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EFFECT OF DEMONETIZATION ON FINANCIAL INCLUSION IN INDIA

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ABSTRACT

Financial inclusion has come up as a key measure for achieving inclusive growth. The government of India has taken up several measures for financial inclusion. Although the degree of financial inclusion has improved still India has a long way to go to become digitally financially included. Indian government adopted demonetization in November 2016 to tackle with black money and make India a cashless digital economy. With the implementation of demonetization and considering the country's agenda to improve financial inclusion, this paper makes an attempt to study the effect of demonetization on financial inclusion. The effect of demonetization has been studied on various participants of financial inclusion drive such as ordinary individuals, informal sector, rural population, MSMEs, NBFC MFIs and E-wallet companies. The findings of the study reveal that ordinary individuals were the most adversely affected. The new type of deposits called benami deposits have also come up with demonetization. With the aim of achieving financial inclusion along with making India a cashless and digital economy, efforts are required to make technology reach the bottom of the pyramid.

Keywords: *Cashless Economy, Demonetization, Digital Economy, Financial Inclusion.*

1. INTRODUCTION

The concept of inclusive growth has gained a lot of momentum in India. It means that all sections of society contribute to benefit from economic growth of the country. Financial inclusion has come up as a key measure for achieving inclusive growth. Financial inclusion is defined as "the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated mainstream institutional players" [1]. It aims to take banking services to the doorstep of everyone to meet their entire savings, credit and remittance needs initially, and needs for all other financial products and services subsequently [2]. When the poorest of the poor have access to credit and savings facilities, this translates to their financial security. They can grow larger businesses, manage consumption and household expenses better and plan for shocks. The standard of living improves and poverty falls, allowing people to contribute more to the economy as well [3].

2. FINANCIAL INCLUSION IN INDIA

The government of India has taken various measures for financial inclusion. The proportion of adult population with a bank account has increased to 65 percent with the financial inclusion reforms in India over the last 5 years. However, a substantial 23 percent of those accounts remain dormant, indicating that it will take a lot more than just opening formal bank accounts for the financially excluded to be truly included [4]. Table 1 shows the degree of financial inclusion in India in comparison to other emerging and advanced economies of the world.

Table 1: Degree of Financial Inclusion (in 2014)

Indicators of Financial Inclusion	*Advanced Economies*	*Emerging Economies*	*India*
Account at a financial institution (% age 15+)	95.85	67.88	52.75
Commercial bank branches (per 100,000 adults)	33.57	19.41	11.38
Automated teller machines (per 100,000 adults)	136.45	86.38	11.21
Debit card (% age 15+)	84.50	49.48	22.07

Source: cited in [5]

The above table reveals that as on 2014, 96 percent of the population above 15 years of age holds account at a financial institution in advanced economies while only 53 percent of the same age group have an account at a financial institution in India. It was also found that the number of commercial bank branches catering per 100,000 population in advanced economies is 3 times higher than in India whereas the number of ATMs available to per 100,000 population is more than 11 times higher in advanced economies and 8 times higher in other emerging economies than in India. While 22 percent of the population above age 15 holds debit card in India, the corresponding number for emerging economies and advanced economies are 49 percent and 84 percent respectively.

Keeping this in view, government launched a financial inclusion scheme called Pradhan Mantri Jan Dhan Yojana on 28 August 28 2014. The purpose of the scheme was to open zero balance saving account for every unbanked Indian household, providing access to financial literacy, credit and pension. Under this scheme, as on 28 October 2015, 19.02 crore accounts have been opened, out of which 11.58 crore accounts are in rural areas and 7.44 crore in urban areas [5]. With this scheme, the bank account penetration increased from 35 percent to 53 percent during last three years, however, 74 percent of these new accounts remained non-operational with zero balances [6].

With the introduction of digital financial services i.e. access to financial services through numerous electronic platforms, the concept of digital financial inclusion has also gained a lot of importance in recent years. People who are digitally financially included transact digitally using debit/credit cards, point of sale (POS) machines, online banking, and mobile financial services. As per the latest Financial Inclusion Insights survey, 49 percent of Indian adults are digitally included. However, usage of these digital accounts remains debatable [4].

3. DEMONETIZATION IN INDIA

Indian currencies with denomination 500 and 1000 have ceased to be the medium of exchange from the midnight of 8th November 2016. This demonetisation move is implemented as a tool to measure the stock of black money hoarded in these high denomination currencies, and to curb terrorist activities in the country. The government aims to bring the unaccounted money back to the formal banking sector by allowing limited exchange and unlimited deposit of old notes in bank accounts till the end of 2016 [5]. However, the biggest problem is that the distinction between unaccounted cash and black money is lost. Money that is derived from illegal activity is harmful, but money circulated in small businesses only adds to economic activity. Indian economy is heavily dependent on cash. Inadequacy of bank branches is one primary reason why cash dominates especially among small businesses. Every bank branch in a rural and semi-urban centre caters to more than double the number of people in an urban and metropolitan centre. According to December 2015 Reserve Bank of India Report, each rural and semi-urban bank branch serves 12,863 people compared with an urban and metropolitan branch which serves just 5,351 people. There were 7.8 branches for one lakh people in rural India, but 18.7 branches in urban India. The spread of ATMs too is skewed in favour of urban centres [7].

4. NEED AND OBJECTIVE OF THE STUDY

With the recent implementation of demonetization and considering the country's agenda to improve financial inclusion, it becomes imperative to study the effect demonetization on the financial inclusion drive of the county. Therefore, the broad objective of the study is to examine the effect of demonetization on financial inclusion.

