

# A Macro-Micro effect of Demonetization an Indian experience

<sup>1</sup>Dr.A.Karthigeyan, <sup>2</sup>Dr.Anandhi, <sup>3</sup>Mr.Mani Ramasamy

<sup>1</sup>Faculty, <sup>2</sup>Faculty, <sup>3</sup>Research Scholar

Department of Banking Technology, Pondicherry University

**Abstract** - The demonetization is the process by which particular denominations of legal tenders has been withdrawn from the circulation. This has been exercised by the respective Governments to reduce black money accumulations, terror funding and counterfeit currency circulations in the country. In Indian scenario the demonetization created multiple effects to the country's economy. The effects including curbing black money, terror funding and counterfeit currency circulation in one side and also opened up large space for digital mode of banking. This paper aimed to analyze the Macro-Micro effect of demonetization by evaluating the black money, terror funding and counterfeit currency and digital banking.

**keywords** - Anti-money Laundering (AML), Digital Banking, Demonetization.

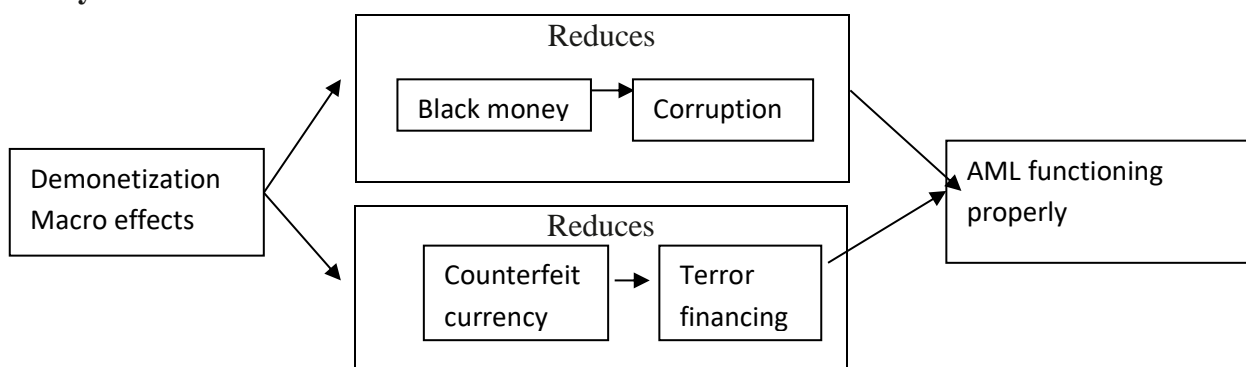
## 1. Introduction

The demonetization is the strategic move towards curbing black money, terror funding and counterfeit currency circulation in the country. In 12<sup>th</sup> January 1946 the first demonetization happened and followed by 16<sup>th</sup> January 1978 and in 8<sup>th</sup> November the recent and the third demonetization happened in India. It has been announced by overnight about the withdrawal of higher denominations like Rs 500, Rs 1000 notes which is accounted for more than 85 % of total currency in circulation. It hits the whole country horribly and most of the people were standing outside the banks for changing the old currency. Obviously it creates ruckus in the process of demonetization in one side and the same time it creates opportunity for the banks to increase the cash less transaction on the other side. The main objective of demonetization also moved towards the cashless economy and the Government of India also started projecting the demonetization as a move towards digital economy.

The government of India made enormous steps taken to reduce the block money accumulation in the country like Income Declaration scheme (IDS), the income tax payers given a chance to disclose their income and pay 45 % flat tax. Pradhan Mantri Garib kalyan yojana (PMGKY) is another programme to disclose unaccounted wealth and black money in a secret approach and by paying a fine of 50 per cent on the undisclosed income to avoid further legal proceedings. And there is also an option to invest 25% of the undisclosed income the returns will be given back after four years without interest. Likewise there are programmes offered by the Government of India to curb black money circulation in the country.

On this background, the central government move towards demonetization is that the higher denominated currency will be the most favorable currency for black money accumulation, banning those notes will reduce the black money in the system. Unfortunately after withdrawal of Rs 500 and Rs 1000 notes only 1.04 per cent or Rs 16,000 crores did not come back to the system. The remaining 99 % of higher denomination notes came back to the banks. It shows the overall effect of demonetization doesn't meet the requirement of curbing the unaccounted or undisclosed money. Or otherwise there is a collapse or leakages in the implementation of demonetization properly. And also there may be chance of corruption happened knowingly or unknowingly with the help of bankers. There are arguments in favor of the move of demonetization also we cannot completely ignore those arguments it is that the demonetization enhance the usage of digital economy. It paves way to the digital banking through the digital payment channels against the traditional banking channels. Hence there is a high motivation for the study starts to assess the micro macro impact of demonetization in Indian financial system.

