

# Impact of Demonetization on Accelerating Digitalization in the Indian Economy

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## Abstract

On 8<sup>th</sup> November 2016 when world is curious to know the US Presidential candidate; there in India Prime Minister Mr. Narendra Modi did a surgical strike against Currency through a weapon called —Currency Demonetization. Demonetization means termination of agreement that 500 rupees and 1000 notes will no longer act as a legal tender of the country. The rapid Globalization has opened a door for faster transactions across the world in turn moving the individuals to Corporates to indulge in paperless, faster and highly transparent transactions by using internet and moving the global economies to digitalization. The current Paper focuses on how demonetization has improved the digital transactions across the nation and its impact on diversified Sectors, Markets and Economy.

**Keywords:** Demonetization, Economy, Digitalization, GDP, UPI, BHIM

## Introduction

The Government of India has made an historical decision and declared on 8<sup>th</sup> November 2016 that the five hundred and one thousand rupee notes will no longer be legal tender from midnight. The RBI will issue Two thousand rupee notes and new notes of Five hundred rupees which will be placed in circulation from 10<sup>th</sup> November 2016. Notes of one hundred, fifty, twenty, ten, five, two and one rupee will remain legal tender and will remain unaffected by this decision. This measure has been taken by the PM in an attempt to address the resolve against corruption, black money and counterfeit notes. This move is expected to cleanse the formal economic system and discard black money from the same. The year will be etched in the annals of the Indian history like year 1991 for its long standing impact owing to demonetization.

## The Indian Economy and Its Dependence of Cash

Even after the global advent of technology, India has severely lagged behind in successfully incorporating digital payment methodologies. This is mainly driven by two factors – the lack of awareness and a conscious pushback on digitization of payments. With a majority of masses remaining untaught about the various means of cashless payments, there wasn't much they could do up until now, to participate and avail the benefits of digital payments. According to a 2015 report by PWC, India's unbanked population itself stood at an alarming 233 million. With the Government's push towards opening bank accounts for these masses under the Jan Dhan Yojna, a huge number of bank accounts were opened, but they were largely inoperative up until the demonetization announcement.

Apart from this obviously unaware lot, there is another set of the population who deliberately avoid digitalization in order to not leave a trail of such transactions. Disturbingly, India carries the highest cash to GDP ratios in the world. Further, the RBI spends close to Rs. 21,000 crores each year in lubricating core-

cash operations. These numerals tell us of everything that is wrong with an overbearing cash economy and the urgent need to turn it around with digitization.

As per Finance Ministry the Consequences of Currency Demonetization decision on various economic variables and entities are as follows.

1. Effect on parallel economy (Black Money): The removal of these 500 and 1000 notes and replacement of the same with new 500 and 2000 Rupee Notes is expected to - remove black money from the economy as they will be blocked since the owners will not be in a position to deposit the same in the banks, - Temporarily stall the circulation of large volume of counterfeit currency and - curb the funding for anti-social elements like smuggling, terrorism, espionage, etc.
2. Effect on Money Supply: With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to reduce in the short run. To the extent that black money (which is not counterfeit) does not re-enter the system, reserve money and hence money supply will decrease permanently. However gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pickup.
3. Effect on Demand: The overall demand is expected to be affected to an extent. The demand in following areas is to be impacted particularly:
  1. Consumer goods
  2. Real Estate and Property
  3. Gold and luxury goods
  4. Automobiles (only to a certain limit)

All the above mentioned sectors are expected to face certain moderation in demand from the consumer side, owing to the significant amount of cash transactions involved in these sectors.

4. Effect on Prices: Price level is expected to be lowered due to moderation from demand side. This demand driven fall in prices could be understood as follows:
  1. Consumer goods: Prices are expected to fall only marginally due to moderation in demand as use of cards and cheque would compensate for some purchases.
  2. Real Estate and Property: Prices in this sector are largely expected to fall, especially for sales of properties where major part of the transaction is cash based, rather than based on banks transfer or cheque transactions. In the medium term, however the prices in this sector could regain some levels as developers rebalance their prices (probably charging more on cheque payment).
5. Effect on various economic entities: With cash transaction lowering in the short run, until the new notes are spread widely into circulation, certain sections of the society could face short term disruptions in facilitation of their transactions. These sections are:
  1. Agriculture and related sector
  2. Small traders
  3. SME
  4. Services Sector
  5. Households
  6. Political Parties
  7. Professionals like doctor, carpenter, utility service providers, etc.

