



Demonetisation and Digitalization in India

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Abstract

Demonetisation is a revolutionary step made by the government to curb the black economy, counterfeit currency, terror financing and corruption. The introduction of new series of notes could provide an opportunity to tackle counterfeiting terror financing and black money. It can catalyse long term economic reform. Low Inflation, more affordable real estate and possibility of lower tax rates as the net tax base could become wider are among the fruits of demonetization which reap in the long-run. Black money places an unfair burden on honest citizens of the country. This paper discusses the economic impact of demonetization on digitalization of Indian Economy and gave suggestion to improve the digital structure in India.

Keywords: Indian economy, black money, demonetisation; corruption

Introduction

Demonetisation has been the burnt debatable topic after November, 8 2016. It is the act of removing a currency unit of its status as legal tender and circulation. It occurs when government retired the currency in circulation and insert new currency in circulation. It is not the first time in India, earlier The Indian government had demonetised bank notes on two prior occasions—once in 1946 and then in 1978—and in both cases, the goal was to combat tax evasion by "black money" held outside the formal economic system. The PM surgical strike is the policy enacted by the government of India on Black economy. It ceases the high denomination notes in circulation. The demonetisation of Rs. 500 and Rs. 1,000 banknotes was a policy decision by the Government, ceasing the usage of all 500 and 1,000 banknotes of the Mahatma Gandhi Series as legal tender in India from 9 November 2016. The demonetization process is estimated to mop up 86 percent of India's currency in value terms. Indian Economy is the highest producer and consumer of currency notes after china around 90 billion banknotes were circulating in India till March 2015.

The announcement was made by the Prime Minister of India Narendra Modi in an unscheduled live televised address at 20:00 Indian Standard Time (IST) on 8 November 2016. In the announcement, Prime Minister declared that use of all 500 and 1,000 banknotes of the Mahatma Gandhi Series would be invalid past midnight, and announced the issuance of new 500 and 2,000 banknotes of the Mahatma Gandhi New Series in exchange for the old banknotes. The banknotes of 100, 50, 20, 10 and 5 of the Mahatma Gandhi Series and 2 and 1 remained legal tender and were unaffected by the policy.

The government claimed that the demonetisation was an effort to stop counterfeiting of the current banknotes allegedly used for funding terrorism, as well as a crack down on black money and corruption in the country. The move was also described as an effort to reduce corruption, the use of drugs, and smuggling.

However, in the days following the demonetisation, banks and ATMs across the country faced severe cash shortages with severe detrimental effects on a number of small businesses, agriculture, and transportation earlier days. People seeking to exchange their notes had to stand in lengthy queues, and several deaths were linked to the inconveniences caused due to the rush to exchange cash. Also, following the announcement, the BSE SENSEX and NIFTY 50 stock indices crashed for the next two days.

Historically, previous Indian governments had demonetised bank notes. In January 1946, banknotes of 100 and 1,000 rupees were withdrawn and new notes of 100, 500 and 1000 rupees were introduced in 1954. The Janata Party coalition government demonetised banknotes of 1000, 5000 and 10000 rupees on 16 January 1978 as a means of curbing counterfeit money and black money.

In 2012, the Central Board of Direct Taxes had recommended against demonetisation, saying in a report that "demonetisation may not be a solution for tackling black money or economy, which is largely held in the form of benami properties, bullion and jewellery". According to data from income tax probes, black money holders keep only 6% or less of their ill-gotten wealth as cash, hence targeting this cash may not be a successful strategy.

On 28 October 2016 the total banknotes in India was Rs. 17.77 trillion (US\$260 billion) in circulation. In terms of value, the annual report of Reserve Bank of India (RBI) of 31 March 2016 stated that total bank notes in circulation valued to Rs. 16.42 trillion (US\$240 billion) of which nearly 86% (around Rs. 14.18 trillion (US\$210 billion)) were 500 and 1,000 banknotes. In terms of volume, the report stated that 24% (around 22.03 billion) of the total 90266 million banknotes were in circulation.

