



De-constructing demonetisation in India : A critical analysis

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ABSTRACT With demonetisation a lot of controversy has started in India. The controversy is about the likely impact on economy, cash crunch in economy, size of black economy, cost to government cost to public, impact on growth and employment. Is India ready to make a successful transition to cashless economy as desired by government. Do we have enough capacity to cope with the increased traffic on our existing telecom due to digitisation of economy? Do we have legal systems in place to deal with cyber-fraud?

KEYWORDS

Demonetisation, black economy, cashless economy, growth etc.

Introduction

On 8th November 2016 at 8 p.m., rupee notes of 500 and 1000 were announced non-legal tender money. Transactions in these notes were made illegal with certain exceptions. And till 30th December 2016, public is allowed to deposit their old 500 and 1000 notes in bank accounts. That made up 86 percent of notes in circulation. On the withdrawal side, restrictions are imposed because of the shortages of cash in economy. In the months to come, these will be relaxed gradually and withdrawn completely. It was announced that with this measure black money, corruption and counterfeit money will be wiped out of economy with one stroke. This will lead to reduction in illegal activities like terrorism etc. But due to lack of money supply in economy, people have to cash less transaction and government has also taken decision to promote cashless economy by providing various incentives. Now with hindsight, it seems that it has not succeeded completely. In an Affidavit filed by attorney general of India on behalf of government in supreme court on 15/12/2016, it is declared till now 13 lac crore worth of rupee 500 and 1000 notes are back into the banking system. While total was 14 lac crore rupee. Thus the attack on black and unearthing of black money seems to be failed. Another objective by default of this demonetisation is digitisation of economy. As every action has some repercussion, so will demonetisation. The impact of demonetisation can be assessed in short (transition period) term and long term. In this paper we will focus on impact on growth and transition to cashless economy.

In economic theory there is a lot of controversy regarding the role of money in real economy. For classical economist money is neutral hence does not affect level of economic activities. But follower of Keynes thinks otherwise, Amount of money in the economy influences the level of economic activities. To explain the transitory influence on economy second viewpoint seems more plausible. As circulation of money has decreased drastically in the economy, level of economic activities are bound to decline in the transition period. Whether this decline in economic activities will continue or not in the economy will depend upon how soon normalcy of money supply is restored. The longer the delay, the higher the chances of economy going into decline. In the long run demonetisation will promote growth. A Moody's report has pegged the impact of electronic transactions to 0.8 per cent increase in GDP in emerging markets as against 0.3 per cent increase in developed markets. People need to make full use of electronic payments as they are faster and easier to trace.

In terms of the sectors in the economy, the sectors to be adversely affected are all those sectors where demand is usually backed by cash, especially those not within the organised retailing. For instance, transport services, kirana, fruits and vegetables and all other perishables, would face compression in demand which is backed by purchasing power. Another sector where one expects to see effects in the very short run is the real estate space. With contraction in demand from one set of agents – say agents who

have earned unaccounted incomes and placed them within the real estate space – either price within this segment would fall or transactions would cease to happen. To give an example from two sectors which are supposed to have large employment effect on the economy, we can talk about agriculture, automobiles.

The various options towards a cashless or less-cash economy include Unified Payments Interface (UPI), Bank Card, prepaid cards, using various cards at any PoS (point of sale)/ ATM, Unstructured Supplementary Service Data (USSD) based mobile banking, Aadhaar-enabled payment system (AEPS) and e-wallet or digital wallet. Even as ordinary citizens queue up for cash and economists are busy estimating the extent to which economic growth will be hit because of the ongoing drive to replace high-value banknotes

Reducing Indian economy's dependence on cash is desirable for a variety of reasons. India has one of the highest cash to gross domestic product ratios in the world, and lubricating economic activity with paper has costs. According to a 2014 study by Tufts University, The Cost Of Cash In India, cash operations cost the Reserve Bank of India (RBI) and commercial banks about Rs21,000 crore annually. Also, a shift away from cash will make it more difficult for tax evaders to hide their income, a substantial benefit in a country that is fiscally constrained.

According to finance minister, situation will return to normalcy in two quarters. If so this move will have only temporary impact on the economy in terms of growth, but the impact can be minimised by promoting digitisation of economy.

Government is trying to promote the transaction in cashless form, which is a move in right direction. To promote cash less economy, finance minister Mr. Jaitely have announced following measures.

Here are the 10 key points of Jaitely's digital push announcements and likely impact on transactions.

