

Demonetization: Challenges it poses and Opportunities it presents

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Abstract

Demonetization is the act of withdrawing currency units of its status as legal tender. As a major step to check undeclared black money, the Government of India on the 8/11/16 , announced demonetization of rupees 500 and 1000 banknotes with effect from 9/11/16 making these notes invalid.

Apart from combating black money, the stated purpose is also to check fake currency or corruption. However, 50days of demonetization scheme created chaos and frenzy among public and also welcomed various opportunities.

In this paper, the authors try to investigate various opportunities and challenges that Government and public are and would face in post-demonetization period.

The information relevant for study is drawn from secondary data. The data has been collected from newspapers, magazines, books, published journals and trusted websites.

INTRODUCTION

Demonetization is a radical monetary step in which a currency unit's status as a legal tender is declared invalid. This is usually done whenever there is a change of national currency, replacing the old unit with a new one. Such a step, for example, was taken when the European Monetary Union Nations decided to adopt Euro as their currency.

However, the old currencies were allowed to convert into Euros for a period of time in order to ensure a smooth transition through demonetisation. Zimbabwe, Fiji, Singapore and Philippines were other countries to have opted for currency demonetisation.

The Indian rupee (INR) is the official currency of the Republic of India. The

rupee is subdivided into 100 paise (singular paisa), though as of 2011 only 50 paise coins are tender. The issuance of the currency is controlled by the India. The Reserve Bank manages currency in India and derives its role in currency management on the basis of the Reserve Bank of India Act, 1934. The rupee is named after the silver coin, rupiya, first issued by Sultan Sher Shah Suri in the 16th century and later continued by the Mughal Empire. The sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. Rs 1,000 and higher denomination notes were first demonetized in January 1946 and again in 1978. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data. In a major step to check undeclared black money, the Government of India on the 8th November, 2016 announced demonetization of Rs 500 and Rs1000 banknotes with effect from the same day's midnight, making these notes invalid. Apart from combating black money, the stated purpose is also to check fake currency and corruption. A new redesigned series of Rs500 banknote, in addition to a new denomination of Rs 2000 banknote is in circulation since 10 November 2016. Previously it was very less approx 15% of the money exchanged. But this time it is 86% of the money in circulation which has

been demonetized .This bold step of government has immediately shown affect on manufacturing, trading, service and many other sectors and has also welcomed many opportunities.

RESEARCH METHODOLOGY

Our research is based on secondary data from trusted websites, magazines, newspapers. It is also based on discussions by various experts on social media.

NEED FOR STUDY

The main objective is to focus on the various challenges encountered by general public and the economy as a whole after demonetization. It also focuses on various opportunities created in the economy post demonetization

LITERATURE REVIEW

As per Working Paper No: 182 , titled, "Demonetisation: Impact on the Economy" by National Institute of Public Finance and Policy, New Delhi, very short term impact is as follows

"The demonetisation, by removing 86 per cent of the currency in circulation, has resulted in a very severe contraction in money supply in the economy. This contraction, by wiping out cash balances in the economy, will eliminate a number of transactions for a while, since there is no or not enough of a medium of exchange available. Since income and consumption are intrinsically related to transactions in the

economy, the above would mean a severe contraction in income and consumption in the economy.”

The paper also mentions about short term impact on the economy would depend on the speed with which and the extent to which the cash is replaced by the authorities. But a few sectors such as agriculture, automobiles and construction are likely to be seriously affected. The first medium term effect would be a compression of the economy to the extent the extinguished currency was working as a medium of exchange. The currency that is placed in the banks but not withdrawn, it is argued, would generate an expansion in deposits in the economy. In the discussions on demonetisation, there is a consistent reference to the resultant increase in credit creation in the economy. Like Finance Minister Arun Jaitley says, “Bank deposits will increase and they will have more capacity to support the economy.” The total cumulative credit that can potentially be generated is defined in terms of the reserve ratio.

