

Demonetization: A Strategy Paradox (A Case Study Approach)

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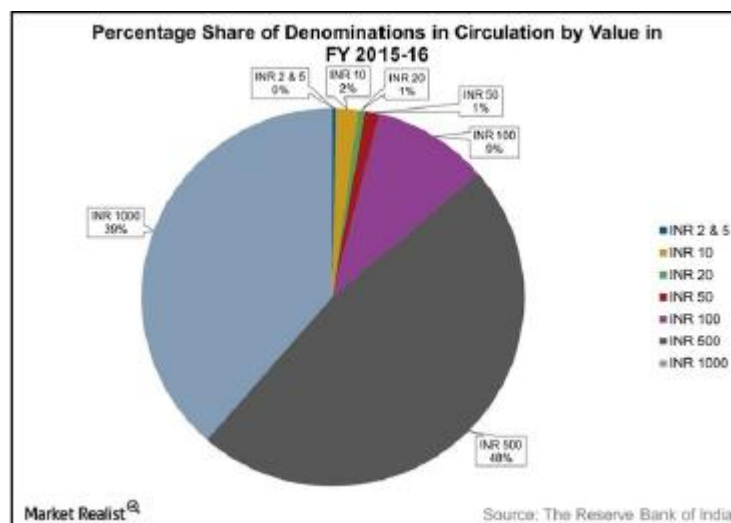
ABSTRACT

On 8th November, 2016, demonetization came into force when Rs. 1000 and Rs. 500 currency notes ceased to be legal tenders, and the days of curiosity, inquisitiveness, and surprises engulfed the entire Indian population, and simultaneously took away the financial security of those who possessed huge undisclosed wealth. This major step implemented by government was to invalidate 86% of Indian currency, specifically to demolish the network of FICN - Fake Indian Counterfeit Notes, curtail circulation of undisclosed cash, restrain the large scale funding of the Naxalite hit states, J & K terror network, and North-eastern state terror activities, as it entirely upset the political, social, and economic dimensions of the country [1]. Although this sensational news of demonetization shook the entire country, the decision of government was an immense step forward to save the country from the accumulation of excessive black money, and unrestricted access to illegal activities. However, demonetization in India has certainly affected the common masses and different sectors of economy in an adverse manner. The present study aims to assess the impact of demonetization on people and various sectors, furthermore it is an attempt to evaluate the digital payment status in the cashless economy advanced by the move of demonetization.

Keywords: Black money, Cashless economy, Demonetization, Digital Payments.

I. THE PROBLEM

Demonetization means divesting of money, and it came like an unexpected Surgical Strike, without warning, on all kinds of notorious and illegal activities being conducted in India. 1000 and 500 Rupee were the two prime notes, formed more than 80% of circulating legal tender the demonetization of which aimed to affect the activities like cross country terrorism, unaccounted accumulation of funds and counterfeit currency flow. It gave a shocking blow to the unorganized share market, haphazard trades, and unstructured real estate. However, it came as a boon to counteract various kinds of crimes in the booming Indian economy.



The sudden move of demonetization was a clear indication of transforming the Indian economy towards a cashless economy, consistently making digital transactions with the ultimate goal of making country's financial system robust. Thus, development of a cashless economy is seen as the primary motive of India's Demonetization initiative [2].

The RBI appointed committee of Nachiket Mor of December, 2013, concluded that in spite of significant improvements in the banking payment system, a huge gap remained in its essential payment system and service procedure for low-income families, communities, small businesses and industrial groups. Today, digital transaction methods are imperative as such a system is expected to generate multiple benefits in capital efficiency, with higher tracking ability, transparency of monetary transactions, law enforcing capacity and significantly improve and maintain tax revenue generation for social welfare [3]

In February, 2016 the government instituted NITI Aayog high profile committee headed by Shri R. P. Watal, to evaluate and transform Indian payment procedures and to promote and encourage digital payment system. Thereafter, the Committee suggested the following:

- (a) To form payment regulations, autonomous from central banking functions;
- (b) To update Settlement and Payment System Act of 2007;
- (c) To promote digital transactions and payment system in the entire economy;
- (d) To generate more funds by enlarging the scope of digital payments;
- (e) To upgrade the existing system of payments;
- (f) To enable ease of inter-operational payment capability.