5. EFFECTS OF DEMONETIZATION ON FINANCIAL INCLUSION IN INDIA

The demonetization has created a tremendous impetus toward greater financial inclusion. It has operationalized the Jan-Dhan bank accounts, with around 210 billion rupees ($3 billion) in deposits [6]. However, it brought in a new concept called Benami Deposits. The Jan Dhan bank accounts opened for the poorest of poor are now swelling with cash since demonetization. This implies that these accounts have become holders of somebody's account i.e. the poor have been used by those with hordes of unaccounted for money to park their funds [8]. In detail, the effect of demonetization on the process of financial inclusion has been studied on various sections of the society which are the participants in the financial inclusion drive.

5.1 ORDINARY INDIVIDUAL

The common man has had to bear the economic hardship as 90 percent of all transactions are paid in cash [6]. Millions of people are crowding the banks and queuing outside ATM centers to deposit their cash, revealing that India has a long way to go before it fully transitions into a digital financial economy. In spite of expanded digital access to bank accounts, a very small percentage of the population has been able to operate without withdrawing cash or visiting the bank regularly. This is due to lower level of digital financial literacy [4].

5.2 INFORMAL ECONOMIC SECTOR

India's massive informal economic sector comprising of domestic help, contract labourers, daily wage workers, farmers, fishermen, micro-entrepreneurs etc. runs almost entirely on cash. These groups of people typically do

not have a formal bank account. Cash is their only means of receiving income and making payments. The demonetization has led to a situation of cash crunch in the economy which has created a huge disruption on work and daily lives of these people with severe adverse impacts on their livelihoods and well-being [4]. The small service providers like auto-rikshaws, road-side eateries, local kirana stores etc. are being abandoned for cab aggregators, online food home delivery, online grocery respectively. These informal services providers although being very large in numbers, are not part of the digital economy and are losing business. The demonetization has led them to compromise on their work and stand in long queues outside banks for their own hard-earned cash. However, through demonetization, the wealth produced and saved by the poor can be brought into the formal banking system [3]. The 'dead capital' which was not available in the formal economy is now being turned into 'live capital'.

5.3 RURAL POPULATION

The effects of demonetization have been even more worrying in the rural parts of the country which are even more dominated by cash and which have limited physical accessibility to banks and other financial institutions. Visiting physical bank branches in rural areas still remains a time consuming and costly exercise for many. Other digital financial services like ATMs and POS machines at shops are limited in number and crippled with infrastructural issues. Ordinary rural residents are placed in great stress with nowhere to go [4].

5.4 RURAL MSMES

The data on MSMEs, as per the latest available Fourth Census of MSME, 2006-07, reveal that there are 200.18 lakh unregistered rural sector units, and they make up over 55 per cent of such enterprises in India while urban MSMEs are 161.58 lakh. The bulk of the MSMEs in India have turnover in just a few lakhs of rupees [7] and maximum of MSMEs are dominated by the micro enterprises. Majority of their transactions are on cash. With uneven spread of bank branches and ATMs among rural and urban regions, the micro and small enterprises operating in rural areas are adversely affected. The demonetization made impossible for them to get cash in lower denominations for their daily operations.

5.5 NBFC MFIS AND THEIR CUSTOMERS

There are a large number of micro financing institutions (MFIs) in India, catering to the financing needs of rural and semi-urban Indian population. Customers, typically individuals (women, daily wage workers, farmers), small traders and retailers, mainly operate on a cash basis due to informal and trifling nature of the amounts involved in such transactions. Loan instalments from some such customers are usually collected on a weekly and sometimes on daily basis. Demonetization has halted, albeit temporarily, business transactions of these individuals which are now running on a daily credit basis, and more importantly has led to a domino effect on employees/daily wage workers and other customers of non-banking financial companies-micro financial institutions (NBFC-MFIs) whose livelihood is based on cash payments. Such customers do not have bank accounts and/or sufficient means to either exchange currency in their possession into notes of acceptable denomination, or make a transition to cashless means of finance. This is adversely affecting their daily businesses/lives which in turn is affecting the timely repayment of loans taken by them from NBFC-MFIs. These loan defaults have lead to temporary increase in non-performing assets of NBFC-MFIs which generally rely on borrowing from banks for further lending. The adverse affect on the overall asset quality

of NBFC-MFIs will eventually trickle down to banks and other financial institutions and may subsequently, affect the Indian economy as a whole [9].

5.6 E-WALLET COMPANIES

The demonetization promotes cash-less economy and increase in use of digital financial services. The e-wallet companies have seen a rapid surge in the number of transactions and traffic on their web and app-based platforms which are mostly driven by urban and metropolitan parts of the country [4].

6. CONCLUSION

RBI statistics shows that 80 percent of monetary circulation in India consisted of Rs. 500 and Rs. 1000 notes [3]. This demonetization is putting more than 80 percent of the country's monetary economy under suspicion of black money. This creates confusion between 'unaccounted money' and 'black money'. The government's move towards demonetization aims to convert black money into white money but inclusive growth can be achieved only if this money is used for development purposes. However, the government is withdrawing subsidies, and reducing expenditure on development sectors. The development contemplated is in the sense of smart cities and cashless economy. But for India to be a cashless and digital economy, sufficient time and efforts are required. The process cannot be completed over night or fortnight or within months.

This demonetization is much different from the 1978 demonetization which never really affected ordinary people. The 1978 demonetization covered notes of Rs 500 and Rs 1000 and those denominations were hardly used by the common man. The hundred rupee note was what most people used [3]. However, in comparison to present scenario, the effect has been largely upon the ordinary man than on the ones who are the main contributors to the black money. With the aim of achieving financial inclusion along with making India a cash-less and digital economy, efforts are required to make technology reach the bottom of the pyramid. For this purpose, the young generation should be leveraged upon to educate and support the poor, rural and elderly with digital literacy and transactions.

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