

DEMONETIZATION- ISSUES AND CHALLENGES

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ABSTRACT

Banks are the financial backbone of a country. Banks play a crucial role in channelizing the money from the one who has capital to the one who needs capital. Considering a wider scale, banks pool small savings of individuals into a relatively larger investment under various industrial and agricultural sectors. In a developing country like India, it solves major problems like the deficiency of capital formation and helps generate employment opportunities. By providing financial assistance to trade, industry, agriculture and individual customer activities it promotes new entrepreneurs. It thus aims at an overall balanced economic development.

Demonetization is an act of replacing the current currency in the economy with a new one. It is the process of removing a currency from general circulation in a country. Demonetization helps fight inflation, corruption, remove counterfeit currency and discourage cash system. It is a massively serious economic phenomenon. If handled with proper plan and protocol, demonetization can bring down corruption and anti-national activity. To fight corruption, fake currency and undisclosed black money, the government of India announced demonetization of high denomination currency notes Rs 1000 and 500 on 8th November 2016. A new series of Rs 500 and fresh Rs 2000 bank notes were introduced to circulation from 10 November 2016. This decision by the government of India could be seen more as a surgical strike overnight that caused huge chaos in the lives of millions. The whole country had to go through a really tough time. Many lost their lives; many faced huge turn down in businesses and profits too, in a sense that the socio-economic lives were disturbed as a whole.

On the other hand demonetization brought a load of challenges to the banks in addition to the ones already existing. Initially it disrupted the banks and stressed strongly to carry out bank operations and in long run helped the banks to pool the deposits without incurring of any cost. The cash flow in the banks, interest rates, money lending, online-banking and no. of account holders and various other parameters have changed dramatically which could play a crucial role in the future times of Indian economy. Initially post-demonetization management brought various ugly consequences and impact on the country's economy. Many argue that the whole act of demonetization turned out to be waste. Many banking conditions haven't reached back to the normal conditions which need still more time to settle back. There are both benefits and drawbacks regarding this movement that dramatically affected the Indian banking systems. This paper is an honest attempt to analyze various issues and parameters of Indian banking system affected due to demonetization both positive and negatively.

KEY WORDS: Demonetization, entrepreneurs, denomination, counterfeit currency, corruption.

INTRODUCTION

Demonetization, the worst nightmare black money holders and corrupt professionals has ever seen in the history of Indian economics and finance. On 8th of November 2016, the Prime Minister Narendra Modi brought the biggest strategic plan to defeat corruption and black money- demonetization. This decision by the government of India, affected every economic and financial segment of the country. Many small scale businesses and daily transactions were disturbed. Not only people faced a financial set back, but many lost their lives during the process of currency exchange. Addressing the country regarding the frequent modification post demonetization and uncertainty that has prevailed, the PM says, **“One must be able to distinguish between neethi (policy) and ran-neethi (strategy) and not put them in the same basket. The decision of demonetization, which reflects our neethi, is unequivocally clear, unwavering and categorical. Our ran-neethi however needed to be different, aptly summarized by the age old saying of “Tu daal daal, Main Paat Paat”, that we must stay two steps ahead of our enemies”**. The government of India sees demonetization as a strategy to demolish corruption. An action against the terrorist funding and money encouragements for various anti-social practices like human trafficking and drug trafficking. After the introduction of new currency notes of Rs 500 and Rs 2000, it was under the hands of RBI and banks to bring the new currency into circulation effectively. This brought huge impact on Indian banking system ever. Not only the work load on the bank employees was increased but many banking parameters were also affected. The no. of account holders, money deposits, money lending, interest rates, online banking, plastic card usage and functioning of ATMs etc. changed dramatically. This paper is an attempt to discuss the impact of demonetization on these banking variables.

OBJECTIVES

1. To understand the issues and challenges concerned with Indian banking system.
2. To understand demonetization and its relation with the Indian banking and economy.
3. To analyze the good and bad outcomes of demonetization.
4. To understand the influence of demonetization on banking operations under both short and long terms.