II. STRATEGIC RATIONALE FOR DEMONETIZATION

The reasons as stated by government concerning the big move of demonetization are to:

1. Eradicate unaccounted money;
2. Eradicate crimes and corruption, stopping the circulation of fake currency [4];
3. Curtail funding of illegal activities;
4. Cleanup funding to terrorist activities and naxalism;
5. Control tax evasion activities;
6. Promote and encourage cashless economy and digital transaction methods in India [5].

III. SITUATING THE CASE

Zhu et al. (2017) studied the issue of demonetization in India by conducting a study on 90 households belonging to the four rural regions of Sunderbans, West Bengal in India. The findings revealed an increase in consumption-related purchases and decrease in borrowing post demonetization among the selected group [6]. Paramahansa & Eliot (2017) studied the long-term benefits and short-term costs of demonetization. They discussed the positive and negative implications of cashless economy and the effects of demonetization on circulation of currency, GDP, black money, corruption and taxation [7]. Gupta (2017) considered demonetization as a less-cash strategy instead of cashless plan and highlighted that after the move of demonetization, there has been an increase in the digital payments. Annamalai & Muthu Iakkuvan (2008) projected Credit or Debit card growth in all the retail transactions [8]. Das & Agarwal (2010) stated the various problems encountered by escalating of fake Indian currency, a large amount of counterfeit currency notes is being circulated which goes undetected, and it is a herculean task to get rid of them. They argue that there were several counterfeiters so far, who had restrained the notes printing facilities [9]. Kumar (2015) stated in the roadmap to progress, concerning cashless payments in India, where cash transactions will be an expensive payment mode for the Indian Government. India must maneuver from cash system transactions towards an electronic cashless system of payment. Such a system will minimize the cost of currency management, tracking transactions, tracking tax avoiding frauds and so on. It will also improve the government financial position and the parallel economy to integrate with the main financial system [10]. Devi & Kukkar, (2015) declared that E-banking and E-payments will surely reduce and control the circulation of black money, and argued that the cashless money business deals is the sure way for economic growth of the country and India should take the full advantage of it for funds transfer; financial, business and institutional transactions [11], and moreover, the cashless transaction system will be risk free, with fast remittances and payment processing, as it operates with an advanced technology, by which more funds will be available to the government and banks, at any time (12).

IV. PARADOX OF DEMONETIZATION

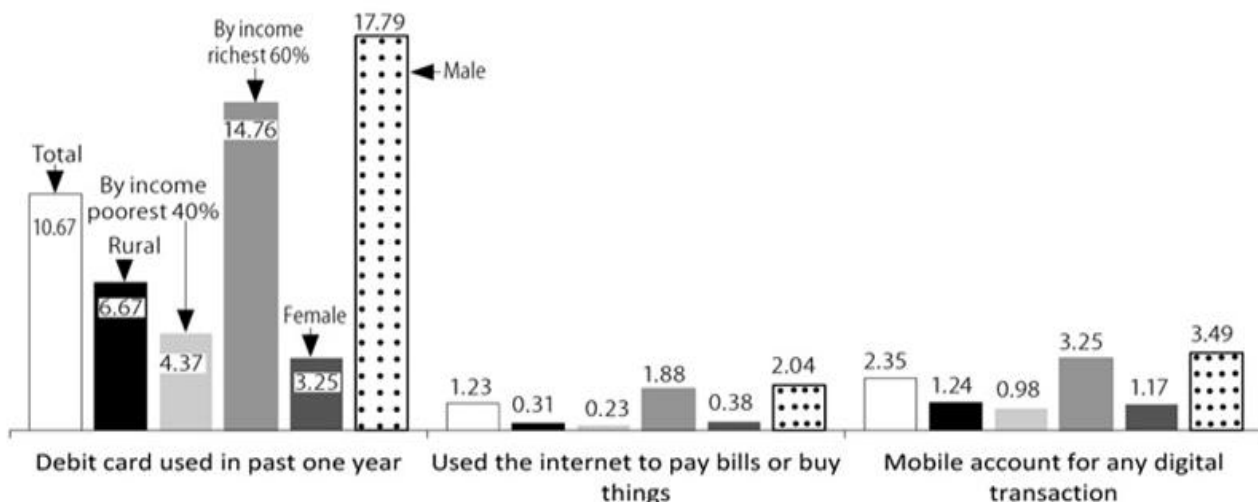
- **Impact on Inflation and Prices:** There was agricultural output squeeze due to shortage of cash circulation. Prices of commodity increased due to depreciation of the currency exchange rate. However, the demonetization process is expected to produce long term, permanent benefits [13].
- **Impact on Taxes:** As per Hasmukh Addhia, the Finance Revenue Secretary, the Indirect Net Tax flow increased by 16.8% in comparison with the previous year, while the net collection growth rates in January, 2017 of Central Excise, Customs, and Service Tax were 26.5%; 10.3%; and 9.45% respectively. Whereas, the Direct Net Tax collected until January, 2017 were Rs. 5.85 lakh crore, 10.89% higher than the net overall collections made in the

