KY Publications

RESEARCH ARTICLE
Vol.4.Issue.4.2017
Oct-Dec

IJBMAS
www.ijbmas.in

ISSN INTERNATIONAL STANDARD SERIAL NUMBER INDIA
ISSN:2349-4638

INTERNATIONAL JOURNAL OF BUSINESS, MANAGEMENT AND ALLIED SCIENCES (IJBMAS)

A Peer Reviewed International Research Journal

REMONETISATION AND ITS IMPACT TOWARDS CASHLESS ECONOMY

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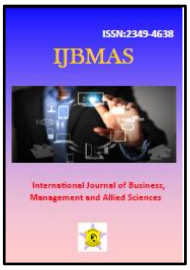


ABSTRACT

This article offers an account of the impact of recent government decision of demonetization decision in November 2016 with the intent of combating fraud, tax avoidance, and other economic problems. The article assesses the impact after remonetisation of the economy and moving from cash to cashless economy. The article provides an analysis of the outcomes of demonetization and remonetisation during the eight months period, as well as looking at the performance of digital platforms and societal impact of the changes, including the way in which the behaviour of Indian citizens has been 'nudged' with particular regard to use of banking, transactions, social effects, and payment of tax.

Keywords: cashless, demonetization, remonetisation, unbanked, banks accounts

I. Background:

In his initial speech of 8 November, the PM mentioned the phrase "black money" many times without utter a word about cashless or digital. Nearly after two weeks on 27th November, he started to use cashless/digital instead of black money. Apparently, it is now no longer a "war on black money" but a "war on all cash" with "short-term pain for long-term gains". The PM now claims that invalidating nearly 86% of the country's currency overnight and throwing millions of people in disarray was just to induce behavioural change in Indians' fancy for cash prevalent from decades and antediluvian and not befitting of a modern liberal society. Prominent commentators would do better to deride such extreme, rash policy decisions and call out this entire objective of cashless a myth to achieve within the short span of time rather than encouraging it and creating a perverse incentive for other such extreme policy measures in the future. The pique is not about the merits of the objective but the manner it has been forcefully adopted by making helpless. Although it might be right in the spirit of objectives and advantages it bring to society but one needs to think how transformation need to take in the right spirit and bring win-win situation to all the stakeholders who are getting effected in this process of cashless economy.

II. Introduction

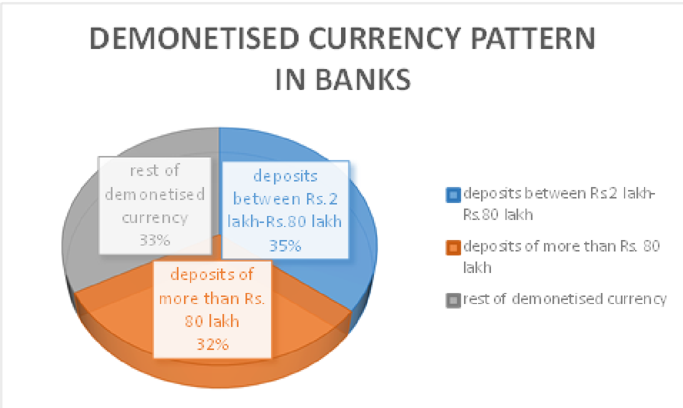
It's been more than eight months the demonetization act has been taken place and the mission of making India cashless economy started. India has highest of 51 percentage of money held in bills and coins as compared to the amount held in deposits and savings account which is higher than economies like Egypt, South Africa, and Mexico. One needs to understand that there is a cost involved in maintaining the cash in the economy which includes cost incurred in cash handling and processing, insurance cost, payments for cash to transit companies and losses on interest for standing amounts in branch and ATM.

"The cost of dispensing cash through ATMs alone is approximately Rs.17 per transaction; the opportunity loss for holding idle cash would be approximately 9 percent; the cost per transaction at ATMs ranges from Rs.6.60 to Rs.15.88 in case of fully outsourced operations depending upon the service provider and area of operation". Discussion Paper on Dis-incentivizing Issuance and usage of cheques, RBI (2013)

Even going digital way has its costs which economy needs to bear. Sometimes rational decision from retailers that business cannot afford these costs. Apart from this, there are multiple dependencies which impact the performance of digital transactions like connectivity, POS terminal, identification, financial address etc on which success of the digital transaction depends.