INTERPRETATION CHALLENGES:

1. Digital ignorance among people :

In India Cash transactions account 95% of all transactions, 90% of vendors didn't have card readers or the means of accepting electronic payments, 85% of workers were paid in cash, and almost half of the population didn't even have bank accounts. Even Uber in India

accepted cash the only country in the world where this option is available and Cash on Delivery was the preferred choice of 70% of all online shoppers. As weeks passed, demonetization which was essentially seen as an attack on black money was gradually projected as an attempt to make India a cashless economy. But an important question is, “Is India ready to welcome this new way of life?” In UttarPradesh's Gorakhpur district a man enters a store selling VIP bags. After selecting his product, he asks the shop owner whether he accepts debit or credit cards. The store owner reluctantly replies in affirmative and takes the card from the customer. He swipes the card and punches the amount. The bill is produced. But the story has an anticlimax. As the man leaves the store, he is stopped by the owner. The store owner reveals to the customer that instead of the actual payment of Rs 6,600, by mistake he punched only Rs 66. The customer looks upset and amused at the same time. He asks a simple question: What if by mistake one extra zero was pressed? The store owner replies, “This is new to us. You cannot expect us to learn all this in a day. In another case a person books a private airlines flight using Paytm wallet and his ICICI debit card. The flight gets cancelled due to bad weather. The man calls up the airlines for the refund. He is told that as he has made the booking through a travel portal, he should contact the portal for the refund. Fair enough. The man calls up the portal and is

told by the portal that as he has made the payment through Paytm, he should contact Paytm for the same. The man calls Paytm and is informed that the payment was made using ICICI debit card so he should call the bank. The bank, in turn, asks the customer to call Paytm. After much of argument, Paytm accepts that the amount will be refunded in 72 hours. A happy ending may be? No, this story too has an anticlimax. Four days have passed and the man is waiting for his refund, frantically making calls to all the parties. Above incidents during the phase of demonitisation highlights the various challenges due to digital ignorance among people.

2. Adverse effect on GDP in short run :

Demonetizing Rs.500 and Rs.1,000 currency notes will adversely impact India's economic growth, at least in the short run. The government has announced that withdrawal through ATMs will be limited to Rs.2,000 per day up to 18 November and Rs.4,000 per day thereafter. Cash withdrawal from one's bank account is also limited to Rs.10,000 per day and Rs.20,000 per week till 24 November. Such policies of government have slow down economic activities in country. Former chief statistician of India Pronab Sen said informal sector accounting for around 40% of the economy which will be impacted the most is especially in rural India. "This is likely to reduce GDP growth by one percentage point

this year (2016-17)". GDP growth in the first quarter (April-June) slowed down to 7.1% from 7.5% during the same quarter a year ago and the slowdown is attributed to increase in subsidy payments by 53% which resulted in lower growth in indirect taxes.

3. Counterfeiting 2000 rupee note

Immediately after demonetization, a message stating that new 2000 rupee notes carry a GPS enabled chip making them easy to track went viral. This was later trashed by the Finance Minister. Changing the security feature is a huge exercise and takes at least five to six years. Quoting a Government official, The Hindu (newspaper) reported that since the decision to introduce the new notes was taken only six months ago, there was no time to alter the security features. The new 2000 rupee note released have several features like a see through register with the denominational numeral which can be seen when the bank note is held at a 45 degree angle at the eye level. The note will also have colour-shifting windowed security thread with the inscription 'Bharat', RBI and 2000. The colour of the thread will change from green to blue when the note is tilted. Pakistan, which produces counterfeit Indian currency in Government press and flood Indian markets with fake currency, would also be able to produce the notes with the same security features.

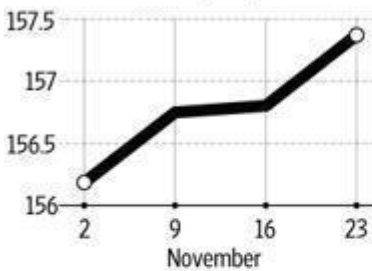
4. Possible misuse of Jan Dhan Accounts:

The possible misuse of Jan Dhan accounts has been a common concern in Public discourse ever since the Prime Minister announced the withdrawal of high denomination notes on 08th November, 2016. There has been a special concern about the so called “Zero Balance Accounts” since they are likely to belong to marginalized sections of the society. Data on these accounts released on 23rd November 2016 show that Zero balance accounts are unlikely to have been misused. The total number of these accounts has decreased by less than 1% since demonetization from 59.4 million accounts on 09th November to 58.9 on 23rd November worrying that the holders of these accounts are not using them even in times when cash transactions are restricted. It also raises a question as to whether these accounts are real and if the holders are aware of the existence of their accounts. It is also intriguing to note that there are significant

