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Demonetisation to Digitization

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Abstract

The objective of the paper is to analyse the impact of demonetisation on the Indian economy along with analysing the barriers in moving towards cashless economy (Digitization) and investigates the influence of demonetisation towards cashless economy. Scale was constructed for measuring effectiveness and impact of demonetisation on Indian economy. Demonetisation of Rs. 500 & Rs. 1000 currency note constitutes 86.4% of economy. When this percentage of currency circulation is to be invalidated in the cash-dependent economy, the reintroduction of cash must be planned to minute details to minimize the disruption, especially for those who had no alternative to using cash. The demonetisation has been done to deal simultaneously with black money, corruption, and terrorism financed by a counterfeit currency which was the work of anti-national and antisocial elements. Results suggested that demonetisation's main motive was to lay the path for cashless India. It is true that demonetisation was one of the crucial decisions of the Modi government against the black money. The drive has affected some extent to the public; however, for the larger interest of the country, such decisions are inescapable. Demonetisation has affected the different business sector in dissimilar ways. While some believed this reform would have a long-term positive impact on the economy, others focused on the challenges caused by the announcement in the short-term. Now the question is did demonetisation lead us to cashless and digitized economy?

***Keywords:* Demonetisation, Business & Service Sector, Indian Economy, Cashless Economy, Digitization.**

INTRODUCTION

Demonetisation by definition is "the act of stripping a currency unit of it's status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency". There are multiple reasons why nations demonetize their local units of currency. To combat Inflation, corruption and crime and to discourage cash-dependent economy.

HISTORY

Stripping a currency unit of it's status as legal tender is not a new thing, demonetization goes back to the early 1870s when the United States of America introduced The Coinage Act of 1873 it demonetized silver as the legal tender of the United States, in favor of fully adopting the gold standard. Several coins, including two-cent piece, three-cent piece, and half dime were discontinued. The withdrawal of silver from the economy resulted in a contraction of the money supply, which subsequently led to a five-year economic depression throughout the country. In response to the dire situation and pressure from farmers and silver miners and refiners, the Bland-Allison Act remonetized silver as legal tender in 1878. Remonetization means a form of payment is restored as legal tender.

Demonetization for trade purposes occurred when the nations of the European Union officially began to use the euro as their everyday currencies in 2002. When the physical euro bills and coins were introduced, the old national currencies, such as the German mark, the French franc and the Italian lira were demonetized. However, these varied currencies remained convertible into Euros at fixed exchange rates for a while to assure a smooth transition.

In 2015, the Zimbabwean government demonetized its dollar as a way to combat the country's hyperinflation, which was recorded at 231,000,000%. The three-month process involved expunging the Zimbabwean dollar