RESEARCH METHODOLOGY:

This study is descriptive in nature. The methodology of the present study exclusively relies on the secondary data and information of national and state level. “Demonetization-impact and challenges” is estimated based on the available secondary sources such as government publications, reports of various state level and national level journals and books.

INDIAN BANKING SYSTEM ISSUES AND CONCERNS

Today banking can seem very complex but originally the idea was to make life simpler. Banks are in the risk management business. The banks play a crucial role in our day to day life. Banking can be defined as the business activity of accepting and safeguarding the money owned by individuals and entities and lending out this money in order to earn a profit. Basically Banking performs financial intermediation by pooling savings and channelizing them into investments and hence keeping the country's economy growing. Other sources of income for banks include accepting saving deposits, the credit card business, buying and selling currencies, custodian business and cash management services.

India banks have a brief history of over 300 years with Bank of Hindustan being the first one to be established in 1770. There are currently 27 public sector banks in India out of which nineteen are

nationalized banks and six are SBI and its associated banks and rest two are IDBI bank and Bharathiya Mahila bank. There are total 93 commercial banks in India. However, India's banks face different kinds of problems, which have affected their profitability and financial stability. Developing countries like India, still has a huge number of people who do not have access to banking services due to scattered and fragmented locations. But if we talk about those people who are availing banking services, their expectations are raising as the level of services are increasing due to the emergence of Information Technology and competition. Some of the issues like bad loans, NPAs, cyber threats and other banking frauds bring huge losses to the banks. Since a majority of Indian population is illiterate and lack knowledge of banking and loan facilities, many don't reach out to banks. Also banks face the problems of customer retentions.

DEMONETIZATION

Demonetization is an act of replacing the current currency by a new one for various economic and financial reasons in favor of the country. It is a massive step taken by the government to tackle corruption. Demonetization is a very powerful weapon that can affect many lives. Hence it is very important to handle the whole process of demonetization carefully with proper authority. On 8th November 2016, 20:00 IST, the government of India under the leadership of Prime Minister Mr. Narendra Modi announced the demonetization of notes Rs 500 and Rs 1000 from legal circulation. The sudden striking step by the government left the whole country in shock.

In United States, 40% of transactions involve cash, 25% with debit cards and 17% with credit cards. In India with a huge economy as well have 90% of its transactions in cash. Analyzing further, it is surprising that 86% of the cash in circulation existed in the form of two banknotes, the Rs 500 and Rs 1000 notes. Since majority of transactions were from the based on these currency notes, major setback hit the whole country. The major of the country's business transactions under formal and informal sectors was paused. The whole country went nearly cashless until new currency notes of Rs 500 and Rs 2000 was brought into circulation from 10th November 2016. Banks being the center for all the currency switching and exchange processes, was put under severe stress. The economic and financial situation was facing hard time to pass.

REASON FOR DEMONETIZATION:

1. To beat black money in the economy.
2. To lower the currency in circulation that is basically from an illegal corrupt basis.
3. To eliminate fake currency and tackle terrorist funding.

India has always been fighting corruption and black money. The present day's Indian economic growth is being greatly affected by corruption, black money and terrorism. Talking about black money, there is no formal definition of black money in economic theories. In India Black money refers to the capital earned in the black market, on which income and other taxes have not been paid. Basically black money is the fortune which couldn't be counted on for legal economic development of India. The next biggest enemy is fake currency. When fake currency flows into the system, the overall currency in the economy increases. With the increase in demand for consumption due to increased currency circulation, production, supply increases. Sometimes, worse situation like, increased production can face decreased true demand, leading to inflation in the economy. With this fake currency and black money many illegal and anti-social activities are being funded. Thus to overcome these situations the government of India came up with a plan to demonetize higher denomination currency which is a huge 86% of Indian cash flow.

BANKS AND DEMONITIZATION:

The legal currency printed by the Government of India flows into the system by two major ways. Through public expenditure the government spends money in creating country infrastructure, pensions and developmental schemes. The second way is through banks. The banks are authorized to legally introduce this currency into circulation through loans and through exchanges. After demonetization, which is more correct if called a surgical strike, brought enormous pressure on banks. The whole country was in need of new currency for daily transactions and business activities. The bank employees had to work really hard to bring back the financial situation back to normal. All workers – tellers, dispatchers, directors, security personnel, housekeeping staff and clerks have been pulled in the focal point of the clearing storm, the biggest demonetization storm ever known. The act of demonetization brought floods of customers to banks. This made a huge impact on Indian banking system.