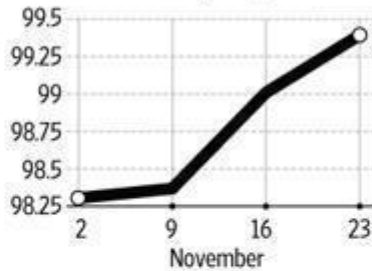
regional variations in the use of Jan Dhan accounts. In Uttarkand the number of Zero balance account went down by 15% while in Jammu & Kashmir they went down by 12%. Interestingly despite banks being overwhelmed with cash operations since demonetization they continued to open Jan Dhan accounts through the fortnight following 8th November. The number of accounts went up from 255.1 million on 9th November to 256.7 million on 23rd November. There is also an interesting rural-urban variation. In rural areas account opening virtually stopped in first week after the demonetization as banks seemed to mainly focus on cash operations while it continued in urban areas. However, after the first week it continued in both rural and urban areas. Finally Jan Dhan accounts have seen a large increase in deposits. The aggregate balance in Jan Dhan accounts went up by 60% from Rs.45000 crores on 9th November to Rs. 72000 crores on 23rd November, 2016

THE JAN DHAN PICTURE

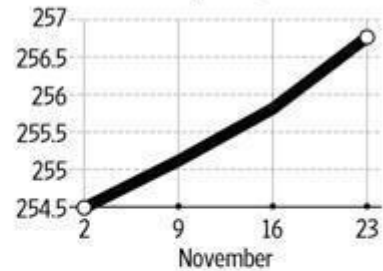
Rural accounts (in mn)



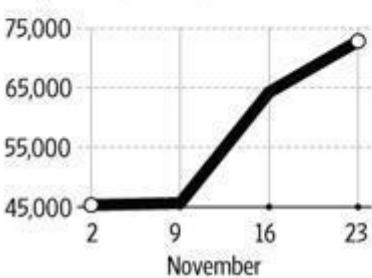
Urban accounts (in mn)



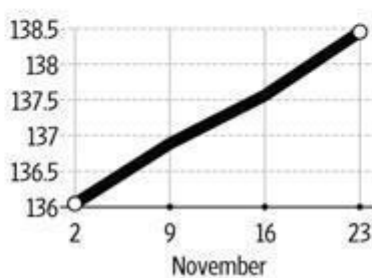
Total accounts (in mn)



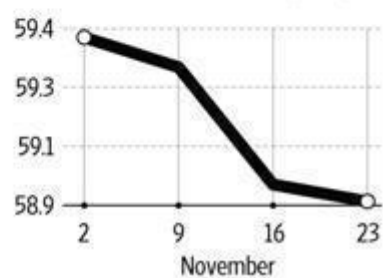
Deposits (Rs crore)



Aadhaar-seeded accounts (in mn)



Zero-balance accounts (in mn)



Source: PMJDY

OPPORTUNITIES

1. Fight black money and terror funding

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The menace of ever raising black money in Indian economy is very high. It is a well known fact that tax evasion generates black money. It is estimated that the volume of black money in 1991 has crossed over Rs. 1,00,000 crores. At present this is estimated to be about 1 trillion USD. Such staggering extent of black money has activated a parallel economy in the country and it affects the vital sectors of the economy. Demonetization of currency of high value say Rs.500 and Rs.1000 could help to unearth the black

money to a large extent. As per ToI report dated 17 November, 2016, the World Bank estimated India's black economy at 22.2 % of its GDP. (It is estimated at 25% in 2016). It is 43.8% in Russia, 27% in Italy, 27.3 % in South Africa, 16% in Germany, 15 % in France, 12.7% in China, 12.5% in UK , 11% in Japan and 8.6% in US. It is 66.1 % in Bolivia! In the U.S. unreported income is estimated to be \$2 trillion resulting in a "tax gap" of \$450-\$500 billion. There were currency notes worth about Rs17 lakh crore in circulation across the country, and according to the RBI, about Rs400 crore of this was believed to be fake currency. So to destroy Rs400-crore fake currencies, the circulation of total Rs17 lakh crore was blocked. Firstly, it rendered all illicit cash in the form of these