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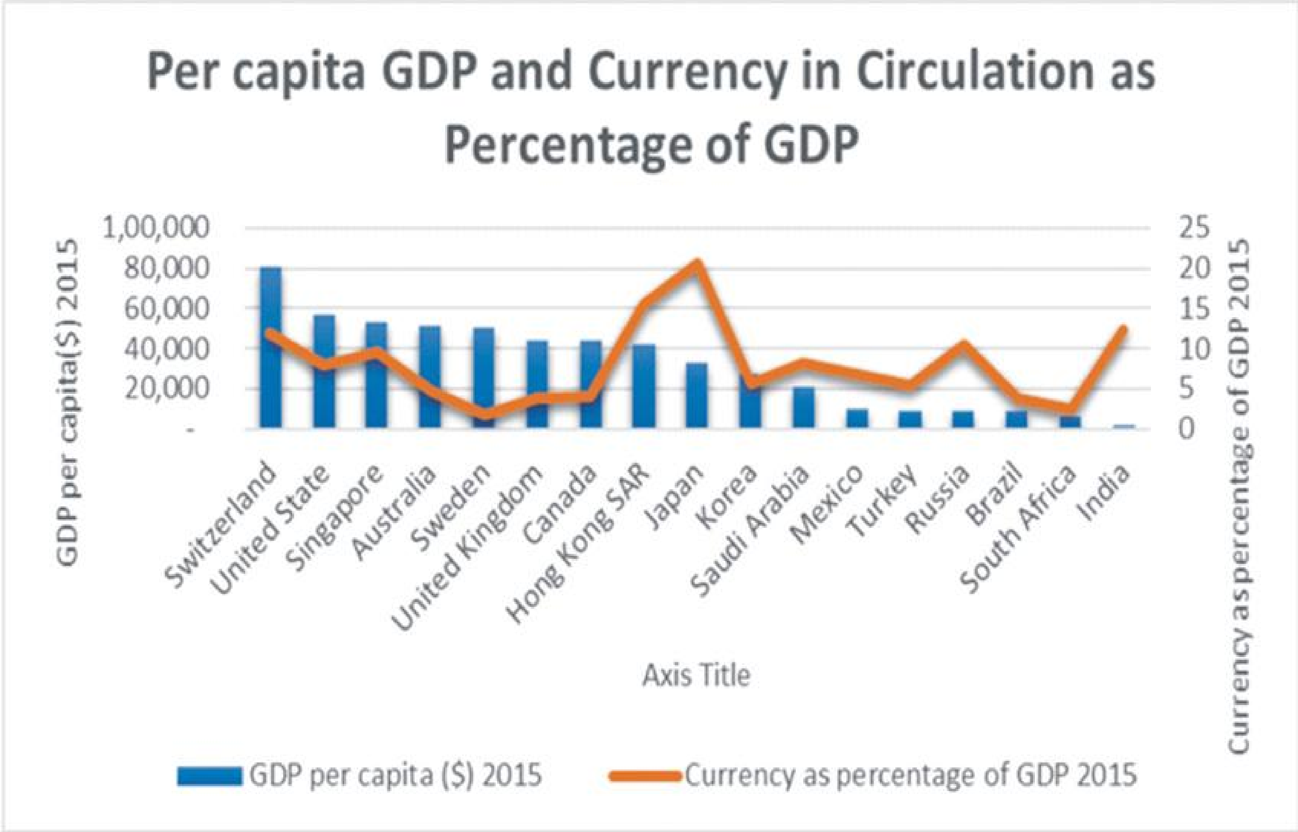
from the country's financial system and solidifying the U.S. dollar the Botswana pula and the South African rand as the country's legal tender in a bid to stabilize the economy.

India's Demonetization

In 2016, the Indian government decided to demonetize the 500- and 1000- rupee notes, the two biggest denominations in its currency system; these notes accounted for 86% of the country's circulating cash. With little warning, India's Prime Minister Narendra Modi announced to the citizenry on Nov. 8 that those notes were worthless, effective immediately – and they had until the end of the year to deposit or exchange them for newly introduced 2000 rupee and 500 rupee bills. Chaos ensued in the cash-dependent economy (some 78% of all Indian customer transactions are in cash), as long, snaking lines formed outside ATMs and banks, which had to shut down for a day. The new rupee notes have different specifications, including size and thickness, requiring re-calibration of ATMs: only 60% of the country's 200,000 ATMs were operational. Even those dispensing bills of lower denominations faced shortages. The government's restriction on daily withdrawal amounts added to the misery, though a waiver on transaction fees did help a bit. Small businesses and households struggled to find cash and reports of daily wage workers not receiving their dues surfaced. The rupee fell sharply against the dollar. The government's goal (and rationale for the abrupt announcement) was to combat India's thriving underground economy on several fronts: eradicate counterfeit currency, fight tax evasion (only 1% of the population pays taxes), eliminate black money gotten from money laundering and terrorist-financing activities, and to promote a cashless economy. Individuals and entities with huge sums of black money gotten from parallel cash systems were forced to take their large-denomination notes to a bank, which was by law required to acquire tax information on them. If the owner could not provide proof of making any tax payments on the cash, a penalty of 200% of the owed amount was imposed

DATA ANALYSIS

The chart above shows the Gross Domestic Product of INDIA. You can clearly state from the above that India's GDP was better like never before until Demonetisation. The GDP was at it's peak in mid Jan-March 2016 and started completely declining at the end of 2016.