corresponding previous year 2016. Total revenue collections from tax grew by 19.5%, the highest figure in the previous 5 years [14]

- **Greater financial inclusion:** Fifty million new accounts have been opened under Pradhan Mantri Jan Dhan Yojana (PMJDY) since demonetization as shown in Exhibit I.
- **Impact on Bank Deposits:** Between 8 November and 30 December of 2016, the overall bank deposits were increased from Rs. 2.5 lakh to Rs. 81 lakh in around 10.95 million bank accounts indicating the average amount of deposit Rs. 5.13 lakh. While above Rs. 81 lakh Deposits were processed in 1.58 lakh bank accounts showing an average amount of Rs. 3.32 crore deposit. Such mining of data helped the government profusely to enlarge the net tax and increase the revenue amount, which happened to be the prime aim and purpose of demonetization [15]
- **Impact on black money:** Post demonetization, the unaccounted, black money unearthed cash between November, 2016 and January, 2017 was Rs. 515 Crore [16] and unusual cash deposits in various accounts such as the Basic Saving Bank Deposit, Kisan Credit Card (KCC), etc.) are estimated to be 1.6-1.7 trillion rupees.
- **Impact on Mutual Funds:** After demonetization the decrease in the price of gold and moderation in bank deposits' interest rates increased the attractiveness of both debt and equity oriented mutual funds. Because of this, Assets Under Management by mutual funds increased to `17.5 trillion by end-March 2017 and further to `21.4 trillion at end-October 2017 as shown in Exhibit II.
- **Challenges faced by common man:** Many challenges a common man had to face because of demonetization: 1) Shortage of cash in ATMs; 2) Currency in exchange was not available; 3) Forced to open E-Wallets; 4) Banks were unable to meet customer needs; 5) Many old people lost their lives waiting in an ATM queue for too long.
- **Impact on Various Sectors:** 75% of Indian population depends on labor oriented agrarian economy, and they contribute 55% of GDP, where mainly cash business deals function which suffered badly due to demonetization. Demonetization impact was also drastic on Manufacturing and Industrial sectors. Similarly, FMCG, Real Estates, Textile Industries had to suffer for almost 5 months due to cash and banking problems.
- **Impact on perishables:** There was a drastic impact on perishable fruits and vegetables, which operate on cash transactions.
- **Worker's wages:** As per CRISIL report, due to cash crunch, the normal and daily transportation system suffered heavily, resulting in a 40% reduction in fertilizer, seeds and equipment sales that had an impact on daily wages of workers.
- **Lack of understanding of E-payments:** Farmers do not understand the format of E-Payments.

V. NPCI DATA CONCERNING CASHLESS TRANSACTIONS AFTER DEMONETIZATION

National Payments Corporation of India (NPCI) is an umbrella organization for all retail payments in India. It was set up with the guidance and support of the Reserve Bank India (RBI) and the Indian Banks Association (IBA) [17].



Source: World Bank Global Findex Data Base, 2014.