notes worthless at the end of 30th dec 2016. Secondly, it immediately invalidated all fake currency floating within the country. But more importantly, it forces black money hoarders to find new and innovative way to stash their ill-gotten wealth. Before demonitisation Rs 17,54,000 crores worth of notes was in circulation, according to the RBI's database. Rs 500 notes comprise almost 45% of this, while 39% of the notes were of the Rs 1,000 denomination, which accounts 86% of total currency in circulation ban lead surgical strike on black money, terrorism funding and drug money. Hawala cash transfers to terrorists and separatists in Kashmir, which were mostly made using the invalid bills, have dried up. It made harder for them to pay young people to stage violent protests, However, two newly-minted Rs 2,000 notes were recovered from the bodies of two terrorists, who'd been gunned down in an encounter with security forces in Bandipora, Jammu and Kashmir. Funding for terrorists has taken a hit after the currency ban. According to intelligence report, Left-wing extremism has been hit hardest by the currency ban. Upto 584 Maoists have surrendered in two weeks and 469 of them did so on or after November 8 - the day on which the the Rs 500 and Rs 1000 notes were demonetised. But in long run Bitcoin, a digital currency that's impossible to trace can be widely used for funding terrorists and by drug-peddlers may increase but demonitisation is undoubtedly a kick start to

avail opportunity to curb black money and terror funding .

2. Fight human trafficking:

Human trafficking industry which is one of the most dreadful mafia working in India kidnapping innocent little girls ,women and use them as sex workers has been come to a grinding halt. According to the study, the girls are kidnapped from all over the country every year, and are transported to different places both nationally and internationally using middleman. But ever since the demonitisation of 500 and 1000 rupee notes was announced on 8th November ,the rescue workers have told that the trafficking has been stopped completely and not one girl has been trafficked . The rescue workers said that they had never seen this market hit rock bottom any time before . In northern India Assam, Bihar and Jharkhand and in Southern India, Chennai, Bangalore and Hyderabad are the places where girls are trafficked the most. All the transactions of selling and buying used to happen through cash and now ban of notes hit the business badly .Rakesh senger ,a child rights activist with Bachpan Bachao Andolan , an NGO said that they till November 2016 10-15 cases of child trafficking used to be recorded every day ,but since month there is no report of any child trafficking which is remarkable outcome of demonitisation. Girls are usually sold at 2.5 to 3 lakhs which

includes the cost of transporting, bribing politicians, local policemen, administration officers which is all paid in black money .

A study conducted by Global March against child labour, a network of trade unions, teachers and civil society organisations reported the annual income of human trafficking to be nearly 19 trillions . Demonitisation 2016 has welcomed an opportunity to minimize human trafficking by means of fighting black money and promoting cash less economy.

3. Combat inflation :

The RBI (Reserve Bank of India) considers the CPI (consumer price index) as its primary method of measuring inflation. Prior to this, another measure of inflation—the WPI (wholesale price index)—was the key method of inflation and it's still considered for reference. The demonetization that has been in effect since November 9 is expected to have a negative impact on inflation. Consumer spending activity fell to grinding halt. Consumers are resisting from making any purchases except essential items from the consumer eatables, healthcare, and energy segments. Activity in the real estate sector, which includes a lot of cash and undocumented transactions, slowed down significantly, Metropolitan and Tier 1 cities reported up to a 30% fall in house prices. India's wholesale price inflation (WPI)

decelerated for the third consecutive month to 3.15% in November from 3.39% a month ago as a squeeze in cash availability impacted prices of perishable commodities. Data released by the Central Statistics Office on Tuesday showed India's retail inflation softened for the fourth consecutive month to 3.63% in November from 4.2% a month ago. The government announced withdrawing the high-value currencies on 8 November, which amounted to 86% of the total value of currency in circulation. The slow pace of supplying the new Rs500 and Rs2,000 banknotes is expected to have led to demand compression and hit small businesses. Data released by the Department of Industrial Policy and Promotion on Wednesday showed food inflation decelerated significantly to 1.54% in November from 4.34% a month ago prices of vegetables (-24.1%) dropped drastically. It will exert more downward pressure on inflation, but this is just a short term effect . In long run rate cuts by the RBI are expected . A change in the repo rate will impact interest rate and in turn results in increases in flow of money in economy.