REVIEW, FINDINGS & SUGGESTIONS

Demonetisation: 86% of Indian currency and 12% of GDP has been frozen overnight

With immediate effect as of November 9, 2016, the GOI has withdrawn the legal tender character of existing and any older series banknotes in the denominations of Rs. 500 and Rs. 1000. The announcement by Prime Minister Narendra Modi that the Reserve Bank of India was going to demonetise existing Rs. 500 and Rs. 1,000 currency notes has been universally termed as unexpected - a surprise and direct attack on black money. The demonetisation initiative stands out as one of its boldest measures so far with a far-reaching impact.

The move is expected to dent immediate consumption, especially of high-end goods, but will have a positive impact on growth and inflation in the long run. This integration of the parallel economy and main line economy will likely expand the country's GDP. It will also help the government improve tax collection and by expansion of the denominator, lower the fiscal deficit to GDP ratio and fiscal debt to GDP ratio. In the short term, sectors with a sizeable magnitude of cash transactions such as microfinance, real estate, construction, jewellery, high-end retail, and travel and tourism are expected to be adversely affected.

We have summarised the impact of demonetisation across industry sectors as below.

Positive Impact

1. Government revenue collections

GOI has imposed a high penalty for the deposit of cash which does not match the income tax returns filed by the individual. This will result in higher income declarations, which will boost tax revenues.

2. Cashless transactions & mobile banking

Orders for new card swipe machines have leaped 200 times. More and more debit cards are being used to buy goods in addition to cash. Mobile banking and mobile wallets have seen a spurt.

3. IT, utility and telecommunication

Sectors which are unaffected or less affected are IT services, utility services (power distribution, gas distribution) and telecommunication, which are more formal and cashless businesses.

Negative Impact

1. Automobiles

There is a fall in the sales of two-wheelers, commercial vehicles and luxury cars, where distribution channels are primarily in cash.

In December, automobile sales fell by 19%, the steepest dip in the last 16 years as a result of weak consumer sentiments and cash crunch post demonetisation.

To offset the impact, manufacturers - through dealers and finance companies - have started offering lower interest rates and zero down-payment to push sales.

2. Real estate sector

Short term: market slowdown

Demonetisation has led to a situation of there being little or no cash in the market to be parked in real estate sector. This has subsequently translated into an abrupt fall in housing demand. Money has become dearer, leading to more cautious spending and minimal transactions.

Liquidity has been severely impacted and this would result in deflation with limited sales over the next 3-4 months. It would take time for all stakeholders in the sectors – broker, buyers, owners, and developers to assess the consequences on their business and decisions.

There will be further delays in ongoing real estate projects due to the massive cash crunch and minimal trading in the economy.

Medium term: reduced inflation, better housing ownership and improved rental landscape

With limited money floating in the economy, the inflation rates are expected to fall in the next 2-3 quarters. With key policy development such as speculative repo rate cuts by RBI, this could mean better home ownership appetite.

With the gap between the circle rates and market rates bridging, owners would reduce “ask price”, impacting the average housing prices. Resale of properties would become cheaper and could add pressure to the primary market as well. Developers might also offer discounted rates.

The dwindling demand for housing could benefit the rental market across metros.

Demand for affordable housing might witness an uptrend due to improved purchasing power.

Long term: transparency, revived trust and capital inflow

The real estate sector is expected to get cleansed of its ailment in due course owing to the elimination of black money coupled with multiple regulatory changes such as the GST and Real Estate (Regulation and Development) Act. Subsequently, project approval will be quicker, resulting in substantial reduction in the cost of construction. Developers can go for fresh sources of funding to complete their projects.