Fig. 2: Percentage share of Adults (Age 15 Years and above) Using Electronic payments in India

NPCI data (Exhibit III) shows that with the relaxation of cash withdrawal limits by banks, and gradual ease of the situation, there is an indication of a move towards cash transactions again. However, it is to be observed, with the passage of time, whether this trend of decrease in digital transactions will continue, or government will come up with better policies and incentives for growth of cashless transactions.

**NPCI data for Cashless Transaction
Nov.16, Dec.16, 2016 and Jan.17, 2017**

Financial transaction	November 2016		December 2016		January 2017	
	Volume (Mn)	Value (Bn)	Volume (Mn)	Value (Bn)	Volume (Mn)	Value (Bn)
APBS Credit (Disbursement based on UIDAI No.)	78.12	16.76	90.51	22.75	86.46	24.05
IMPS	36.17	324.81	52.86	432.01	62.43	496.21
Rupay at POS	18.16	30.06	47.27	70.05	38.73	57.97
Rupay at Ecom	7.30	4.97	11.97	10.95	12.55	10.53

Excerpts from NPCI retail payment statistics FY-2016-17

Exhibit III

As per India Retailing Bureau [18], the demonetization further advanced the digital cashless platforms for on spot payment, and after November 8, it has assisted NPCI card usage and applications at all the merchant workstations increase by the volume by 700% to 2.15 million transactions each day. As per NPCI statement (Exhibit IV), the demonetization indicating data towards digital transactions was showing appreciable, but not exponential growth.

