable, since efficient banks undertake small ticket-size PSL financing for 40% book, at a profit.

While the exact liability profile of the proposed DFI is a moving target, some flaunt its ability to raise 50-year foreign capital from multilateral agencies at about 1% as a game-changer. Sure, long tenor capital is welcome, but don't forget currency hedging that increases landed funding cost to over 5%!

Regarding fundraising via rupee bonds, what stops the government from asking SBI or sectoral DFIs to issue more long-term bonds with tax incentives? It is imperative to develop a robust secondary bond market. Given high government borrowings and preference of Indian banks to hold G-Secs in the HTM segment, there's hardly any trading, and capacity of banks to subscribe further remains limited.

The second problem with the 'low pace of infrastructure development' argument is the absence of sufficient bankable infra-projects. The real issue is not so much about financing *per se*, but the availability of bankable projects.

Bankable projects, for the sake of simplicity, can be defined here as projects where the humongous construction-stage risk has been identified and structuring strategies for tackling it formulated. Managing operations-stage risk, like discoms reneging on PPAs or toll collections being arbitrarily stopped, demands a policy-/legal-certainty framework too.

How, then, to deal with this?

Tighten the regulatory framework, nodal sectoral institutions monitoring payment delays and co-ordinating with authorities for cutting approval red-tape and multilateral agencies for concessional financing of ventures can help make projects more bankable.

Leveraging financing capability of overseas export-credit agency of successful bidders is a simpler solution rather than taking the complete risk on the DFI's books

Ingenious structuring by banks with the assistance of nodal sectoral institutions can help—for instance, to improve prospects of its PPP projects, NHAI could encourage bank funding by showing flexibility/ mitigating risk. If NHAI guarantees fixed repayments to banks for funding timely completion by good developers having stressed balance-sheets, it could be a win-win for all. Developers make money, say, ₹700 crore on project completion, the bank provides competitive 5-year financing with repayment risk on highly-rated borrower and asset gets transferred, say, to NHAI, which then auctions the constructed TOT toll project to concessionaires for 30 years against upfront payment.

Believing the notion of easy DFI money availability being an elixir could potentially lead to a situation of good money chasing bad money. Just as money alone can't buy long term happiness, mere long tenor capital availability won't guarantee the development of world-class infrastructure.

BUDGET FY22

Focus on long-term growth planks

Fiscal consolidation path must be gradual & credible

UPASNA BHARDWAJ

Senior economist, Kotak Mahindra Bank *Views are personal*

TO BRING THE economy back on a sustainable, strong growth path, the government will look to the Atmanirbhar Bharat route in the Budget. The expected focus-areas will be both soft (health and education) and hard infrastructure (roads, railways, highways, real estate, etc), manufacturing (PLI scheme being a good start), financial sector (recapitalisation and privatisation/consolidation policy of PSBs) and possible income support to the bottom of the pyramid (laying out a plan for an urban job guarantee scheme/UBI).

While the government has always had a policy focus on infrastructure development, financing the same has remained a challenge. This Budget must make clear the direction on the financing of overall infrastructure over the medium term, especially at a time when the PSBs may not be willing to go in for such long gestation projects given their stretched balance sheets. It could be through various channels like the establishment of Development Finance Institutions (DFIs) and/or merging these with IIFCL; redefining the role of the Centre-State and private sector in financing; channelising proceeds from divestment/privatisation of PSEs to a corpus for financing long-term projects; and through increasing dependence on external financing.

Given the government's limited resources, expenditure prioritisation will continue to be key, with a higher allocation to capital expenditure in FY22, which has been quite low historically. In this context, the government could provide clarity on the path ahead in terms of progress on global bond index inclusion, a new source of financing the extra spending. Notably, the foreign ownership of the Centre's debt remains very low at ~1.6% as compared to 9.5% in China and 30% in Indonesia.