3. Steel & cement Industry

The steel industry will be impacted as 30-35% of consumption is estimated from real estate, where demand will be affected.

The cement industry, where 60% -65% of demand is estimated from real estate will also be affected.

4. Hospitality & travel

In fine, dining restaurants and no-show rates cancellation is increased by 33%.

The number of inbound tourists visiting national monuments has also dropped significantly. Almost all of these places only accept cash, which leaves no other option for these travellers.

Airlines are also seeing a drop-in booking and an increase in cancellations.

5. FMCG

FMCG companies are already staring at a 20¬-30% fall in sales after the note ban and much of it is coming from rural India. Rural markets account for 40¬-45% of revenue for all major FMCG focused companies.

Most equity analysts expect FMCG sales to drop 35-40% over the next 2 quarters. The only silver lining is the fact that many FMCG companies have managed to collect "pending pay-ins" (collection dues) from powerful wholesalers in old Rs. 500 and Rs. 1,000 notes.

6. Banks & NBFCs

Banks have received deposits in excess of Rs. 6 trillion since the note ban.

With most staffers handling the exchange and withdrawals, "revenue-yielding" operations such as vending loans and cross-selling investment products have taken a backseat in most banks.

Most banks will improve their CASA (current account, saving account) deposit counters, although not many analysts expect this money to remain in the bank for long. Flushed with cash, most banks would now be forced to cut rates ¬ on both deposits and lending ¬ over the next few weeks. This, in turn, may spur credit off take for which banks will have to carefully select and deploy over the course of time.

7. Corporations

The cash crunch due to demonetisation has led to reduced consumption in the economy and delayed investment activity. There has been a significant change in the cash flow cycle with many corporates adopting a wait-and- see approach in anticipation of rate correction or any other governmental measures. Private placement of bonds in November has seen a major fall in the number of issuances. In the case of AIFs (Alternate Investment Funds), many have postponed registration as the investors' community have deferred their plans.

ECONOMIC SLOWDOWN

Three set of numbers tell us why the economic slowdown following the demonetisation exercise is no more an assumption, but a reality---falling manufacturing output, decline in bank credit and consumption demand.

The November core sector data and manufacturing PMI numbers for December give us fresh evidence of a decline in economic activities post the demonetisation launched on 8 November by Prime Minister Narendra Modi. The growth in eight core sectors, which constitute 38 percent of the Index of Industrial Production (IIP), slowed to 4.9 percent in November as compared with 6.6 percent increase in October and 5.01 percent in September.

Similarly, the PMI fell to 49.6 in December as against 52.3 in November. This is the slowest recorded growth in the manufacturing sector seen in this year. Now, take a closer look at the November core sector data. There has been a steep fall in growth of cement and steel output. Cement output slowed to 0.5 percent in November as compared with 6.2 percent in October, while steel output growth fell to 5.6 percent from 16.9 percent month-on-month. This is a clear indication of slowdown gripping the construction segment, one of the sectors that was severely impacted by the note ban resulted cash crunch. Growth in refinery products fell to 2 percent from 15.1 percent on a month-on-month basis, yet again reflecting a poor demand. Where we have seen growth is in fertilizers that grew at 2.4 percent from 0.8 percent, coal grew in November at 6.4 percent vs a negative 1.6 percent in the preceding month and electricity that grew at 10.2 percent in comparison to 2.8 percent in October. The sharp jump in electricity is surprising given the slowdown in other key segments.

The November IIP numbers may come weak and the slowdown could extend to a few more months till the cash crunch eases. It already contracted in October by 1.9 percent after rising 0.7 percent in September. With demonetisation kicking in, the contraction will be sharper in November. One of the key set of numbers one needs to look for is consumer spending in durables and non-durables. In October, growth in consumer goods declined by 1.2 percent and non-durable goods dropped by 3 percent, while growth in consumer durable goods fell to 0.2 percent. The October numbers were a tad surprising because the festive season demand should have spiked the numbers.