Some of the interesting facts which came out of demonetization exercise are as follows.

A. Old Currency back to banks: It is said by Minister of State for Finance Arjun Ram Meghwal that notes in circulation (NIC) as on July 21, 2017 where nearly 86 percent of the pre-demonetization which clearly defeated one of the view of government that roughly Rs.3 lakh crore of the scrapped currency would not come back into the system at the time of announcing demonetization on Nov 2016. Before demonetization there was a view that money not returned in the money will constitute windfall gain for RBI which can be transferred to centre as special dividend. But after eight months it was clear that such option was not possible as Two-Thirds demonetized currency has come back in deposits of more than 2 Lakh.



Total value is in Rs trillion

Source: Mint Calculation from Budget speech

B.Eleven incentives to promote cashless economy taken by the government in pre-demonetization to encourage towards cashless economy by both mix of monetary incentives, waiving of taxes and transaction fee for usage of digital mode of payments instead of physical cash such as discounts on petrol & diesel, toll tax, railway tickets, insurance premiums. On other hand encouraged building required digital infrastructure P0S terminals/Micro ATMs/mobile funding through NABARAD.

C.Cash transactions are back in vogue despite the government's push for a less-cash economy post-demonetization. As on March 13 2017 all restrictions on ATM cash withdrawals limits are lifted indicating that remonetization act has been completed. In spite of the launch of many digital payments platforms cash still holds importance after post demonetization as reported by RBI in March 2017 that 78% of consumer payments in India are in cash against first two months halt during demonetization period since January 2017. Another interesting observation happened after the re-demonetization act is that cash withdrawn from banks was not getting transacted in the economy as hoarding of cash by middle and lower income groups has become vogue post demonetization time with the fear of not getting cash when required, the common man to has started hoarding cash at home. That is why most of the new notes are not coming back to banks and bankers are unable to dispense cash through ATMs regularly.

The value of digital transactions nationwide declined marginally (1.5%) to Rs 92.6 lakh crore in February 2017 from Rs 94 lakh crore in November 2016 according to representative data (provisional) on electronic payments released by the Reserve Bank of India (RBI).The data do not cover all transactions across all banks. But, card payments data for four major banks, mobile banking figures for five banks and prepaid payment instruments (PIP, meaning mobile payment gateways such as PayTM and FreeCharge) data for eight non-bank issuers have been considered as representative for analysing trends in payments. Even though digital transactions (volume) had increased 42% from 672 million in November 2016 to 958 million in December 2016 but have since declined 20% over two months to 763 million in February 2017.

D. Curb fake currency notes and eliminate black money: The initial idea behind demonetization was to curb fake currency notes, terror financing and eliminate black money. As far as fake currency is concerned, only 2.46 lakhs have been detected out of total value of demonetized notes of 15.44 lakhs. Given this, the proportion of fake notes deducted is almost zero and can be ignored. Hence, as far as detecting and eliminating fake notes was concerned, demonetization was a total flop.

And with regard to eliminating black money is concerned? As on 10th December 2016, more than four-fifth of the demonetized notes had already made it back into the banks which shows expected black money is not in the economic system.

E. A Significant increase in bank deposits: Finance Minister suggested in his budget speech that Rs 10.38 trillion, almost two-thirds of the value of the demonetized currency, had come back in deposits which were more than Rs.2 lakh. Out of this, Rs 4.89 trillion has come in deposits of Rs.80 lakh or more. Although high-value deposits came back as deposits into the system it is be know that these money will be accounted in tax returns to be filed by these individuals which diminished government hopes of windfall gains in unearthing black money. Demonetization has also helped bringing significant amount of additional money into the formal banking of around 4.5 lakh crore of deposits from the pre-demonetization baseline. This might not be good news for those putting money in the bank deposits as bank lending rates and likely to fall and possibly giving sluggish credit expansion.