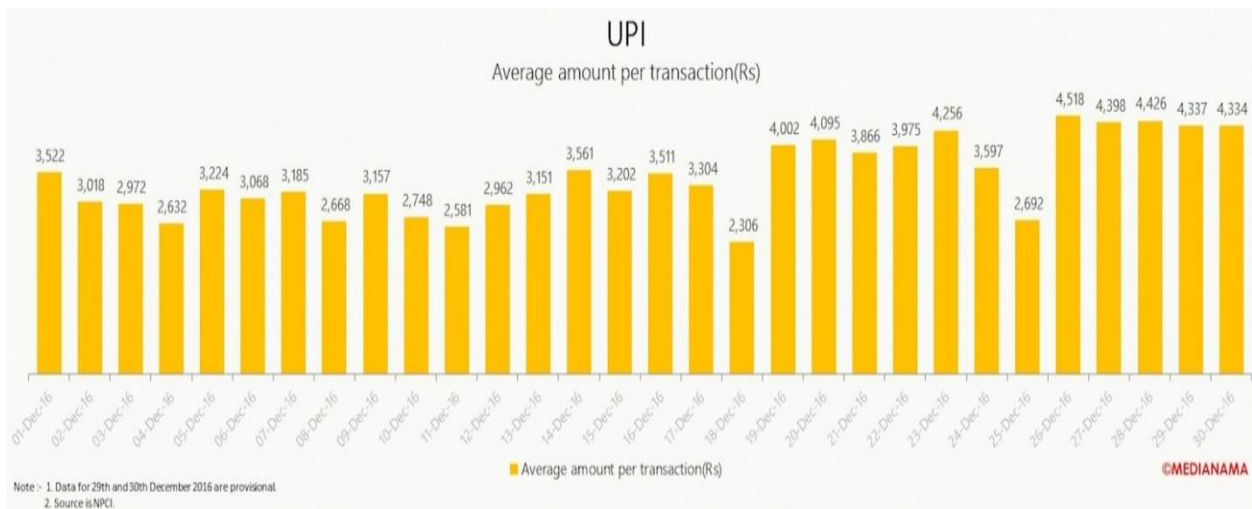


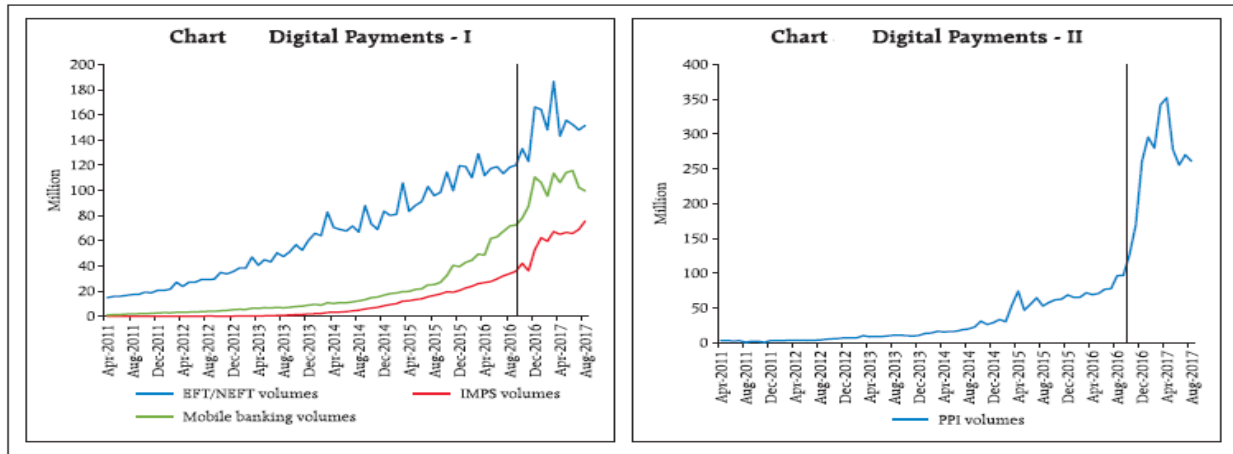
Exhibit IV: NPCI statement of Demonetization

Primarily after demonetization, the volume of digital transactions improved by 43%, from 674 million in the year 2016 to 968 million by the end of 2016. However, it declined gradually by 22%, to reach 765 million in February, 2017 and that made the government problematic to reach digital transactions of 25.5 billion targets in 2017-18. This is described in the Exhibit V below [19].

Category		Oct-2016	Nov-2016	Dec-2016	Jan-2017	Feb-2017
NEFT	Volume	16.2	23.3	39.0	38.0	34.5
	Value	37.6	38.3	40.8	60.2	49.5
CTS	Volume	-1.1	23.0	58.4	52.7	20.2
	Value	2.9	8.6	13.0	19.3	0.8
IMPS	Volume	116.7	89.6	157.2	177.7	150.4
	Value	150.7	135.9	186.6	196.7	184.2
NACH	Volume	53.0	30.8	58.3	19.8	-0.9
	Value	89.8	76.3	116.7	22.8	54.2

Source: RBI Bulletins and Press Releases on Electronic Payment Systems - Representative Data

Exhibit V



As can be seen in Exhibit VI, the average transaction of NEFT increased (in 30 days) by 16.8% by 30 December, 2016, while the daily transactions shown as 4.78 million, November 2016, increased by 8.7% from Rs 295 to Rs 329 Crore each day [20]