Another set of data that gives an indication on slowing economic activities is bank credit growth numbers and auto sales. The RBI data on bank credit trends, collected from 46 banks accounting for 95 percent of the total non-food credit of the industry, shows that non-food credit growth nearly halved to 4.8 percent in November from 8.8 percent in the same period last year, slower than October, when credit rose 6.7 percent. Lending to industries contracted by 3.4 percent in contrast with an increase of 5 percent in the year-ago month.

What do these numbers tell us? There is an actual slowdown in economic activities that should worry the Narendra Modi-government. Despite the expected long-term gains of demonetisation, there is an actual problem to deal with in the short-term. The RBI has lowered the economic growth forecast for this year to 7.1 percent from 7.6 percent earlier while private forecasters have gone even more pessimistic.

Thirdly, the trend of two-wheeler sales is an important indication. Here too the numbers have disappointed (read here) in the last two months. The country's largest two-wheeler maker, Hero MotoCorp, has reported a 34 percent drop in sales for December, while Bajaj Auto sales too declined sharply for the second consecutive month in December, due to the cash crunch brought on by demonetisation. The firm sold 2.25 lakh units in the month, down 22 percent, compared with 2.89 lakh units sold in year-ago period.

Alternative Funds

Soon after the announcement, people rushed to buy gold, a demand that drove prices up, in some cases even to a 60% premium, prompting the tax authorities to conduct surveys, according to the Business Standard newspaper. The government emphasized the need to furnish PAN (Indian Permanent Account Number) card details on purchases for accountability purposes, and many jewelry shops that were flouting the norms came under crackdowns. Simultaneously, rumors of a gold ban started to float, which led to agencies ramping up the volume of gold imports – to around 100 metric tons during November, the highest since 2015, as reported by Reuters.

Many Indians switched to alternative payment avenues – a big deal in a country of 1.2 billion with only 25.9 million credit cards and 697 million ATM cards as of July 2016. The biggest gainers were mobile wallet companies that offer ease of transactions through a large network of partners. Alibaba (NYSE:BABA)-backed Paytm saw a sevenfold increase in overall traffic and a 10-fold jump in money added to Paytm accounts. It also saw the number of transactions double to five million a day. App downloads for Paytm increased by 300%. Paytm rival MobiKwik also saw its app downloads quadruple and a 20-fold increase in money added to the wallets, MobiKwik Founder & CEO Bipin Preet Singh, told CNBC-TV18 on November 13.

Prepaid cash cards were another option that customers found useful, and that meant good news for companies like ItzCash. Other alternatives include mobile payments systems linked to e-commerce businesses like Ola Money, FreeCharge, Flipkart Wallet. Ola Money, the payment portal for popular transportation app Ola Cabs, reported a 1500% jump in money added to the accounts in less than four hours.

When you force someone to do something, you can’t expect them in long term to do it out of his will. The Central Government (seemed to people) put the hard earned money of people in jeopardy. Resulting to 3Ps: Panic, Public outcry, Pain.

DIGITIZATION &CASHLESS ECONOMY

One intermediate objective of demonetisation is to create a less-cash or cash-lite economy, as this is key to channeling more saving channeled through the formal financial system and improving tax compliance. Currently, India is far away from this objective: the Watal Committee has recently estimated that cash accounts for about 78 percent of all consumer payments.9 According to Pricewaterhouse Coopers (2015) India has a very high predominance of consumer transactions carried out in cash relative to other countries (accounting for 68 percent of total transactions by value and 98 percent by volume). And there are many reasons for this situation. Cash has many advantages: it is convenient, accepted everywhere, and its use is costless for ordinary people, though not of course for society at large. Cash transactions are also anonymous,