The Reserve Bank of India laid down a detailed procedure for the exchange of the demonetised banknotes with new 500 and 2,000 banknotes of the Mahatma

Gandhi New Series and 100 banknotes of the preceding Mahatma Gandhi Series. A window of fifty days until 30 December 2016 was stipulated to deposit the demonetised banknotes as credit in bank accounts. For immediate cash needs, the banknotes could be exchanged over the counter of bank branches upto a limit that varied over the days:

- Initially, the limit was fixed at 4,000 per person from 8 to 13 November 2016.
- This limit was increased to 4,500 per person from 14 to 17 November 2016.
- The limit was reduced to 2,000 per person from 18 November 2016.

All exchange of banknotes was abruptly stopped from 25 November 2016.

Cash withdrawals from bank accounts were restricted to 10,000 per day and 20,000 per week per account from 10 to 13 November 2016. This limit was increased to 24,000 per week from 14 November.

Initially, all ATMs were dispensing banknotes of only 50 and 100 denominations and cash withdrawals from ATMs were restricted to 2000 per day. From 14 November onwards, ATMs recalibrated to dispense new 500 and 2000 notes allowed a maximum withdrawal of 2,500 per day.

However, exceptions were given to petrol, CNG and gas stations, government hospitals, railway and airline booking counters, state-government recognised dairies and ration stores, and crematoriums to accept the old 500 and 1,000 banknotes until 11 November 2016, which was later extended to 14 November 2016 and once again to 24 November 2016. International airports were also instructed to facilitate an exchange of notes amounting to a total value of 5,000 for foreign tourists and out-bound passengers.

Under the revised guidelines issued on 17 November 2016, families were allowed to withdraw 250,000 for wedding expenses from one account provided it was KYC compliant. The rules were also changed for farmers who are permitted to withdraw 25,000 per week from their accounts against crop loan.

Experts Comment on Demonetisation

The move disrupted the lives of ordinary peoples. They face cash crunch led to decrease in demand in market, job losses and deaths. Many Economists has criticized demonetization for short run. Initially, the move received support from several bankers as well as from some international commentators. It was heavily criticised by members of the opposition parties, leading to debates in both houses of parliament and triggering organised protests against the government in several places across India. As the cash shortages grew in the weeks following the move, the demonetization was heavily criticised by prominent economists, such as Kaushik Basu, Paul Krugman, Amartya Sen and Steve Forbes.

Nobel laureate Indian economist Amartya Sen, severely criticised the demonetisation move calling it a "despotic action" among other things.

Prof Arun Kumar a former professor of economics at the Jawaharlal Nehru University, Delhi describes how

this hasty drive will adversely impact demand, employment and investment.

Former Senior Vice-President and Chief Economist of the World Bank, Kaushik Basu, called it a 'major mistake' and said that the 'damage' is likely to be much greater than any possible benefits.

Pronab Sen, former Chief Statistician and Planning Commission of India member, called it a "hollow move" since it did not really address any of the purported goals of tackling black money or fake currency.

Prabhat Patnaik, a former professor of economics at the Jawaharlal Nehru University, Delhi called the move 'witless' and 'anti-people'. He criticised the simple way in which black money was assumed as "a hoard of cash", saying that it would have little effect in eliminating "black activities" while "causing much hardship to common people."

Noted economist and journalist, T. N. Ninan wrote in the Business Standard that demonetisation 'looks like a bad idea, badly executed on the basis of some half-baked notions'. Deepak Parekh (Chairman of HDFC) had initially appreciated the decision to ban the Rs. 500 and Rs. 1000 notes, but later said that the move had derailed the economy, and expressed skepticism about its outcome.

Many Economists said that the note ban can affect largely the retails, manufacturing and leads to economic recession.

Steve Forbes described the move as 'Sickening and Immoral'. He stated that "What India has done is commit a massive theft of people's property without even the pretense of due process--a shocking move for a democratically elected government." Nobel laureate Paul Krugman said that it is difficult to see gains from demonetisation, while there may be significant costs to it.

BRICS, ICT and Digitalisation

Networked Readiness Index (NRI) or Technology Readiness is released by World Economic Forum annually as a part of Global Information Technology Report (GITR). The index basically measures the impact of information and communication technology (ICT) on a country and also calculates how much a country has used the ICT to grow.

