

Cash Vs. Alternative Means of Payment

Consequences of Demonetisation in India

Anupam Manur
Research Fellow,
Takshashila Institution

 @anupammanur
anupam@takshashila.org.in





Long queues to withdraw one's own cash

Demonetisation: The shock to the nation

At 20:00h on 8 November 2016, the Indian Prime Minister Narendra Modi announced that the 1000 and 500 rupee notes would no longer be legal tender. 86% of the country's currency notes invalidated. Chaos ensued.

Shifting Goalposts

- ❖ Was the objective to:
 1. Punish holders of unaccounted income?
 2. Eliminate generation of unaccounted income?
 3. War on corruption?
 4. Combat counterfeit currency?
 5. Mitigate funding of terrorism and insurgency?
 6. Promote digital payments?
 7. Replace old currency notes?
 8. Recapitalise the banking system?

The easiest way to prevent the measurement of success of a policy is to have multiple arbitrarily defined set of objectives.

Failed Objectives

Punish holders of unaccounted income

- Nearly 98.6% of the scrapped 1000 and 500 rupee notes were deposited back in banks
- People hold unaccounted income in forms other than cash - gold and real estate. Only 6% of unaccounted income is held in the form of cash.

Prevent the generation of unaccounted income and corruption

- The reintroduction of 500 and 2000 rupee notes did not prevent any illegal transactions or reduce corruption. The higher denomination note made it easier.
- The move could target only the stock, not the flow.

Failed Objectives

Counterfeit currency

- Only about 1/10th of the estimated counterfeit currency was detected after the move.
- Four months after the move, about Rs. 1.3 million (€16.250) counterfeit currency in the newly printed 2000 rupee note was detected, according to the RBI.