4. Accelerate economic growth in long run:

The government's move to ban 86% value of money in circulation by demonetizing Rs.500 and Rs.1,000 currency notes will adversely impact India's economic growth in short run

but in long run demonetization will surely promote a Cashless economy, even promoted by the Government itself. So one can easily expect the motion of the Government moving towards being more transparent to people. This is highly influential for the FDI and and even it can promote young entrepreneurs. These policies of the Government will surely increase the GDP of India. Niti Aayog Vice-Chairman Arvind Panagariya said "Financial intermediation has increased after deposits in bank accounts. This means the capital which was privately invested will now be invested through financial institutions. This will have good impact on the economy. It will increase our efficiency of transactions as we move towards digitised transactions.

5. Rise in bank deposits:

Banks in the country have received deposits of Rs 500 and Rs 1,000 notes to the tune of nearly Rs 9.9 lakh crore until December according to a report in The Times of India that cited government data as the source. That is 70.4% of the Rs 14 lakh crore that was decommissioned by Prime Minister Narendra Modi on November 8th, when he demonetized Rs 500 and Rs 1,000 notes in a bid to curb black money and cut off terror funding.

The government has set a deadline of December 30, to receive deposits of the old Rs 500 and Rs 1,000 notes. The RBI had said that Rs 8.45 lakh crore was deposited and

exchanged during 10-27 November, after the implementation of the note ban from 9 November. Between 28 and 30 November, the State Bank of India saw deposits increasing by Rs 22,000 crore. In a recent submission to the Supreme Court, the Attorney General had said that the government expected Rs 10 lakh crore back as deposits. Increase in bank deposits leads to expansion of firms, which will in turn accelerate economic growth.

6. Increase in number of bank accounts:

Banks in the country have added 46.65 lakh new accounts under the Pradhan Mantri Jan Dhan Yojna (PMJDY) during the five weeks after the demonetization of Rs.500 and Rs.1,000 currency notes on November 8. The total number of PMJDY accounts, which stood at 25.51 crore as on November 9, has seen drastic increase to 25.97 crore by December 14% increase in bank accounts especially in rural area benefits lower income category living under the constant shadow of financial duress mainly because of the absence of savings. So far the unbanked population has been vulnerably dependent of informal channels of credit like family, friends and money lenders. Availability of adequate and transparent credit from formal banking channels shall allow the entrepreneurial spirit of the masses to increase outputs and prosperity in the rural area too .These

accounts provide basic facilities of deposit and withdrawal to account holders makes banking affordable by cutting down on extra frills that are no use for the lower section of the society. These accounts are expected to provide a low-cost mode to access bank account .

7.Reduce loan burden

After the demonetization announcement on November 8, Indian banks saw a rise in deposits. According to Reserve Bank of India report released on November 21, deposits crossed the 5 trillion rupee mark from November 10 until November 18. Banks also saw a rise in term deposit accounts since the demonetization. Due to these factors, commercial banks like State Bank of India, ICICI Bank (IBN), HDFC Bank (HDB), and Punjab National Bank, among a host of others, sharply reduced their deposit rates. Banks also saw a rise in term deposit accounts since the demonetization. Due to these factors, commercial banks like State Bank of India, ICICI Bank (IBN), HDFC Bank (HDB), and Punjab National Bank, sharply reduced their deposit rates. Apart from cutting deposit rates, banks reduced their lending rates as well. In India, loans sanctioned from April 1 are with reference to the MCLR (Marginal Cost of funds-based Lending Rate), instead of the Base Rate, which was used earlier.

It will translate into lower interest rates on existing floating rate loans and new loans. The

reduction in lending rates is expected to stoke lending by tempting consumers to take out loans for purchasing expensive consumer discretionary items like vehicles and houses.

8. Improve saving habits:

Indians save in broadly two forms of asset, physical and financial. While physical savings comprise assets like real estate and other immovables, some also invest in gold as a physical asset. Some others consider gold as a speculative hoarding item. Financial assets, on the other hand, include cash, bank and corporate deposits, equity and mutual funds investments, besides provident and pension fund investments, small savings like post office and senior citizens' schemes .More than half of Indian households are still without bank accounts. But savings in cash and currencies is less than 10% of savings. The initial impact of demonitisation is expected to be on savings in bank deposits. This is because more cash is expected to get converted into deposits. This may result in banks with excess funds, which could force them to lower the interest they pay on these deposits. This would reduce the returns of the depositors. So there could be a shift in savings from bank deposits to stock, mutual funds, insurance and pension products. This is because in the past, whenever interest rates on deposits fell, savers have shifted to non-deposit assets like stock and mutual funds. The

whole objective of demonitisation is to curb black money in the economy. A portion of physical assets, especially homes, is estimated to be purchased out of unaccounted money, and so is gold. Though initial assessment was that there could be a shift in gold purchases, income tax implication is unclear. The government may impose curbs on domestic holdings of gold as one-third of its annual demand of up to 1,000 tonnes is paid for in black money.