In the Networked Readiness Index 2016, India has been ranked at the 91st position out of 139 countries. The ranking has come as a shock because the flagship project Digital India had supposedly raised the digital drive of the country. So the Ranking in Networked Readiness Index goes down.

Brazil comes in at 72nd place due to ICT adoption and usage by both individuals and the business community and supported by very good affordability—in particular, cheap fixed broadband Internet connections. Brazil makes large strides in terms of improving individual usage this year, climbing five places to 57th—this is a considerable achievement, given that other countries are also moving quickly on individual adoption. Yet networked readiness in the country continues to be held back by a weak regulatory environment.

The Russian Federation remains in 41st place this year, as in 2015. The country places in the top third of the rankings for Readiness, Usage, and Impact, yet continues to be held back by a weak and deteriorating regulatory environment.

Despite an overall mixed performance, South Africa makes large strides in the overall NRI rankings to 65th, almost entirely driven by improvements in infrastructure and affordability. South Africa’s digital transformation is mostly business driven, as the country notably performs best in business usage (32nd), followed by individual usage (77th), followed by government usage (105th).

China moves up by three places to 59th based on improvements in Usage and Impact. Adoption by individuals has increased, particularly in terms of mobile broadband subscriptions, which nearly doubled in one year from 21.4 to 41.8 per 100 population. Chinese businesses will need to step up their efforts to embrace digital technologies and spur innovative processes for the country to become an innovation-driven, high-income economy. Although patenting activity has increased significantly in recent years, it is still relatively low compared with that of advanced economies, and the full economic and social impacts of ICTs are still in the process of materializing.

Despite of improvements in its political and regulatory environment (78th, up four) and in its business and

innovation environment (110th, up five), India slips down two positions to an overall rank of 91. Although India’s absolute score has changed only marginally in recent years, the drop can be attributed in part to the fact that other countries are moving ahead at higher speeds. In addition, lack of infrastructure (114th) and low levels of skills among the population (101st) remain the key bottlenecks to widespread ICT adoption, especially in terms of individual usage (120th). A third of the Indian population is still illiterate (95th) and a similar share of youth is not enrolled in secondary education (103rd). Only 15 out of 100 households have access to the Internet and mobile broadband remains a privilege of the few, with only 5.5 subscriptions for every 100 people. This is in spite of the fact that affordability has long been one of the strengths of the Indian ICT ecosystem, with the country ranking 8th this year in this area. A deep divide persists between well-connected metropolitan hubs and remote rural areas, where even the most basic infrastructure is insufficient. In 2015 the government launched the Digital India program, which aims to close this gap by fostering investment in digital infrastructure, improving digital literacy, and increasingly providing online services to citizens. India’s performance in terms of providing online services and allowing e-participation has so far been in line with that of peer countries, but far from the global best (57th and 40th, respectively).

Table 1: The Networked Readiness Index of BRICS

Country	Value (2016)	Rank 2016	Value 2015	Rank 2015	Value 2014	Rank 2014	Value 2013	Rank 2013
Brazil	4.0	72	3.9	84	4.0	69	4.0	60
Russia	4.5	41	4.5	41	4.3	50	4.1	54
India	3.8	91	3.7	89	3.8	83	3.9	68
China	4.2	59	4.2	62	4.1	62	4.0	58
South Africa	4.2	65	4.2	75	4.0	70	3.9	70

World Economic Forum (2016), Global Information Technology Report (GITR)

After analysis of these figures, we are still behind the other countries like Russia, China, South Africa and Brazil.

Government Steps for Digitalization for the economy

Promotion of digital economy is an integral part of the government strategy keeping view of greater formulization of the economy and financial system. To achieve this goal, the government imposed a restriction on cash transaction above Rs. 3 lakhs. To curb the black economy and modernisation towards cashless economy government imposes this step.

‘Black Money’ refers to any income on which the taxes imposed by government or public authorities have not been paid. Such wealth may consist of income generated from legitimate activities or activities which are illegitimate per se, like smuggling, illicit trade in banned substances, counterfeit currency, arms trafficking, terrorism, and corruption. In its 1985 report on Aspects of Black Economy, the NIPFP defined ‘black income’ as ‘the aggregates of incomes which are taxable but not reported to the tax authorities’. Further, black incomes or unaccounted incomes are ‘the extent to which estimates of national income and output are biased downwards

because of deliberate, false reporting of incomes, output and transactions for reasons of tax evasion, flouting of other economic controls and relative motives’(Ministry of Finance, 2012). Black money spoiling the prospects of the country’s true economic growth (Economic Times 2016).