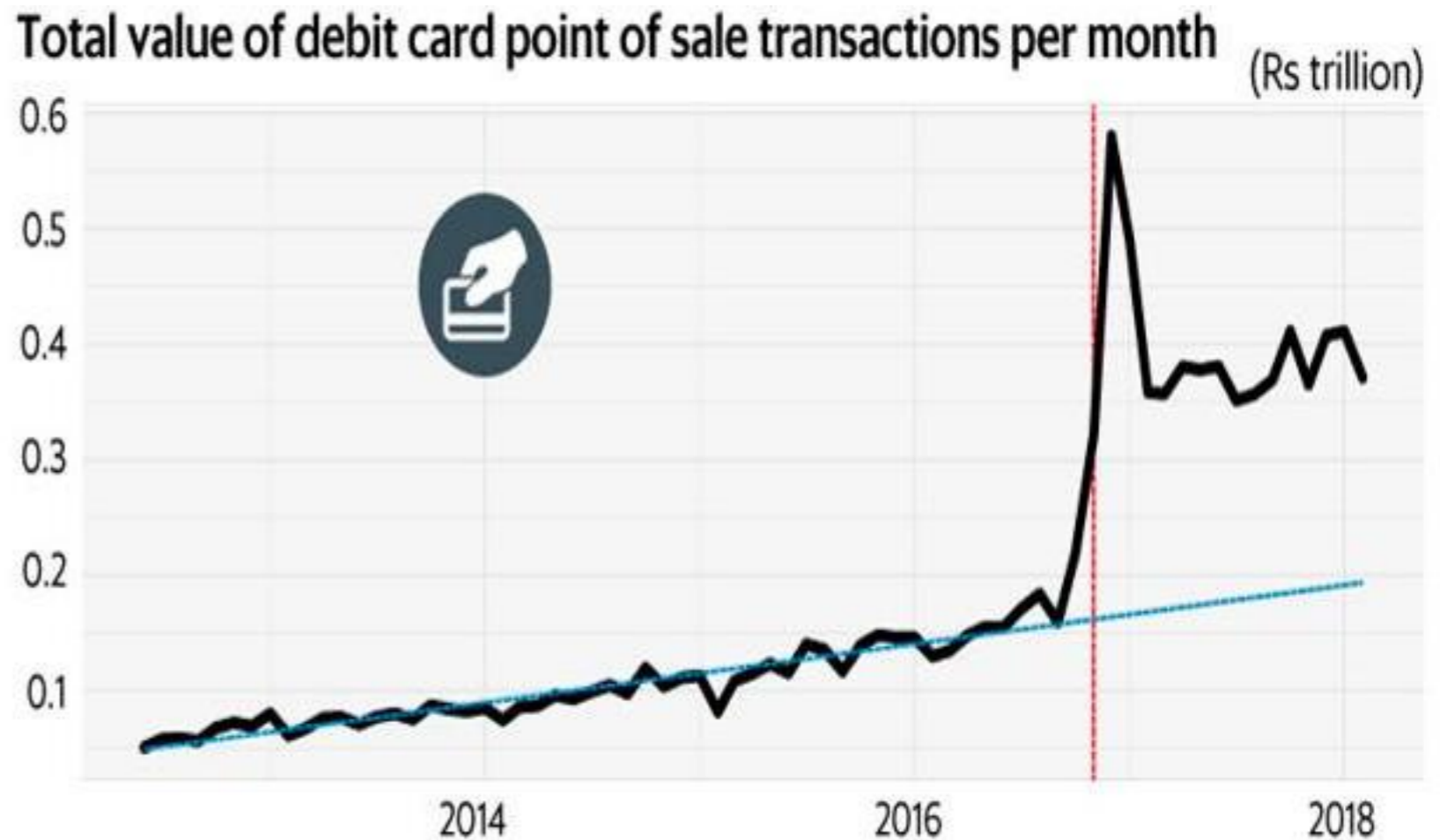
Recapitalise banks

- India's NPA problem has worsened since November 2016, as high as 20% in public sector banks.