IMPACT OF DEMONETIZATION ON INDIAN BANKING:

Demonetization has had both positive and negative impact at particular time frames in various financial sectors of the society. Many banking parameters have been influenced. The inflow of cash, money lending, online banking, cashless transactions, plastic cards and many others have been impacted. Various research studies were done. One of which was done by Bhupal Singh and Indrajit Roy, RBI directors from the monetary policy department and department of statistics and information management, shows that the excess deposits accrued to the banking system due to demonetization range between Rs 2.8-4.3 trillion. “Excess deposit growth in the banking system during the demonetization period works out to 4-4.7 percentage points. If the period up to mid-February 2017 is taken into account to allow for some surge to taper off, excess deposit growth is in the range of 3.3-4.2 percentage points. The liquidity boost resulting from the demonetization announcement has stayed with the banking sector helping banks reduce their high-cost deposits and boosting their current account and savings account (CASA) ratio. CASA is abbreviation of current Account Savings Account. It is the ratio which indicates how much of the total deposits with bank in the current account and savings account. In a simple language, the deposits with the bank are in the current account and savings account. Banks do not pay interest on the current account deposits and pays a very low% of interest on savings on account deposits. It is necessary to focus on different banking variables separately.

- 1. Deposits:** Majority of the population did not have an easy access to banks. Due to illiteracy and lack of knowledge about banking systems major of the population depend on home savings. This is certainly a small saving and won't be accountable for large scale investment purposes. But demonetization initially increased huge money flow from home savings to bank deposits, now available for investment and other commercial purposes. Unaccounted money in the form of Rs.500 and Rs.1000 were flowing to the Banks and the sizes of deposits have been increased. It helped the banks to grab the deposits and increase their deposits.
- 2. Cost of fund:** After demonetization the deposits have increased. It led the banks to keep a major part of deposits in the form of cash deposits. Public service banks whose shares are listed on stock market, have a lion share (over 70%) of the deposits and biggest gainers of the rise in deposits, leading to lower cost of funds. Increased liquidity conditions have helped facilitate the transmission of monetary policy to market interest rates. Post demonetization, several banks lowered their domestic term deposit rates and lending rates. With the sharp increase in low cost CASA deposits, the overall cost of borrowings declined, allowing banks to reduce their lending rates.

3. **Money lending:** Lending growth of the banks is considerably less even after demonetization and its impact of growth in the amount of public deposit. Banks have tried to lend the money to the needy group by reducing their interest rates.
4. **Government Bonds:** After sharp rise in deposits on post demonetization, banks started lending such surplus deposits to the RBI under the reverse repo options. Public service Banks, particularly, deployed excess funds in government bonds. The return on bond investment is likely to add 15 to 20 per cent increase in the earnings of banks.
5. **Digital banking:** In a cashless economy, the transactions are supposed to be made on a virtual basis through electronic channels such as direct debit, credit and debit cards, electronic clearing and payment systems such as Immediate Payment Service (IMPS), National Electronic Funds Transfer and Real Time Gross Settlement in India.
6. **Rural bank lending:** The note ban hurt rural India; loan growth was far below its pre-demonetization levels. Indeed, in the second half of financial year 2017, bank lending to rural Haryana, Punjab, Goa, Maharashtra and Kerala contracted. Lending to rural Maharashtra fell by as much as 9.2%. Putting that in perspective, bank loans in the second half of financial year 2016 to rural Haryana increased by 18% and to rural Punjab by 12.2%, while rural Maharashtra saw an increase in lending of 5.8%. Not a single state had showed a contraction in rural lending in the second half of FY16. In other words, the slowdown in rural lending in the second half of FY17 was very abnormal and may be attributed largely to demonetization.
7. **Jan Dhan accounts:** Post-demonetization, 23.3 million new accounts were opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY), bulk of which (80 per cent) were with public sector banks. Of the new Jan Dhan accounts opened, 53.6 per cent were in urban areas and 46.4 per cent in rural areas. Deposits under PMJDY accounts increased significantly post demonetization. The total balance in PMJDY deposit accounts peaked at Rs. 746 billion as on December 7, 2016 from Rs. 456 billion as on November 9, 2016 - an increase of 63.6 per cent. As there were reports regarding the use of these accounts to convert black money into white, the Government issued a warning against the misuse of such accounts.
8. **Aadhar Pay:** There are lots of payment apps in the market. These are the UPI apps, SBI Pay, Paytm, Phonepe, Freecharge, mobile wallets etc. But the Adhaar Payment App is special as you can pay through the Adhaar Payment App without phone. It is possible because you the customer do not require the app. The merchant or people, who want money, have to arrange a smartphone, app, etc. The payers don't require anything. This app is made for the merchants and shopkeepers. Customer would only enjoy its benefits. The Adhaar Payment requires your fingerprints for the authentication. On the basis of this authentication, the money is paid from your Aadhar linked account.

