

Demonetization in India

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What the Government of India Did

- Late on November 8, 2016, India's Prime Minister Modi went on TV with the surprise announcement that effective midnight, ₹500 and ₹1,000 denomination banknotes – *85% of all the currency in circulation* – would no longer be legal tender.
- ₹2,000 notes and new ₹500 notes would be issued to replace the withdrawn notes.
- Citizens had to turn notes in to banks within a limited time in order to be credited with the amounts they held in cash.

Immediate Steps

11/08/16

11/09/16

11/10/16

Narendra Modi's announcement
(after business hours)

The Reserve Bank of India (RBI) withdraws the legal tender status of the ₹500 and ₹1,000 denominations of banknotes, and all banks are closed to prepare for the transition to new currency notes

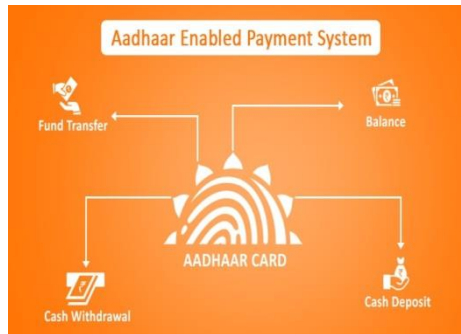
The banks reopen, and ₹500 and ₹1,000 denominated notes can be deposited at any RBI or bank branch, and their value credited to bank accounts

12/31/16: Deadline to deposit ₹500 and ₹1,000 denominated notes (deposit limit)

Purposes of Demonetization

- The originally-stated rationale: to rein in the parallel economy
 - Corruption
 - “Black money” (i.e., untaxed money)
 - Counterfeit notes
 - Curb funding of terrorism
- Subsequently, digitization and financial inclusion were cited as rationales, linking demonetization to a host of initiatives: Aadhaar, UPI, India Stack, PMDJY, payment banks

Demonetization is part of a larger push towards accountability of incomes and digital finance



Income Declaration Scheme 2016



Pradhan Mantri Garib Kalyan Yojana



Short-term: Major inconveniences

- Major inconveniences:
 - Non-functioning ATMS, long lines, crowded bank branches
 - ₹2,000 notes bigger than 1,000 notes – but ATMs were not yet adjusted
 - Initially, cash withdrawal limits
 - Slowdown of small businesses, agriculture, transport
 - Problems for MFIs re: disbursements, etc.
 - Rush to buy gold
 - Chaos in banking records

Transition effects



Economic

- 1% reduction in GDP growth
- Approximate economic loss of US\$20 billion

On the poor

- Burden particularly hard on poor who operate in cash
- No petrol, no planting, no lorries, etc.
- Suicides

Political

- Modi's popularity undimmed, though some private grumbling
- People accept the short term pain

Economic Effects

- ↓ GDP (US\$ 20 billion)
- ↓ venture capital/
private equity
- ↓ housing prices
- ↓ interest rates (excess
liquidity)
- ↑ unemployment rate
- ↑ Loan delinquency
(MFIs)
- ↑ Tax to GDP ratio



Short-term: political response

Overall impact

- No reduction in Modi popularity
- Opposition from the Congress party, others to the BJP
 - “The Prime Minister single-handedly decided to declare war on the world’s fastest-growing economy” (Rahul Gandhi)

Recent elections in Uttar Pradesh

- The first electoral test post-demonetization of Modi’s government
 - First round of Assembly polls seem to indicate BJP victory

Longer-term effects

Opportunities

- India's cashless payment infrastructure
 - PayTM 150m customers; 7m transactions per day
 - MobiKwik and Freecharge have seen large jumps in activations
 - Adoption of digital POS solutions by merchants

Challenges

- Starting from a very low base (only 25m credit cards in India)
- Lack of data privacy and security (legal) infrastructure

The logo for Paytm, featuring the word "Paytm" in a bold, sans-serif font. "Pay" is in dark blue and "tm" is in a lighter blue.The logo for MobiKwik, featuring a stylized "M" icon in teal and the word "MobiKwik" in a teal, sans-serif font.

"All the reluctance and friction in adoption of digital payments has vanished overnight. We are updating our numbers every day as usage is going through the roof."

The logo for Freecharge, featuring a red circular icon with a white lightning bolt and the word "freecharge" in a red, lowercase, sans-serif font.

For more information

From the CFI blog:

- [“What Does India’s Demonetization Experiment Mean for Financial Inclusion?”](#) (11/16/16)
- [“Do Indian Policymakers Understand the Financial Lives of the Poor?”](#) (11/21/16)
- [“Demonetization in India Is Causing More than Economic Harm”](#) (11/25/16)

Podcast episodes:

- Slate Money: [“The Monopoly Money Edition”](#) (11/19/16)
- NPR: [“India Wants To Go Cashless But It’s Easier Said Than Done”](#) (12/21/16)
- Bloomberg Benchmark: [“Surprise! Your Cash is Now Worthless”](#) (02/08/17)