Failed Objectives

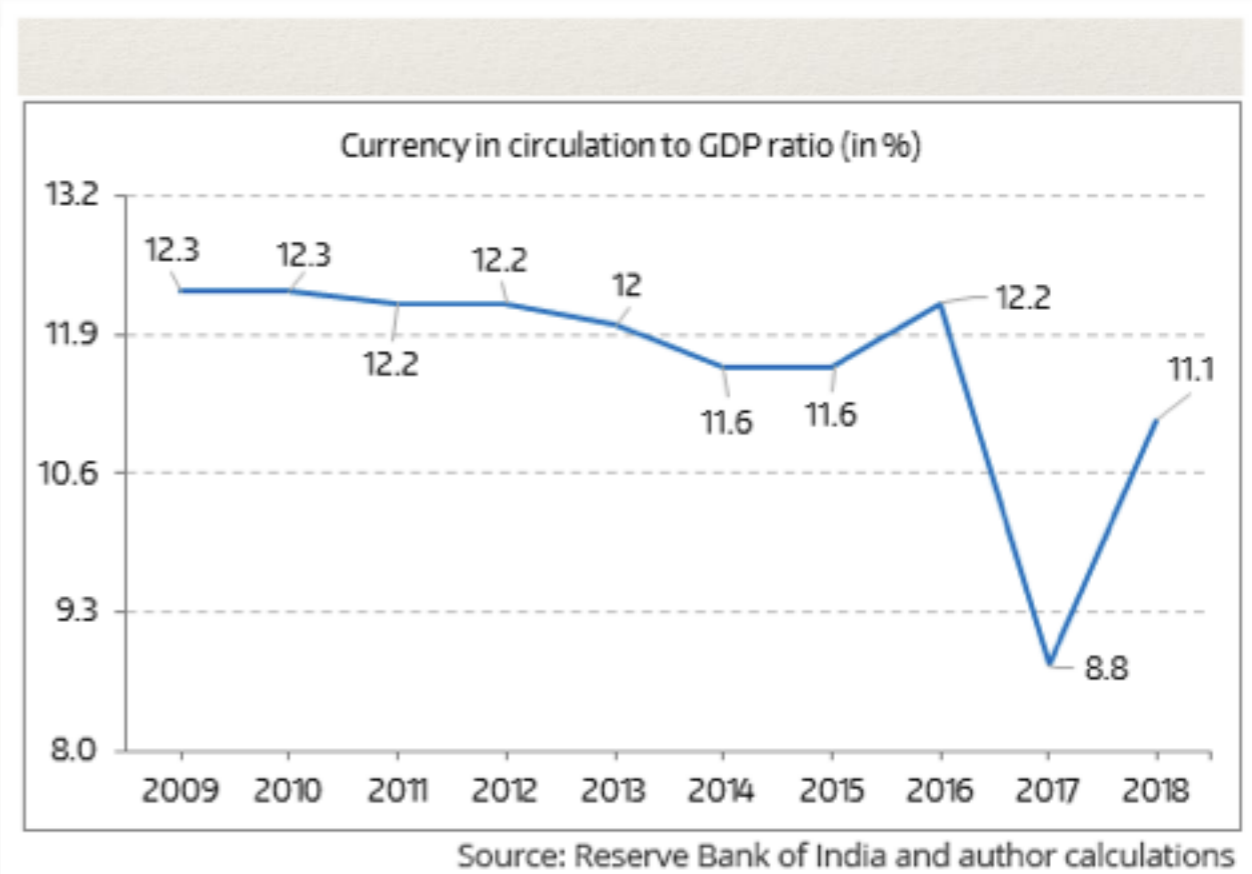