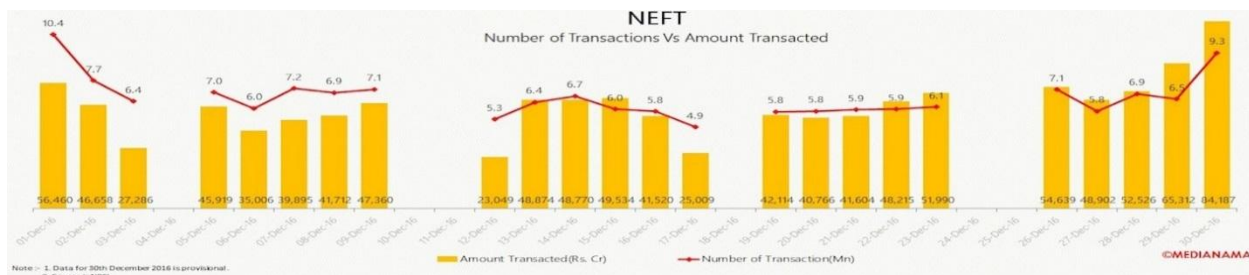
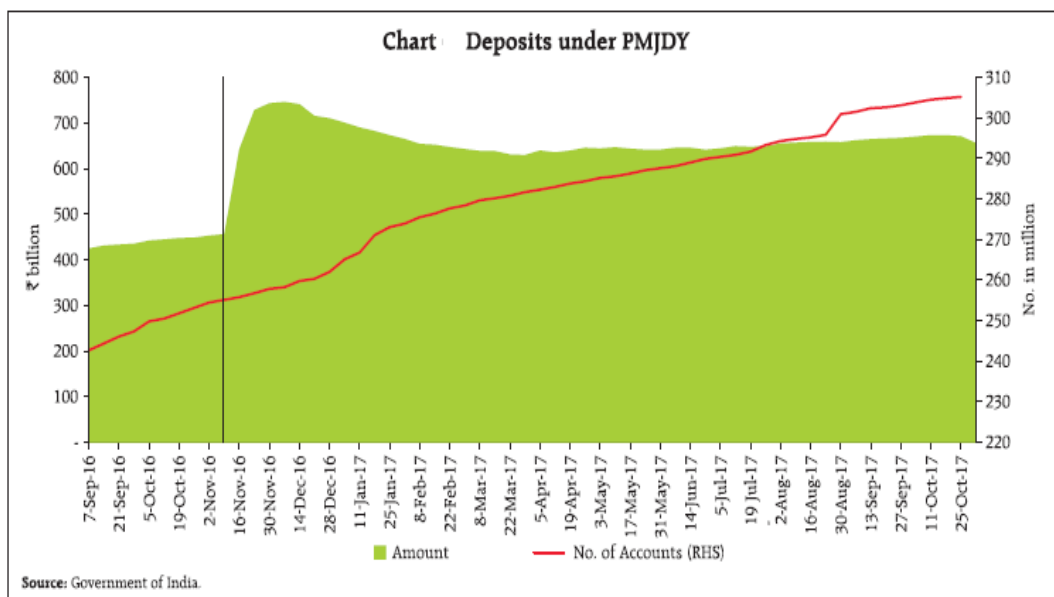


Exhibit VI: NPCI Statement on NEFT

VI. PEDAGOGY AND PRACTICE IMPLICATIONS

Exchange of money helps business transaction, improves taxation methods, and improve national economic integration. However, application of money also corrupts human minds, and generates problems of counterfeit currency formation, rise in parallel economy, acute corruption, rise to the funding of terrorism and destructive activities. Under these circumstances, demonetization is the most valuable tool to benefit the economy in the long run. One of the most important effects of the move of demonetization has been the shift towards formal channels of saving by households giving a boost to financial inclusion. Demonetization has resulted in expansion in the amount of funds, however, the challenge now is to channelize these funds into productive segments in order to boost the economy and improve further the digital economy, which has already witnessed a sharp rise - an important consequence of demonetization.



Source: Government of India.

Exhibit I

Net Inflows/Outflows in Mutual Funds					
Category	(₹ billion)				
	Nov 2015 - June 2016	Nov 2016 - June 2017	2015-16	2016-17	April-September
	2017-18				
Income / Debt Schemes	-328.6	386.2	330.1	2131.5	676.1
Equity Schemes	235.7	670.7	740.3	703.7	803.6
Balanced Schemes	111.4	436.5	197.4	366.1	470.5
Exchange Traded Fund	75.5	203.8	78.2	232.8	72.5
Fund of Funds Investing Overseas	-2.4	-1.9	-4.2	-3.6	-2.6
Total	91.6	1695.5	1341.8	3430.5	2020.0

Source: Securities and Exchange Board of India.

Exhibit II

VII.CRITICAL THINKING QUESTIONS

1. How do you perceive 'demonetization' impact on the Indian economy in the long run?
2. What demonetization teaches us about strategy implementation challenges and strategic decisions?
3. Suggest some policy measures that should be taken by government to further boost the digital economy.
4. What strategic alternatives to demonetization do you suggest to alleviate the political and socio-economic problems of the country?
5. "Demonetization has resulted in expansion in the amount of funds". Can you suggest some measures to the policy makers in the government for channelizing these funds into productive investments?

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