III. Objectives of Paper

1. Recent developments post demonetization period and its implications on economy.
2. Brief analysis of impediments impacting towards economy moving from cash to cashless.
3. Insights of changing which will take place due to cashless economy

IV. Methodology

The study is based on secondary sources of data/ information. Different books, journals, newspapers and relevant websites have been consulted in order to make the study an effective one. The study attempts to examine the Cashless Payment System in India.

V. Can India go Cashless?

There has been a huge push from the Indian government to go from cash to cashless economy in the recent past which can be seen by the recent push by the government towards digital financial transactions by various means. One of the biggest hurdles to getting all Indians on the digital payments bandwagon is that a significant chunk of the population still unbanked and does not have access to the internet and digital financial literacy remains low. It is also to understand that economy is moving from a low volume, high transaction cost to a high volume, low transaction cost regime due to establishment of digital financial platform like BHIM. The age of the physical banking is moving to virtual banking with march of technology which is inevitable.(for example ATM to BC's (banking correspondent's))

1. Infrastructural Gaps

A. Banking System capability to handle cashless economy: Government initiatives such as enabling the rural and poor segment of the population with PMJDY accounts which are zero balance and seeded with Aadhaar has played a pivotal role during post demonetization. These accounts were enabled with RuPay debit cards which will allow them to use digital transactions and ATM.

Taking stock

	Public sector banks		Regional rural banks		Private banks	
	As on Nov 9	As on Dec 28	As on Nov 9	As on Dec 28	As on Nov 9	As on Dec 28
No. of PMJDY accounts	20.36 crore	20.90 crore	4.31 crore	4.44 crore	83.79 lakh	85.30 lakh
Zero-balance (%)	23.37	24.45	20.26	20.50	36.27	35.01
RuPay cards issued (%)	77.19	79.32	68.22	74.16	92.70	96.17
Aadhaar seeding (%)	55.67	58.66	46.26	50.27	42.76	45.32

ource: According to latest data on PMJDY portal

Public sector banks enrolled more PMJDY accounts as compared to regional rural banks (RRBs) and private sector banks after demonetization of currency notes as on 8th November 2016.

B. Eco-System development toward digital payments: It is found that post demonetization the innovation rate in the fin-tech space has opened plenty of options to go digital from UPI (Unified Payments Interface) which integrates multiple banking features into one app, USSD (Unstructured Supplementary Service Data) which enables mobile banking for users who do not have smartphones or mobile data to mobile wallets, credit/debit cards and internet banking.

There are three factors which are needed for ensuring the scalability and sustainability of digital payments. These are cost, convenience, and confidence.

C. Convenience: The liquidity squeeze after note-ban forced people to adopt digital payment methods. Even the less well to do have started using the digital platform as it becomes necessary to meet the need of cash crunch. For any digital payments system to get implemented we need a financial address which can identify the user and payer which is can be authenticated anytime and anywhere which is valid in the eyes of law. Flexibility of transacting will be a critical success factor for all the digital platform service providers in order to ensure and enhance customer experience. With the emergence of e-KYC, it is no longer necessary to know your customer/ payer physically as the payments model has evolved to beat limitations related to physical presence. Due to the emergence of new players, the payments ecosystem has become less of a 'physical presence required' banking and more of a 'faceless' payments ecosystem. Ecosystem players will continue to emerge in the modern payments model. The payer and payee can perform transactions through endpoints like smartphones and tablets. That being said, interoperability has become realistic due to payment gateways and aggregators.

However, latest data from the RBI shows that digital payments are slowing down in both value and volume terms after remonetization. It is been seen observed phenomenal growth in the use of digital payment methods is clearly unsustainable once liquidity crisis eases. In this direction, the Indian government has started to empower residents of India with a unique identity and digital platform called ÄADHAAR a Unique Identification number (UID) which was issued to all residents in India.