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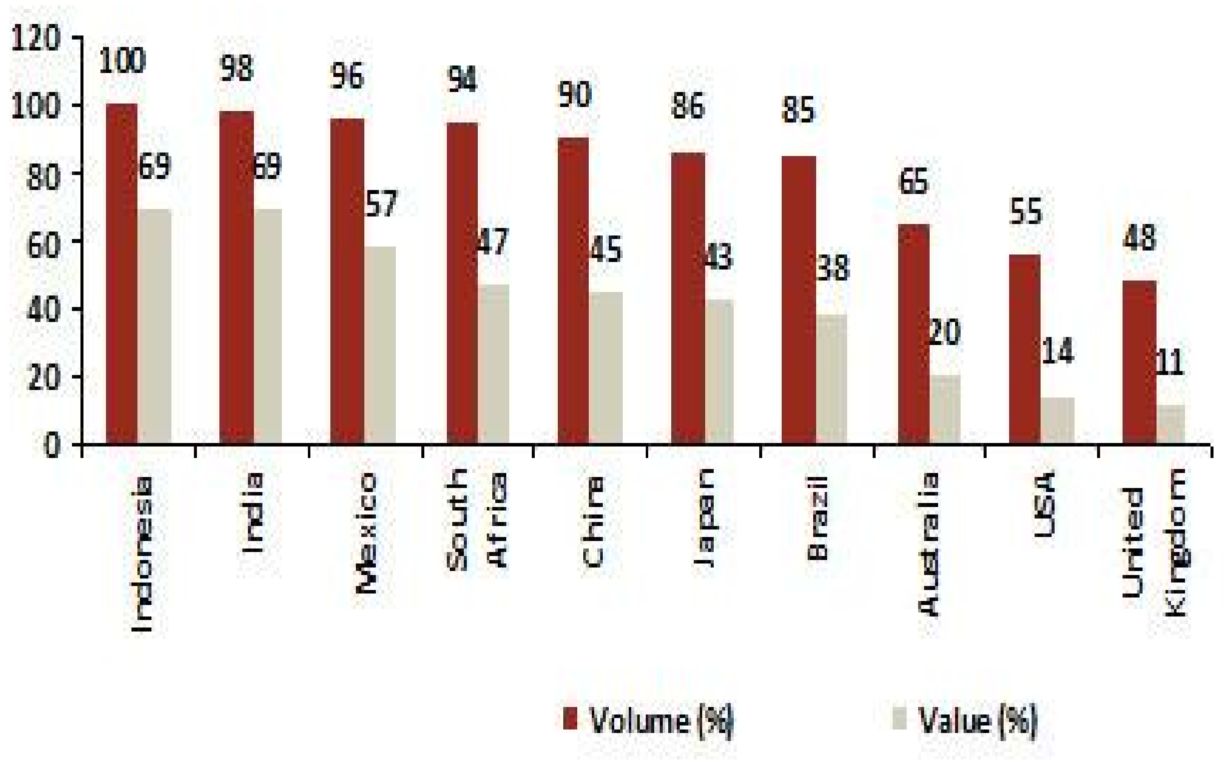
helping to preserve privacy, which is a virtue as long as the transactions are not illicit or designed to evade taxation.

DIGITAL TRANSACTIONS

In contrast, digital transactions face significant impediments. They require special equipment, cellphones for customers and Point-Of-Sale (POS) machines for merchants, which will only work if there is internet connectivity. They are also costly to users, since e-payment firms need to recoup their costs by imposing charges on customers, merchants, or both. At the same time, these disadvantages are counterbalanced by two cardinal virtues. Digital transactions help bring people into the modern "wired" era. And they bring people into the formal economy, thereby increasing financial saving, reducing tax evasion, and leveling the playing field between tax-compliant and tax-evading firms (and individuals).