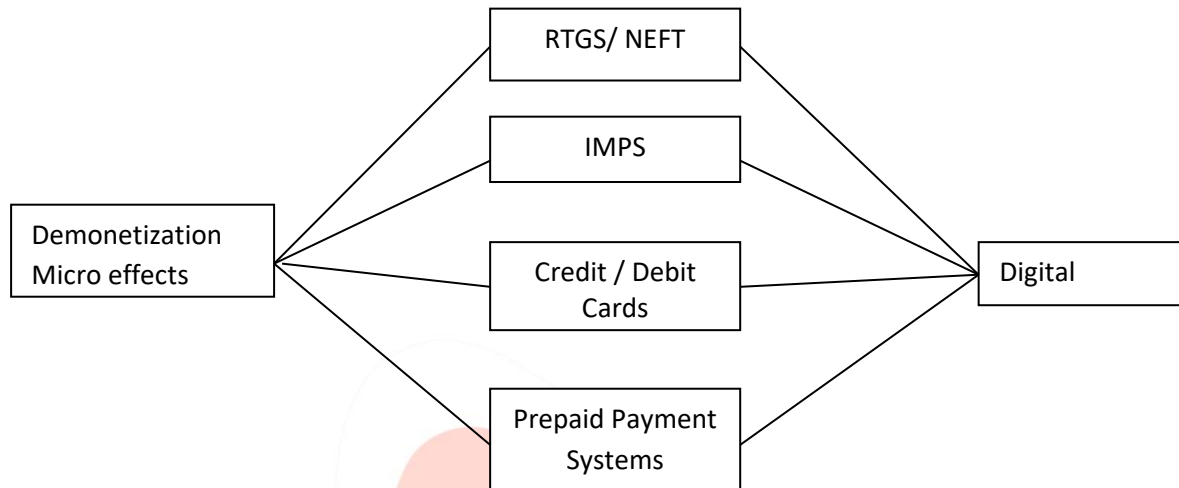
### Study Outline:



**Fig.1, Demonetization Macro effects**

The above flow diagram shows that the demonetization at the macro level concentrates mostly on the two aspects of money laundering i.e Black Money and Counterfeit currency. If the black money is increasing regularly than it automatically affects the money circulation in the economy. Eventually it increases the risk of framing the economic policy away from the hands of the government. Hence the introduction of demonetization helps to eradicate the money laundering in the system than it also means that which is more helpful in improving the proper functioning of Anti Money Laundering (AML).

Secondly the demonetization holds its importance in the micro level effects say it increases the level of usage of digital banking. So obviously the transaction is recorded and it also embraces the proper functioning of AML. The below flow diagram clarifies the micro effect of demonetization and its usefulness in increasing digital banking.



**Fig.2, Demonetization Micro effects**

## 2. Literature review

R. Barry Johnston, et al., (2006) made an attempt to describe that the importance of financial institutions especially banks are working more closely with the adoption of anti-money laundering/combating the financing of terrorism (AML/CFT) standards with integrity. Moreover the study compares the balance between the cost-return associated with the implementation of (AML/CFT) to the banks.

B. Viritha, et al., (2015) assess the level of scheduled commercial banks in India to implement the (AML/CFT) compliance norms and evaluated the difficulties persist in implementing the (AML/CFT) in Indian scheduled commercial banks. The study results shows there is a positive signal that banks are largely involving in (AML/CFT) compliances among various factors the filing of KYC is high and on the other side the author identifies limitations like lack of resources and the less customer support, need of training are the some of the constrains in the effective implementation of (AML/CFT) norms.

B. Viritha, et al (2015) examine the effectiveness in implementing (AML/CFT) reporting system in India by using the Suspicious Transaction Reports (STRs) and also evaluate the impact of countering the money laundering effects by improving the conviction and confiscation rate. Moreover during the study period there is a gradual increase in the number of STRs filed but there is no convictions or confiscations related to (AML/CFT) and the study also suggest that the (AML/CFT) regime is just started and it has to travel a long journey to identify different ways and means of money laundering exist.

Constance Gikonyo (2018) made an attempt to trace out the effective methodology to identify the potential way of money laundering happening in Kenya. Moreover the study emphasizes on the ways and means the Kenya has been exploited by the international drug traffickers and trade-based money launders. The study addresses the weaknesses in the implementation of Proceeds of Crime and Anti-Money Laundering Act (POCAMLA) in Kenya and also stressed upon including the accountants, precious stone and metal dealers and the hawala systems to reduce the loopholes and also the study includes the car dealers and legal professional in the purview of the (POCAMLA) act in Kenya.