The negative impacts are because of regulation, costs of demonetization, loss of opportunity and short-term damage to economy. The 100% cash reserve requirement (CRR) on incremental deposits meant that banks did not earn any interest on Rs 3 lakhs crores of deposits for nearly a fortnight. The waiver of ATM charges would result in banks losing Rs 20 in every transaction. The waiver of merchant discount rate on cards would result in banks losing 1% in every card transaction. Banks use third parties like cash logistics companies for cash transportation. Moving out Rs 15 lakh crores of currency notes and moving in Rs 7 lakh crore plus from currency chests would have cost several thousand crores. As banks have been focused on exchanging currency notes, they have not been able to sell any loan products. Some SME businesses have seen their sales drop 50–80% and could default in their installments. They won't immediately be classified as NPAs because of some relaxations, but if the delay continue bank NPAs might worsen. Uncertainty has resulted in drop in spending on high value

items from credit cards. These are the transactions which are converted into EMIs and banks earn from them. Demonetization has led to the increase in the use of plastic cards, online Banking, opening of new accounts, and number of customers in the branches and the use of ATM.

CONCLUSION

The demonetization is not for a short-term windfall gain, but for a long-term structural transformation. The black money has been forced out into the open, whomsoever it may belong to – whether it is corrupt politicians, bureaucrats, businessmen or professionals. Counterfeit notes under the possession of terrorist, Maoists and other extremists have been neutralized. There has been a crippling impact on dangerous and highly damaging illegal activities, such as human trafficking and the narcotics trade as well. When the black money returns to the bank, it loses its anonymity. Every rupee leaves a trail. This changes the game as the black money that did not have an address till now has been tagged with one. The multiplier effect of introduction of money, which was till now uselessly hoarded and stocked away as cash, into the active economic system will give the economy further boost. Additional government revenues should be pushed into domains such as agriculture, irrigation and rural housing, empowering the poor and the needy. The revenue collected should be used for the welfare of the poor, downtrodden and marginalized. Earlier the income tax department used to shoot in the dark. But after demonetization people have voluntarily come forward and deposited money in their bank accounts. The honest tax payers should not be harassed while the dishonest tax evade should be efficiently caught and punished. Along with this any earring officer or banker involving in illegal transactions should be caught and punished. Digital transactions should not be viewed only as a short-term substitute to help thought the period of cash shortage. Digital transactions deliver multiple benefits. They facilitate proper accounting and sizing of the formal economy. Yet, it is also true that majority of Indian population are illiterates, online banking and digitalization would certainly fail in the current situation but may make some progress with increasing literacy rates and banking awareness among more and more people in the future. The people should be made aware of the greater ease and security provided by digital banking especially for small businesses and ordinary people. Apart from all this the banking sector has made a positive growth in the initial days of demonetization. But the number of customers might fall in the near future. Therefore the government should make effort to make sure that no such thing would happen in the long run of Indian economy.

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