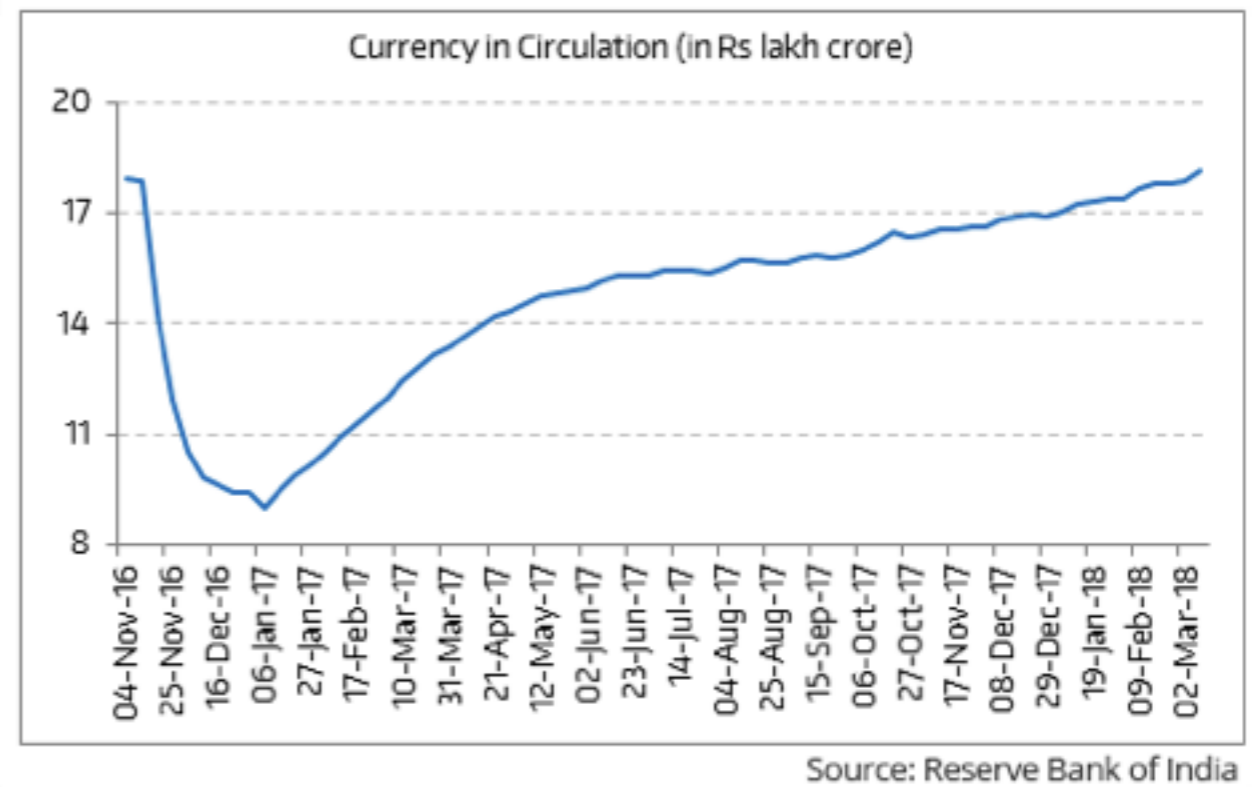
Promote Digital Payments