The government tries to push its digitalization move through smart cities and digital India. The Bharat Net Project has been initiated to broadband connectivity to over two lakh gram panchayats in the country at an initial cost of Rs. 20000 crore through budgetary allocations. By the end of 2017-18, high speed broadband connectivity on optical fibre will be available in more than 150000 gram panchayats with wifi hot spots and panchyats access these services at low tariffs. DigiGaon has also introduced to provide tele-medicine, education and skills through digital technology to the people. The spectrum reforms have removed spectrum scarcity in the country. It gives a major fillip to mobile broadband and digital India for the benefits of people living in rural and remote areas. To curb the black economy and motivate the digitalization in all transaction above 3 lacks reduces the scope of generation of black economy in the system. A mission is proposed with a target of 2500 crore digital transactions for 2017-18 through various modes.

Electronic Payment Systems (RTGS + NEFT + CTS + IMPS + NACH + UPI + USSD + Debit and Credit + PPI + Mobile Banking = Total) Volume in million, Value in Rs. billion

Table 2

Data for the Period	Total	
	Volume	Value
01 Nov 16	671.5	94004.2
01 Dec 16	957.5	104055.3
01 Jan 17	870.4	97011.4
01 Feb 17	763.0	92594.5
01 March 17	893.9	149589.1
01 April 17	853.1	109602.2
01 May 17	858.5	111109.3
01 June 17	844.7	113745.2

Reserve Bank of India (2017) Electronic Payment Systems

After analysis of data the value of Electronic Payment system including all the item which is mention above reveals that there are 21 percent increase in tems of value and the volume is increased from 671.5 millions to 844.7 millions in June 2017. In a similar study Niti Aayog had stated in his document on Digital Payment Revolution: Facts & Figures that the volume of all digital transactions "increased by about 23 times with 63,80,000 digital transactions for a value of Rs 2,425 crore in March 2017 compared to 2,80,000 digital transactions worth Rs.101 crore till November 2016."

Measure to Strengthen the Digital Infrastructure in India

The government had set up a committee on Digital Payments. The committee has recommended structural reform in the payment eco system, including amendments to the payments and Settlement System Act, 2007.

A Computer Emergency Response Team has proposed to monitor Financial Sector. It works in close coordination with all financial sector regulation and other stakeholder. The Government should focus on the digital infrastructure to increase the digital system in the economy. Give motivation to those in terms of gifts that is using digital payments and provide more facilities in rural areas. In the rural areas, most of the population engaged in agriculture and creating digital infrastructure it will provide jobs to the rural youth.

The Finance ministry has also proposed to introduce a merchant version of Aadhar enabled payment system for those who donot have debit cards, mobile wallets and mobile phones.

Reforms in the financial sectors and digitization will also strengthen the industry and services sectors. Digitalisation strengthen the digital economy and generate long term benefits in terms of reduced corruption and greater formulization of the economy.

Conclusion

Digital revolution has a transformational impact in terms of formalization of the economy specially BHIM app and other digital instrument used by government to make the system transparent and vigilant.

The immediate consequences of the demonetization of

500 and 1000 rupee notes and their replacement by new currency of 500 and 2000 rupee notes have major impact on transaction in short run. This has less obvious intermediate and long term consequences.

Digitalization reduces the risk of tax evasion, widens the tax base and curbs the black economy in many aspects. Many Business activities in rural and urban areas neither paid tax not registered. Their earnings were spent on buying luxurious items and increase prices and direct money to wasteful consumption rather than investment. By sucking money out of the economy and digitalisation would help to monitor the black economy.

A trust has been made for increasing the digital payments in the economy through debit and credit cards, internet banking, mobile apps and e-wallets. It also increases the digitalization of the economy through using of technology in transaction activities. The government believes that this will hasten the shift to a cashless economy, making life both easier and more transparent. Enhancing digital infrastructure, capping cash transaction, reducing cash donations using Aadhaar are significant measures for digitalization.

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