- Announces 0.75 percent discount for people buying petrol, diesel via digital payment platforms. A total of 4.5 crore consumers buy petrol and diesel worth Rs 1,800 crore daily. In one month, digital payments have doubled to 40 percent. He said that the government expects fuel transactions worth Rs 2 lakh crore being carried out via digital mode.
- Effective 1 January 2017, 0.5 percent discount would be available for people buying monthly seasonal tickets in the suburban railway networks through digital payment mode, starting from the Mumbai suburban railways.
- Insurance cover worth Rs 10 lakh for travellers who book railway tickets through digital mode

- A discount of 5 percent for transactions on digital payment mode for railway facilities like catering, retiring rooms has also been announced by the Union finance minister.
- Buying general, life insurance policies from the websites of public sector insurance firms and using the same for paying premium would attract discounts of 10 percent and 8 percent respectively
- NABARD will give Rupay card to people who possess Kisan Credit Card
- Seeking to expedite the digital switchover, the government has decided to provide two point-of-sales machines each to villages with and over 10,000 population. A total of one lakh villages will be selected for the purpose across the country.
- A 10 percent discount on digital payments for RFID or fastags for highway toll has also been made.
- In order to ensure government departments and public sector enterprises go on a cashless path, the Merchant Discount Rate will not be borne by customers for public dealings
- Public sector banks are advised that merchant should not be required to pay more than Rs 100 per month as monthly rental for PoS terminals/Micro ATMs/mobile POS from the merchants to bring small merchant on board the digital payment ecosystem

There are no official estimates regarding the percentage of transactions in cash. But vast majority of economists think more than 90% of transactions are in cash form. Remaining are cashless transactions.

Now the key question is that can we really convert india into a cash less economy? What are the challenges and hurdles in the process ? A brief review of some facilities required for cashless economy will help in understanding the situation well.

1. According to data available on TRAI, there are 342 million internet users that is 27 percent of total population roughly . That means 73 % of population does not have access to internet. While the global median is 67 percent (*India Spend report march 2016*) . For the rural India this percentage is only 13%. This is the section worst hit by demonetisation. In urban India, 58 percent of people access the Internet.

2. Smartphone usage rate among adults 17 percent. Only 7 percent of adults in low-income families own a smartphone; the figure for wealthier families is 22 percent.

3. 1.02 billion mobile subscriptions, but only 15 percent have broadband internet: India had 1.02 billion wireless subscriptions, India has 930 million (90%) active subscribers, according to this November 2016 TRAI report. Of these, 154 million subscribers (15 percent) have broadband connections (3G + 4G).

4. The average time to load a page on a mobile phone is 5.5 seconds in India, compared to 2.6 seconds in China, 4.5 in Sri Lanka, 4.9 in Bangladesh and 5.8 in Pakistan, according to the "State of the internet Q1 2016" report by Akamai Technologies, a global content delivery network services provider. Israel has the fastest load time at 1.3 seconds.

5. There were 1.46 million PoS machines in use in India—that is, 856 machines per million people—according to this August 2016 Reserve Bank of India report. More than 70 percent of the PoS terminals are installed in India's 15 largest cities, which contribute to more than 75 percent of transactions, says the Ernst and Young report.

As an incentive to banks and manufacturers of PoS terminals, the government has waived 12.5 percent excise duty and 4 percent

special excise duty on these machines, as it hopes to install an additional 1 million PoS machines by March 2017.

6. Number of debit cards 712 million and on these 130 million numbers of transaction are made. That means 18 transactions for every 100 cards. Number of credit cards are 26.38 million and total number of transactions on these are 83.95 million.(medianama.com)

Impact on financial inclusion

RBI has also issued licences to open new-age small finance banks and payments banks which are expected to give a push to financial inclusion and bring innovative banking solutions. Things are also falling in place in terms of technology for India. The recently launched Unified Payments Interface by National Payments Corporation of India makes digital transactions as simple as sending a text message.

It is possible that a section of people which has used electronic mode of payment for the first time due to the cash crunch will continue to transact through this medium, but there are still a number of hurdles in making India a cashless economy.

First, a large part of the population is still outside the banking net and not in a position to reduce its dependence on cash. According to a 2015 report by Pricewaterhouse Coopers, India's unbanked population was at 233 million. Even for people with access to banking, the ability to use their debit or credit card is limited because there are only about 1.46 million points of sale which accept payments through cards.

Major hurdles in the transformation of economy into cash-less economy are following

Physical infrastructure:

Not enough physical infrastructures is available. So there is need to improve the availability of physical infrastructure in india. Number of citizens on mobile: Not all Indians use mobiles and not everyone is connected. The latest figures from the Indian telecom regulator TRAI show that, as of July 31, 2016, India had a tele-density of 83%, Note that these are the number of connections, not users, so you will have to discount this significantly, because many users have multiple SIM cards. The proof: Delhi has a tele-density of 234.77%. Urban wireless tele-density is 148%, and rural is 50.72%. And of the 1,034.23 million connections, 88.88% are active.-

Payment and mobile network capacity:

What we've seen with demonetisation and the increase in usage of cards and online payments is that somewhere in the value chain, banks and/or payment gateways were not in a position to handle the load. Transactions failed and we were told that Visa wasn't able to handle the load.