- An extremely expensive method to promote digital payments.
- Total value of debit card point of sale transactions increased after demonetisation
- As of April 2018, value of currency in circulation has reached pre-demonetisation levels, however, the currency to GDP ratio is still lower than November 2016.



Reliance on cash

- Despite the government's efforts, a large part of the Indian economy still relies on cash for transactions.
- The painfully slow pace of remonetising the economy has had disastrous impact on the economy.



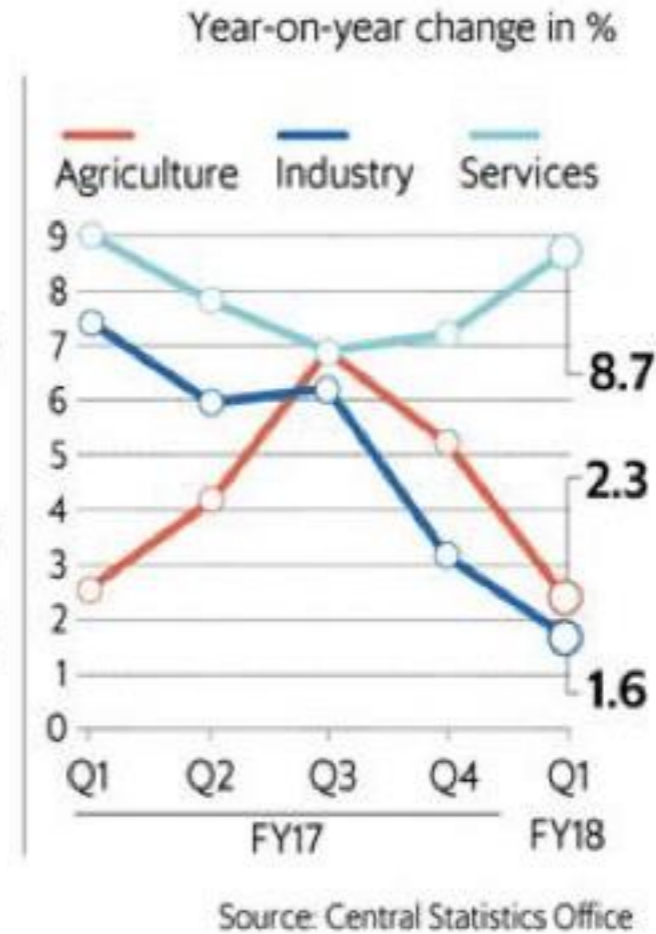
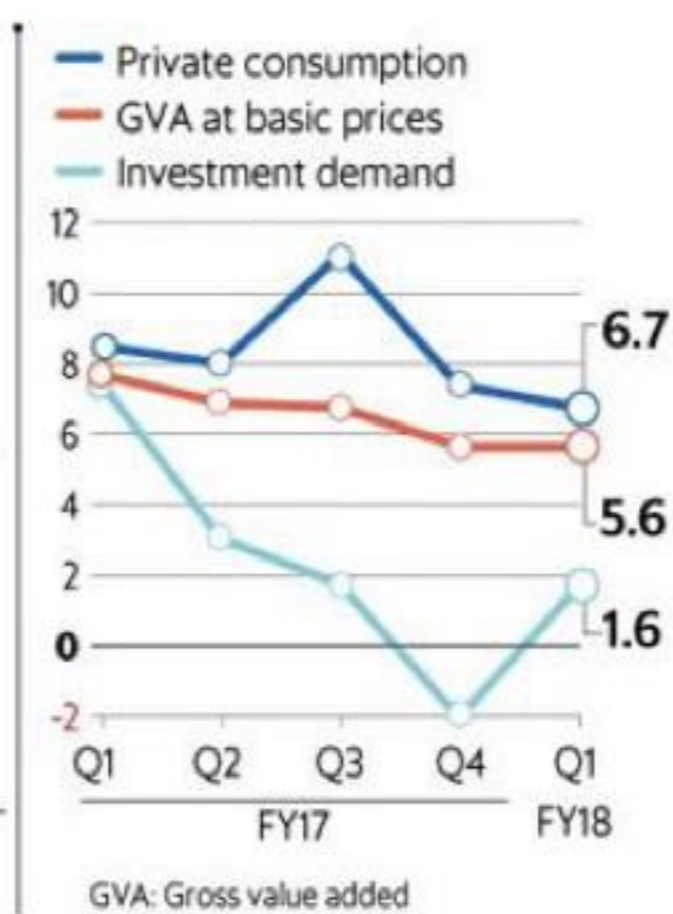
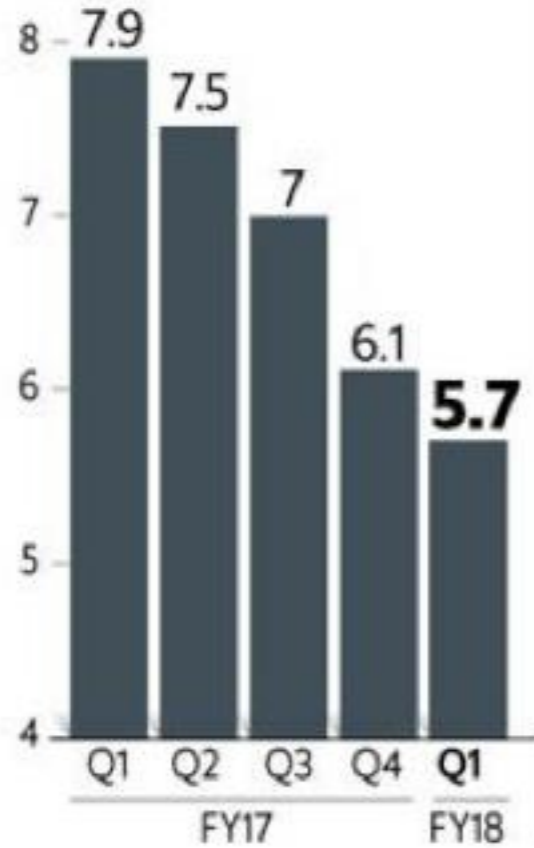
Effect on the Indian Economy