#### 8. Retail outlets

The nature, frequency and amounts of the commercial transactions involved with these sections of the economy necessitate cash transactions on more frequent basis. Thus, these segments are expected to have the most significant impact post this demonetization process and the introduction of new notes in circulation.

6. Effect on GDP: The GDP formation could be impacted by this measure, with reduction in the consumption demand. However with the recent rise in festival demand is expected to offset this fall in overall impact. Moreover, this expected impact on GDP may not be significant as some of this demand will only be deferred and re-enter the stream once the cash situation becomes normal.
7. Effect on Banks: As directed by the Government, the 500 and 1000 Rupee notes which now cease to be legal tender are to be deposited or exchanged in banks (subject to certain limits). This will automatically lead to more amounts being deposited in Savings and Current Account of commercial banks. This in turn will enhance the liquidity position of the banks, which can be utilized further for lending purposes. However, to the extent that households have held on to these funds for emergency purposes, there would be withdrawals at the second stage.
8. Effect on Online Transactions and alternative modes of payment: With cash transactions facing a reduction, alternative forms of payment will see a surge in demand. Digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), etc. will definitely see substantial increase in demand. This should eventually lead to strengthening of such systems and the infrastructure required.

#### Effects of Demonetization

The alternate platforms – cards, internet banking, mobile banking, and PoS terminals have further gained momentum post the demonetization announcement. However, there is heavy disruption to the business due to which growth expectations have reduced. International rating agency Fitch has lowered India's GDP growth to 6.9% for the financial year 2017. The following are the other effects: It may cause deflation in the market as people who have earned money through illegal ways would be afraid to declare the money in fear of prosecution due to the illegitimacy of the income. It has already led to reduction of money circulation in the economy and this may result in deflation. A lot of cash which are legally earned will be deposited in the banks and now the banks with more deposits will be able to do more lending and the rate of lending may come down. Accessibility of loans will become easier and as interest rates reduce economic activity will be boosted.

#### Pre-Requisites and Need of A Digital Economy In India

The Digital India dream as visualized by the Indian Government may become a full-fledged reality sooner than not if collaborative efforts are taken in the right direction. Considering that 90 percent of the transactions in the country are predominantly in cash, powerful efforts will be required to champion this change. The demonetization move, though criticized by many, has been a fool-proof plan to urge the population in employing cashless payment models. There has been a remarkable rise in digital payment pathways such POS terminals (pioneered mainly by banks), mobile wallets (pioneered by a few prepaid wallet players), government-powered interfaces such as UPI, among others that are providing an important aid to the economy as a whole. Post demonetization; some of the wallet providers have already confirmed an exponential growth.

Earlier last year, the Reserve Bank of India (RBI) had granted permissions to a bunch of Indian companies

to setup payment banks in India. Further, with India being a growing economy, a rise in digitization will only create favorable conditions for inducing foreign investments, which will go a long way in bolstering the Indian economy. With the Government initiating the digital movement and various players such as the Banks, Financial Institutions, IT firms, etc. piloting their own supporting platforms, the only pending prerequisite is for the public to receive the changing cashless wave with open arms.

#### The naive trends of the cashless movement post demonetization

As discussed earlier, there has been a substantial rise in the popularity of a number of technology-enabled payment methods since the dawn of demonetization. Apart from the noticeable growth of mobile wallets, usage of cards at POS terminals and faster adoption of mobile banking methodologies, there are few more initiatives that have supported the digitization of payments:

### 1. Online payment gateways like EBS play a vital role in this transition

Online payment gateways have traditionally catered to sellers selling their product & services remotely over the internet through websites and mobile applications. EBS (E-billing Solutions Pvt. Ltd), a fully owned subsidiary of the Ingenico Group, is one such leading online payment gateway in India. It is a payment aggregator that helps online sellers receive payments from the end customers via a cluster of payment methods including net banking, debit/credit cards and mobile wallets.

Post demonetization announcement there was a cash crunch for a number of days and the clients of EBS started facing challenges to fulfill their cash on delivery (COD) orders. EBS was very quick to react in this situation and supported its online sellers to convert the COD transactions into payment links that can be sent over Email & SMS. The customer can simply click the link and make a payment using one of the listed payment methods. The seller would dispatch the goods only after receiving a payment confirmation from EBS, thereby converting a good chunk of their COD transactions into prepaid and thereby avoiding returns.