At present, there isn't sufficient capacity to accommodate escalated usage if everyone starts transacting digitally. More importantly, do we have the network capacity to deal with this? What happens in an emergency situation,

Security issues: The weakest security link in any transaction is not the technology system but the user and a lack of understanding of security issues. For instance, to withdraw money from ATMs, some people were giving others their card and PIN numbers . But there are other risks, too. In 2011, it was believed that payment gateway CC Avenue was hacked. HDFC Bank, too. And just last month, HDFC and Axis Bank were hacked.

The difference between depending on cash and digital payments is that using cash limits the damage from losing a note or a number of notes. When it comes to digital transactions, the risks are higher. Language compatibility: Paytm has recently updated its application with some features enabled in Indian languages. Mobikwik has done English and Hindi. Phone works in English, Hindi and Tamil. However, most mobile handsets don't have an Indian

language interface and that's the case for most mobile apps and services, too. Ola is available in Indian languages only for drivers, not passengers. Apart from Snapdeal, no e-commerce company has tried going the Indian language way. There's a part of the population in India which still isn't able to read and write, let alone read and write English. The digital divide here is massive and that's why physical notes worked.

Merchant costs: Merchants need a working internet connection to accept digital payments. They also need to pay a monthly cost to rent a machine or own a smartphone with an application to accept payments. On credit cards, merchants are charged a merchant discount rate (MDR), an inter-bank exchange fee, of 1.7%-2.5% per transaction. On debit cards, they need to pay 0.75% per transaction below Rs2,000 and 1% for transactions above Rs2,000. For UPI, merchants are charged 0.75% per transaction plus other costs (on par with debit cards).

Customer costs: You need a smartphone and an internet connection, plus you'll need to pay USSD charges (Rs0.5 per session) and data charges when applicable. Cash might be more expensive for the government, because of tax evasion, corruption, the need to keep recirculating old, spoiled currency, and the cost of enabling transfers, but digital is very expensive for citizens. What is happening here is a transfer of the cost of money from the government to citizens, as well as a massive collection of data. Using cash isn't the same as using digital payments because:

- Not enough people have mobile connections or internet connections, and the internet isn't prepared to accommodate a massive surge in use at times of emergency. What's more, many don't use the internet regularly and smartphones and mobile apps that support all Indian languages aren't available. Internet connectivity isn't reliable, available or as cheap for users as cash.
- The process of making digital payments in India is not easy and it's time consuming.
- Making digital payments costs more for both the merchant and the customer.
- Digital payments can lead to major security risks and currently there aren't adequate processes in place to address issues among either merchants or customers. Above all, not enough is being done to educate the consumer, the weakest link in the chain.
- Digital payments aren't a single standard like cash: money in one type of account is not the same as in another type of account, and it is not interoperable, unlike cash.

The important thing is to give people choice, and switch people to living cash-free gradually.

Parity between cash and digital money is probably impossible to achieve, but there are means of getting closer to it by creating an incentive structure for that switch. That involves making cash more expensive than going cash-free, and ensuring better enforcement.

Conclusion

About 90% of the workforce, which produces nearly half of the output in the country, works in the unorganized sector. It will not be easy for the informal sector to become cashless, and this part of the economy is likely to be affected the most because of the ongoing currency swap. Third, there is a general preference for cash transactions in India. Merchants prefer not to keep records in order to avoid paying taxes and buyers find cash payments more convenient. Although cashless transactions have gone up in recent times, a meaningful transition will depend on a number of things such as awareness, technological developments and government intervention. For instance, mobile wallets have seen notable traction, and it is possible that a large number of Indians will move straight from cash to mobile wallets. A study by Boston Consulting

Group and Google in July noted that wallet users have already surpassed the number of mobile banking users and are three times the number of credit card users.

However, as noted above, a material transition to a cashless economy will depend on a number of factors. First, the availability and quality of telecom network will play an important role. Presently, people face difficulties in making electronic payments even in metro cities because of poor network. Second, as one of the biggest beneficiaries of this transition, banks and related service providers will have to constantly invest in technology in order to improve security and ease of transaction. People will only shift when it's easier, certain and safe to make cashless transactions. Third, the government will also need to play its part. It will have to find ways to incentivize cashless transactions and discourage cash payments. Implementation of the goods and services tax, for example, should encourage businesses to go cashless.

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