Disruptive factors

The June quarter saw uncertainty related to the rollout of GST from 1 July, about eight months after the government's shock demonetization move

GDP



Demonetisation along with a new tax regime

Macroeconomic Impact

Steep decline in GDP, investment demand, and private consumption.

Demonetisation jitters

Across segments, auto sales declined 18.61%, the most since December 2000, when they fell 21.81%.

	Domestic sales in Dec	Dec	Jan-Dec 2016
		Year-on-year change (in %)	
Passenger cars	158,617	-8.14	1.38
Utility vehicles	58,309	30	28.25
Vans	10,898	-18.76	3.83
Total PVs*	227,824	-1.36	7.01
Total CVs**	53,966	-5.06	7.67
Total 3-wheelers	29,904	-36.23	6.12
Total 2-wheelers	910,235	-22.04	9.70
Grand total	1,221,929	-18.66	9.17

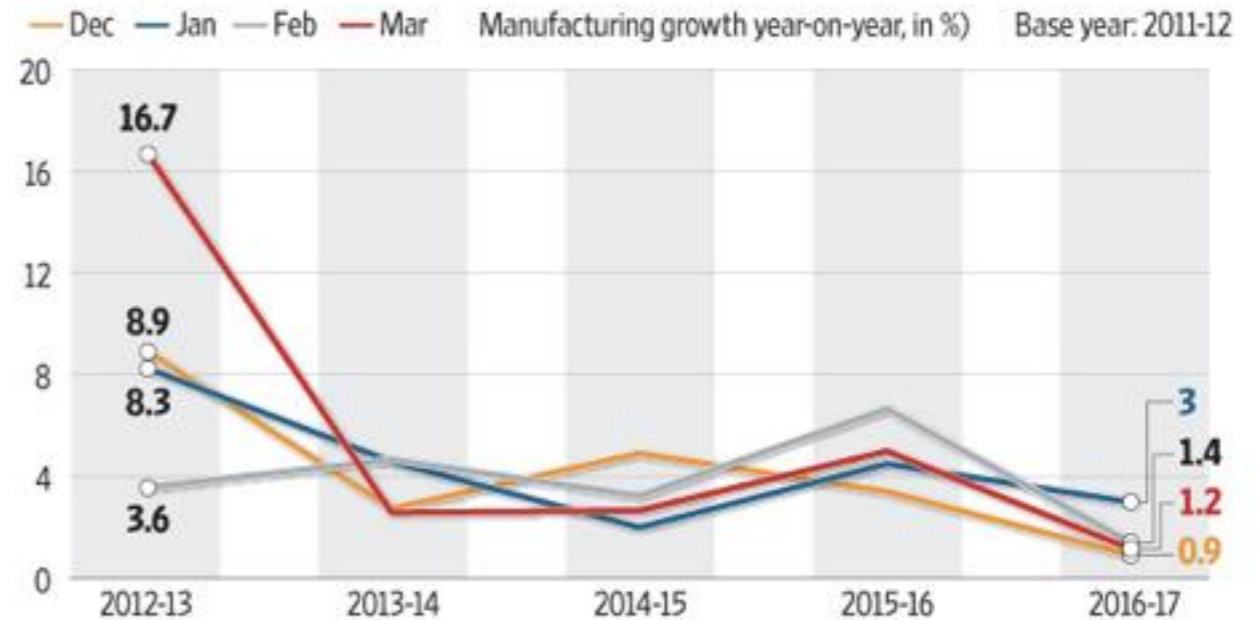
*Total passenger vehicles are inclusive of cars, utility vehicles and vans

**CV: Commercial vehicles

Source: Siam

GROWTH TREND

Manufacturing growth in Dec 2016-March 2017 was the weakest in the past five years.



Source: Ministry of Statistics and Programme Implementation

TAX COLLECTION ALSO HIT BY NOTE BAN

Growth in excise and service tax collections has moderated in November, in a reflection of the slowing economic activity in the country after demonetization of high-value currency notes.

Growth rate (2016-17)