9. To move towards healthy cashless economy:

Demonitisation removed 86% of its currency from circulation. In adequate supply of new notes left hundreds of millions of people without the means to engage economically, to buy the things they wanted and needed, and myriad businesses were left without a readily available mechanism to receive payment for their goods, to buy supplies, or pay their staff. Such chaotic situation and strict exchange limits pushed millions of new users onto the country's digital economic grid. As the demonetization process continues, Modi's rhetoric more about transitioning India to a cashless economy. Up until this campaign, India was an incredibly cash-centric economy. Cash accounted for upwards of 95% of all transactions, 90% of vendors didn't have card readers or the means of accepting electronic payments, 85% of workers were paid in cash,

and almost 50% of population didn't even have bank accounts. Even Uber in India accepted cash — the only country in the world where this option is available and “Cash on Delivery” was the preferred choice of 70% of all online shoppers. By temporarily turning off the engines which drove the cash economy, India hoped that more people could be brought into the fold by using track-able and taxable digital financing vehicles, like debit cards and e-wallets.

India is currently in the phase of digital economy. After demonitisation policy was announced New bank accounts are being opened at a heightened rate, e-payment services are seeing rapid growth, cash-on-delivery in e-commerce has crashed, and digitally-focused sectors like the online grocery business have started booming. Even the vegetable vendors on the streets have opened up Paytm accounts and they have a machine outside their shop where someone can scan the bar code and make the payment. A lot more retail outlets are accepting e-wallets, including my laundry provider and my dabbawala.

Modi's demonetization initiative has been a boon for India's e-payment providers. Paytm reported a three-time surge in new users tacking on over 14 million new accounts in November alone. While Oxigen Wallet's daily average users increased by 167% since demonetization began. “Ever since Prime Minister Narendra Modi's demonetization

announcement, suddenly rise in both app downloads & merchant registrations have seen. This spike is now coming from all cities, big and small, consisting of small merchants like vegetable vendor ,small convenience stores, street vendors, rickshaw drivers, taxi's etc.The farmers' markets of Telangana has come up with a innovative solutions. Due to lack of cash in economy they began experimenting with their own electronic payment system where customers with Aadhar-linked bank accounts could buy vegetables using tokens which could be purchased via debit cards at specialized kiosks.These changes indicate towards a more inclusive society in the future . To promote cashless economy government of India launched two schemes -- Lucky Grahak Yojna and Digi Dhan Vyapari Yojna --will go live from December 25 till April 14 t cover small transactions between Rs 50 and Rs 3,000 to encourage every section of the society to move towards digital payments.Implementation of cashless economy also increases government revenue in longrun. India's informal economy is responsible for roughly 45% of GDP and 80% of employment, which means that billions of dollars are being exchanged each year without the tax collector taking his cut. Currently, only 1% of India's population pays income tax. Cash less economy brings transparency and create a cleaner, more transparent economy via digitalization that will lead to an improved

climate for foreign investment, boost economic growth.

SUGGESTIONS:

1. Even in Singapore, which is one of the most developed economies in the world and which stands as the 1st cashless transaction country,the total percentage is only 61%India is a country with only 2% usage of the electronic modes.According to the study,it will take about 20 years for India to become a cashless economy which has poor telecom network. It is suggested to introduce digital awareness programs specially in rural and remote areas. If this initiative is given to UG and PG studentsby providing them certificates could reduce government expenditure
2. High denomination notes like,2000 rupee note should be demonitised in a year as there is a greater chance of printing fake currency and also eases corruption.
3. Slow down of economy in 3rd quarter can be compensated by proper implementation of GST which is expected to reduce burden of tax on various firms. Rate cut by RBI is suggested as it brings liquidity in economy and ultimately accelerates economic growth.

4. Jan dhanyojana accounts which were flooded with cash from 9th Nov 2016 to Dec 30 2016 should be investigated and monitored .

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