In the period of demonetization five best possible digital methods evolved are E-Wallets, Unified payments Interface Apps(UPI), Plastic money(Debit/Credit Cards), Net Banking (Online Fund Transfer) and Aadhaar Card(AEPS). Only two payment platforms, Unified Payments Interface (UPI) and Aadhaar Enabled Payments System (AEPS), show a consistent rise in value (in Rupees) and volume (number) of transactions post demonetization. All other forms have shown a decline – either consistently or in one or two months in the four-month period. While UPI links mobile applications to a person's bank account directly, AEPS is an Aadhaar-linked bio-metric identification system used for direct cash transfers under government schemes.

D. Financial Transaction Cost: In a country where major population leaves in rural with below poverty needs is cost sensitive towards transactions. If digital transactions need to be a success it should be zero as compared to the cash transaction. Currently there are various charges for these digital transactions which are charged by the stakeholders involved in delivering the service. For credit cards transactions the fee is levied as merchant discount rate (MDR) which includes cost of three parties the institution issuing credit cards, the sponsoring bank of the point-of-service device with the merchant and the settlement provider (typically RuPay, Master card or VISA) all charge for a transaction. This is also followed for Debit card transactions where there is no risk credit default risk. The justification given for these financial transactions is PoS device is supplied by the acquirer and there is inter-connect user charge (IUC). But these charges are levied on mobile transactions and even on online transactions where we don't need any POS terminal and phone call for doing transactions.

Apart from this government needs to incentivize users with compared to cost of cash transaction. The government in this direction made all government benefits to be disbursed through Direct Benefit Transfer (DBT) and Aadhaar Enabled payment System (AEPS).

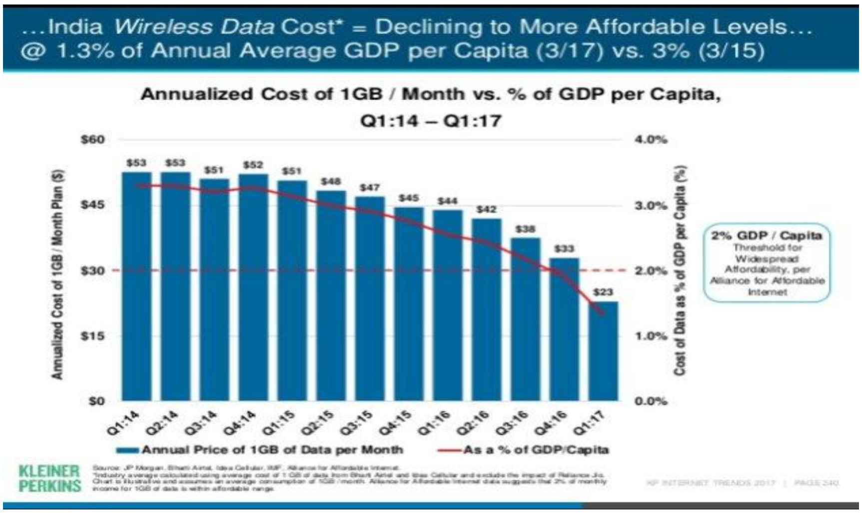
E. Confidence: The major concern for the users is that of potential loss of privacy which is an obvious concern that comes with a cashless economy. The modern technology is porn to risk of cyber-attacks and possible piracy which is challenge as technology is every changing and such risks are unavoidable. A cashless society can potentially give the government unprecedented access to information and power over the citizens such is the case of Aadhaar which would require strong technical and legal frameworks to protect against misuse of power. The problem is compounded by the fact that data protection laws and public policies often lag way behind technology and change in policy is a long process to induct those changes in law to give legal protection to those who suffer in due course.

E2. Government launch of Aadhaar and enacted through legal law for building confidence: On 16, March LokSabha, while rejecting the five amendments suggested by the opposition members of the Rajya Sabha, passed the Aadhaar (Targeted Delivery of Financial and other subsidies, Benefits and Services) bill, 2016 through a voice vote in its original form. The bill caters statutory support to Aadhaar, the unique identify number, through which the government intends to target delivery of subsidy benefits and services.