There are a number of other initiatives that players like EBS are working on. Given the need for the businesses to go live and start accepting payments faster to minimize the opportunity loss, EBS promises a prompt on-boarding process with minimum human intervention. It allows businesses to register at a zero set up cost and a go-live turnaround of just 24 hours post online registration by the seller. Apart from a multilingual payment page (supports 7 regional languages), EBS also allows merchants to customize their own payment gateway page by adding their logos and designing edits if need be.

Recently, the Government of India and then the Reserve Bank of India announced sops on MDR for some of the debit card transactions. EBS promptly responded to these initiatives and passed on these MDR benefits to its online sellers.

### 2. Rise in Payment on delivery in contrast to COD transactions

E-commerce portals and online businesses were thriving on the Cash on delivery functionality to a great extent prior to the introduction of demonetization. Despite 600 million plus debit and credit cards in the country, cash was the preferred means of payment for online buyers. However, the liquidity crunch in the country led to reduction in cash transactions across domains. To safeguard themselves in such a scenario, the e-commerce sector shifted towards promoting prepaid transactions and also towards acceptance of cards (debit and credit) on delivery by ensuring that the delivery personnel carry a POS device.

Apart from this, the other method of enabling digital payment transactions without the need of a POS terminal is very similar to how EBS helped some of its sellers convert COD transactions to prepaid transactions. In this, the seller is equipped with a mobile or web application using which they can then raise a payment request to their customers over email & SMS. Customers can then make an online payment on their mobile phones or any other device by accessing the EBS payment page. Once the payment confirmation is provided to the seller, the goods and/or the services are dispatched / delivered.

### 3. Introduction of government led initiatives such as UPI and BHIM

Being the forerunner of Digital India, the Government of India is widely fostering the growth and disbursement of digital platforms. Apart from granting licenses and permits to many private players in this domain, the government is also leading such initiatives with the help of NPCI:

**UPI:** UPI stands for Unified Payment Interface and it is run by the National Payments Corporation of India (NPCI). The mechanism behind this novel platform involves the use of an app to transfer funds from one bank to another, without the hassle of typing out bank account details or the IFSC code. In UPI, the recipient is required to register with any UPI enabled app (mostly provided by the banks) to create a unique virtual payment address (VPA). Over 21 banks including ICICI, HDFC, SBI and others now have their own UPI app for android/IOS users. The sender can simply transfer money using their UPI app to the recipient's VPA. The money is instantly debited from the sender's account and credited into the recipient account. Though it is still in its early stages, UPI is a boon for many in India in the current era of post-demonetization.

**BHIM:** BHIM stands for Bharat Interface for Money, another Government of India initiative, is operated by the National Payments Corporation of India (NPCI). To use this service, one needs to download the BHIM mobile application and register their bank account using debit card credentials. BHIM allows its users to create UPI VPAs and transact digitally over the UPI rails. To explain it simply, it is the UPI application created by NPCI and can be used by all account holders of UPI enabled banks. This service also has the ability to function without the internet over USSD channel. With several banks now supporting the BHIM, it is another solicited initiative that wholly supports the Digital India movement by the Government.

As per the India-E-Commerce-Market-Forecast-and-Opportunities, 2020;<sup>7</sup> India's ecommerce market is projected to grow at a CAGR of more than 36% between 2015-2020, with the B2B segment predicted to grow by 2.5 times by the end of the period. These numbers further corroborate the burning need to embrace digital, cashless mechanisms. Demonetization has certainly helped the Indian economy to take a leap towards the eventual goal of digitization. With its positive force, the populace including common masses, online as well as physical sellers and marketplaces are incorporating various electronic models and payment methodologies that are slowly but significantly guiding the country towards the pinnacle of a digital and a -less- cash India.

### Conclusion

The rewards of demonetization are much encouraging and the demonetization is in the long term interest of the country. Government need to ensure that there will be a smooth flow of currency exchanges. Demonetization will have a massive impact on parallel economy. The current demonetization initiative by the Government of India will take Indians ten steps ahead. Though it has given temporary pains, it taught financial lessons. It will also impact corruption, elections and terrorism. It is a reaping time for the banks that made considerable investments on digitization of banking services. The cashless and transparent mechanism has gained momentum post demonetization. In spite of the initial hiccups and disruptions in the

system, eventually this change will be well assimilated and will prove positive for the economy in the long run. Black money hoarders will definitely lose out, eventually boosting the formal economy in the long run. Short term fall in real estate prices might benefit middle class citizens. This move by the Government along with the implementation of the GST will eventually make the system more accountable and efficient. No restriction of any kind on non-cash payments by cheques, demand drafts, debit or credit cards and electronic fund transfer would further boost the economy.

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