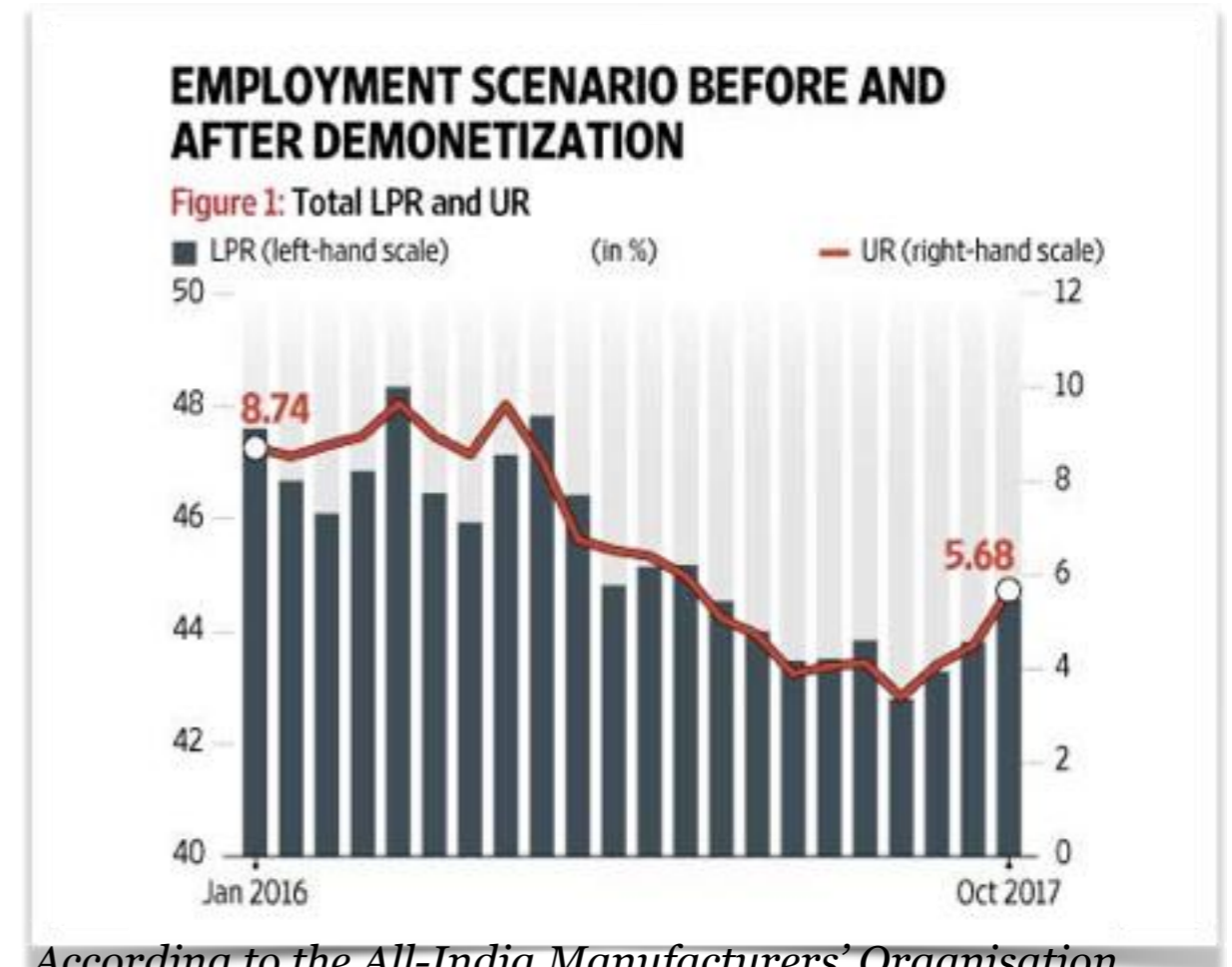
(Year-on-year, in %)



Source: Ministry of finance

Employment

- ❖ The Labour Force Participation Rate (LFPR) sharply declined following demonetisation.
- ❖ Millions of workers left the labour force because of reduced job opportunities.
- ❖ There was also 1.5 million jobs lost between January and April of 2017.



According to the All-India Manufacturers' Organisation, macro- and small-scale industries and traders have incurred 60 percent job losses and a 47 percent revenue loss because of demonetisation.

Transaction Costs

- ❖ The Centre for Monitoring Indian Economy (CMIE), an independent think tank, has estimated the total costs accumulated in the 50-day period after demonetisation at **Rs1.28 trillion (€16 billion)**.
- ❖ This includes
 - ❖ Rs. 168 billion (€2.1 billion) spent in printing, transporting, and circulating the new currency.
 - ❖ About Rs. 150 billion (€1.9 billion) in wages that were foregone by households waiting in queues to get new notes at ATMs and Banks.
 - ❖ An estimated Rs. 351 billion (€4.4 billion) in costs has been incurred by banks, putting other business aside to exchange notes.
 - ❖ The greatest losses fell on business enterprises hit by the sharp curtailment of currency transactions, estimated at Rs. 615 billion (€7.7 billion).

Human Costs

The Costs of Demonetisation: Death Toll Rises to 82, Eight Million Workers Remain Unpaid

A daily round-up on the human impact of demonetisation.

NEWS 18/11/2016 5:33 AM IST | Updated 18/11/2016 7:37 AM IST

Day 9: Demonetisation Death Toll Rises To 55


A compilation of deaths reported by national and regional media.

Demonetisation: 33 deaths since government scrapped Rs 500, Rs 1000 notes

As lines outside banks and ATMs continue to grow, the death toll rises as well.



Thank you

 [@anupammanur](https://twitter.com/anupammanur)
anupam@takshashila.org.in