2. Digital Divide

In spite of high mobile penetration India is suffering from digital divide in terms of awareness about using of digital solutions like smartphone based transactions, feature phone based transactions, usage of credit/debit cards at POS solutions etc are some of the key issues. Apart this lack of bandwidth and reach of technology to various remote locations is still challenge for viable solution. After 8 November 2016 these figures changed with the launch of new telecom players like Reliance Jio in India where the trend shows that India is moving in the direction wherein it estimated that by 2020, half of all Internet users in India will be rural with expectation of 40 per cent of them will be women and 33 per cent will be 35 years of age or older.

There are two major factors driving this surge. First is the trend of declining smart phone prices over the past couple of years. And, second is the fall in Internet data prices, which was certainly spurred by the arrival of Reliance Jio last year.



Source: http://www.huffingtonpost.in/2017/06/01/reliance-jio-is-driving-indian-internet-growth-says-the-mary-me_a_22120777

3. Behavioural Change

For any behavioural change, a leader is needed who has both authority and inclination. In this case, we have seen Prime Minister Modi taking the initiation of moving towards cashless economy by demonetization 86% high denomination currency. Since demonetization it is observed that their Savings in banks has reached all-time high with almost two-third of currency coming back to banks and citizens using digital channels to use the same due to the shortage of cash. Even micro finance institutions (MFIs) have increased their use of digital channels for their operations of disbursement and collections. This trend is expected to continue with eight MFIs

In spite of government taking numerous initiatives for promoting digital transactions, including reduced cash circulation even after remonetisation importance of cash has not reduced which can be seen in drop of 13% (i.e. Rs.9832 crore) in over 6 months period against highest peak of 70% at Rs 74,609.5 crore in 25.82 crore accounts by 7th December 2016.

4. Tax base increased:

It is estimated that because of the note ban, India's income tax net has increased and could achieve double in next few years. Looking at the current scenario

The number of people who have filed self-assessment forms for the financial year 2016-17 increased by 23.8% out of which 10% is the result of demonetization

Post demonetization government added 9.1 million new tax payers in 2016-17, an 80% increase over the previous year which is due to November demonetization of high-value currencies. As said by finance minister during the period 8th November to 30th November 2016 deposits between Rs.2 lakh and Rs.80 lakhs were made in about 10.9 million accounts with an average deposit size of Rs. 5.03 Lakhs.

It is also found that before demonetization close to one lakh new PAN cards were issued every day. Now the number of new cards issued daily averages between 2-3 lakh. Moving to digital transactions has made possible of accountability for the economy which was not possible in cash economy.

VI. Conclusion:

Mere building the infrastructure and digital platform of payments for closing the digital divide gaps will not give results of making economy cashless. The toughest part is been that of changing the habits of the population that have been using cash for decades. Demonetization has forced them to adopt the digital platform and made “digital” a household term. But going from awareness to adoption will require a concerted effort to push home the advantage. While it is true that in the last couple of year’s significant progress has been made in creating eco-system such as Aadhaar platform which will allow the country to move in the direction of cashless, but in reality, there is a long way to achieve the goal of cashless economy. If the benefits of an economy that is less dependent on cash are obvious, it is not clear if India is ready for this 'revolution'. There are plenty of roadblocks which were observed during post demonetization period and mitigated in due course of time which has never been thought before. One big and basic hurdle which cannot change within a short period of time is that of infrastructural requirements. The good thing is that recent entry of new players in telecom sector such as Reliance Jio has changed mobiles and internet penetration scenario in rural India. With regard to enabling banking facility government had taken initiatives such as PMJDY which will ensure financial access to banking services. The success of PMJDY can be accessed with Post demonetization (PSB) accounted for 75% of new JhanDhan accounts.

Simply put, India was not well equipped to make the transition of the economy from cash to cashless at the time of demonetization. But it has taken a big leap forward from a predominantly cash economy to a digitally enabled optimal/less cash economy and brought unproductive money into productive. It is also to be understood that digital transactions are a parallel mechanism but not substitute to cash. So India needs to aim at the less-cash economy as short term goal and in the long run, they can think about the cashless economy.

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