IMPACT

Digitalisation can broadly impact three sections of society: the poor, who are largely outside the digital economy; the less affluent, who are becoming part of the digital economy having acquired Jan Dhan accounts and RuPay cards; and the affluent, who are fully digitally integrated via credit cards. One simple measure that illustrates the size of these three categories is cell phone ownership. There are approximately 350 million people without cellphones (the digitally excluded); 350 million with regular "feature" phones, and 250 million with smartphones.



The above chart shows the consumer transactions carried out in cash. India's 98% transactions are cash based with this you can say how much the Indian's are habitual using cash.

GOVERNMENT'S INITIATIVES

In the wake of the demonetisation, the government has taken a number of steps to facilitate and incentivize the move to a digital economy. These include:

• Launch of the BHIM (Bharat Interface For Money) app for smartphones. This is based on the new Unified Payments Interface (UPI) which has created inter-operability of digital transactions. As of January 10, there had been 10 million downloads, and over 1 million transactions had been conducted. The 250 million digital-haves can use their smartphone to make simple and quick payments.

• Launch of Aadhaar Merchant Pay, aimed at the 350 million who do not have phones. This enables anyone with just an Aadhaar number and a bank account to make a merchant payment using his biometric identification. Aadhar Merchant Pay will soon be integrated into BHIM and the necessary POS devices will soon be rolled out.

• Reductions in fees (Merchant Discount Rate) paid on digital transactions and transactions that use the UPI. There have also been relaxations of limits on the use of payment wallets. Tax benefits have also been provided for to incentivize digital transactions.

• Encouraging the adoption of POS devices beyond the current 1.5 million, through tariff reductions.

CONCLUSION

If you look at demonetisation in isolation and the shock it gave to the Indian economy, it failed. But step back and see it as part of a larger plan to weed out corruption, a different story begins to emerge. Apart from the personal shock to our money lives, demonetisation quickly became a huge political, social and intellectual battle. The battle lines got drawn deep in the ground and your pro- or anti-Modi stance decided where you stood on the demonetisation debate. Has there been a dent in corruption and black money? Anecdotal stories say that high-level corruption in the central government is gone, but the cancer of graft elsewhere in the system still thrives. It is unrealistic to expect the deep-rooted habit of graft to disappear overnight, but at least there is serious political will behind the anti-corruption war in India today.

What of black money, or money on which income tax has not been paid? Black money is back in the system—talk to any builder (real estate is the biggest sump of black money and talking to builders is a quick way to figure out if cash deals are back) and they say it is as if demonetisation never happened. But they admit to the cash ratio going down and the fear factor lurking at the back of every deal. The government's expectation that a chunk of the cash will not come back and therefore will hurt the corrupt disproportionately did not play out the way it was forecast. Almost all of the notes returned to the system as brazen operators found ways to game the system using a mix of dirty bankers, Jan Dhan accounts, poor people who lined up for them, shell companies and false invoices to justify the cash. A cat-and-mouse game began to catch the bad guys.

What about terror financing and fake notes? Demonetisation also led to instant extinguishment of Pakistan-printed high quality Fake Indian Currency Notes. It also adversely affected the *hawala* operators. Even terrorists didn't go anywhere.

The PM is silent on these because the answers will expose the entire demonetisation exercise as a policy fiasco, which has yielded peanuts in terms of recovered black money while inflicting heavy economic pain on the people through a policy-induced recession.

Did demonetization lead us to digitization? It did, but at what consequences? The negative outweighs the positives. A surge in NEFT(9.5 Trillion-12.5Trillion) and mobile transactions doesn't justify to an economic slowdown, GDP at it's lowest, unemployment, 132 lifes lost.

Demonetisation was an ill-conceived economic policy decision. Even if one were to take the purported economic motives of eradication of black money or enabling a digital economy at face value, arbitrary demonetisation was not the means to achieve those objectives. Contrary to belief, demonetisation was not a case of a "good idea, bad execution". It was a fundamentally flawed idea.

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