The recommendations of the Fifteenth Finance Commission are awaited, which will likely provide guidance on the medium-term fiscal roadmap, fiscal anchor (point-based, range-based or debt/GDP), and revisions to revenue-sharing between the Centre and the states. The fiscal space will accordingly be defined. Given that the recovery remains nascent, a gradual consolidation, with the fiscal deficit for FY22 at 5.5% of GDP, down from 7.1% in FY21, is likely. While the nominal GDP growth will likely be ~14%, the tax buoyancy should be significantly higher, led largely by expected jump in corporate earnings amidst normalisation (towards pre-Covid levels). The Tax-GDP ratio should also pick up to 10.2%, from 9.7% in FY21, although significantly lower than the pre-Covid average of ~11%. Additionally, the non-tax revenue and divestment proceeds will be key in defining the magnitude of expenditure expansion and the pace of fiscal rectitude. Overall expenditure growth will likely be 7%, with a greater push from capex (expected at 12%).

The fiscal maths suggests FY22 gross market borrowing to be marginally lower, around ₹10.7 lakh crore against ₹12 lakh crore (for financing deficit) in FY21, and net supply at around ₹8 lakh crore (₹9.7 lakh crore in FY21). The short-term borrowing is expected to be ~₹50,000 crore, with other sources amounting to ₹3.7 lakh crore.

Finally, the government must aim to provide a credible fiscal consolidation path along with relatively acceptable budget numbers. The consistently widening gap between budget estimates and actuals has led to volatility in the bond market. Market sentiment already is jittery amidst fears of excess supply and early monetary policy normalisation that will restrict RBI's intervention in the bond market going ahead.

Digital tax remains an unsolved puzzle

Govt must offer clarity on a range of open issues

PAVAN SISODIA

Partner, International Tax and Transaction Services at EY LLP *Views are personal*

THE RAPID DEVELOPMENT of technology, with new-age tech companies leading the charge, has changed the way businesses are being run across the world. In a digital economy, even though consumers and business owners are spread across the globe, there is a free flow of goods and services—whereby, for instance, the service provider may be in the US, provision of services may happen through a server located in the Netherlands and the end-consumer may be in India. In such cases, it is difficult (let alone, quite complicated) to determine the taxing rights and share of tax of each country—with erstwhile laws proving ineffective.

While the international bodies (such as the Organisation for Economic Co-operation and Development, or the OECD) and the law-makers have also been grappling with this issue, many countries—the UK, Italy, Australia. Mexico, and Spain, among others—have already introduced a digital service tax (DST). While India has also introduced provisions to tax overseas digital players based on their number of users in India, the impact of these measures is uncertain considering that these changes will also be subject to applicable tax treaties with different jurisdictions that India has entered into.

The government of India has also recently introduced a new Equalisation Levy (EL), which is in the nature of a DST, besides introducing a levy on online advertisements in 2016 (Ad EL). EL is a flat 2% tax on consideration received by a non-resident 'e-commerce operator' (EOp) for providing or facilitating 'e-commerce supply of goods or services' to Indian residents or even non-residents in certain cases. EL does not apply when: i) EOp has a permanent establishment in India; ii) EOp's turnover is < ₹2 crore; or iii) such services are subject to Ad EL. Unlike Ad EL, EL is also applicable on business-to-consumer (B2C) transactions, payable by the EOp on a 'quarterly' basis. Such income is, however, tax-exempt thereafter.

As far as EL is concerned, there are various areas that require further clarification from the government. While it seems that the intent was to tax goods and services sold over a marketplace, considering the term 'online' is very wide, it would be important to explicitly clarify that the EL applies only to digitised products and services (and not to traditional businesses/ services). Another issue is the taxability of 'technical services' or 'royalties' which attract income-tax (at 10%)—the current scope may result in such transactions being covered by EL (at 2%) as well. Such overlap should be addressed and clarified by the government at the earliest possible. Currently, it may be difficult for EOps to claim a tax credit of EL in their home-countries since it is not strictly in the nature of 'tax'—this increases the cost of doing business in India, and a suitable mechanism should be devised to provide relief to EOps.

In conclusion, while India has taken proactive steps to tax digital transactions, it would nevertheless be important for the government to clarify its stance on the various open issues that have lingered for some time now—this will, without doubt, help taxpayers plan their affairs and conduct business more efficiently in India.

With contributions from **Arjun SK**, *senior tax professional with EY*