Ramandeep Kaur China (2017) critically examines the “politically exposed persons (PEPs)” in accordance with the PMLA Act 2002 in India. The study mainly focuses on the definition of the PEPs in the Indian anti-money laundering (AML) regime is somewhat diluted and it excludes the PEPs close relatives and their associates out of picture. Hence the study concludes that the these dilution in the definition of PEPs will create more easy laundering in domestic as well as foreign and it suggested to include the PEPs close relatives and their associates to make it clear to reduce the money laundering.

Sandeep Goel (2018) attempts to study the effect of demonetization on abolition of black money and its impact on corporate world and its consequences on Indian economy. The study expresses its views on like the previous policies implemented the demonetization also have multiple effects. But not like other policies the demonetization has its own advantages in unearthing the stocked and staked up money. It also ensures the proper functioning of AML and it sets transparency standards in the system.

### 2.1 Objective

Based on the above literatures reviewed, the study aimed at analyzing the Macro, Micro effects of demonetization in Indian perspective.

## 3. Methodology

The study uses secondary data collected from Financial Intelligence Unit (FIU), Reserve Bank of India (RBI) relating to Cash Transaction Report (CTRs), Suspicious Transaction Report (STRs), Counterfeit Currency Reports (CCRs) and Digital Payment and Settlement Indicators like RTGS, NEFT, IMPS, Credit cards, Debit cards and PPIs for a period of 5 years starting from 2013-14 to 2017-18. The Trend analysis is used to fulfill the above objective.

### 3.1 Empirical analysis and Findings

#### 3.1.1 Cash Transaction Report (CTRs)

Table 1. Cash Transaction Report from Banking Companies

Types of Banking Companies	2013-14	2014-15	2015-16	2016-17	2017-18
Public Sector Banks	4989143	4876909	10077939	10406673	8774954
Trend		97.750	206.646	103.262	84.320
Private Sector Banks	3261219	3157826	4440307	4242521	3496477
Trend		96.83	140.61	95.55	82.42
Foreign Banks	35083	39755	46,962	51,593	22,657
Trend		113.32	118.13	109.86	43.91
Others	493637	733747	1828081	1228389	1070388
Trend		148.64	249.14	67.20	87.14
Total	8779082	8008237	16393289	15929176	13364476
Trend		91.22	204.71	97.17	83.90

Source: Annual Report of Financial Intelligence Unit (FIU)

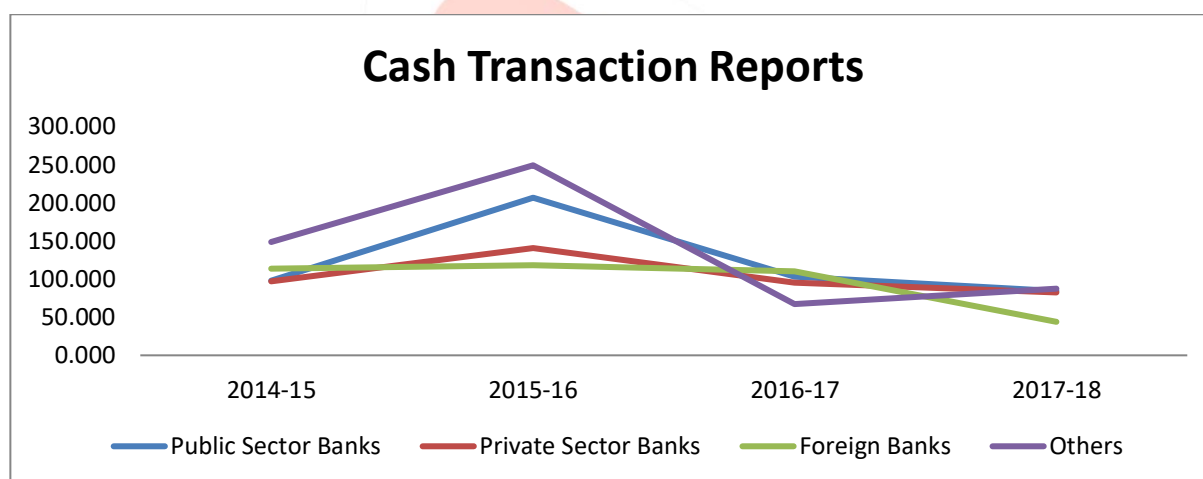


Figure 3. Cash Transaction Report from Banking Companies

During the study period 2013-14 to 2017-18 the compliance of cash transaction report (CTRs) of above 1 million by the banks according to table.1 shows that public sector banks have filed more CTRs than the foreign and private banks. In the year 2015-16 there is a spurt in the volume of CTRs reports generated by the public sector banks accounts to 1007793 and the trend analysis clearly indicates that there is almost 100 times increase to the previous year i.e. 97.75 percent to 206.64 and in the private sector banks it is 4242521 reports and a increase in the trend shows 96.83 to 140.61 percent. In case of foreign banks it is 46962 CTRs reported and a increase in trend of 113.32 to 118.13 and in case of other than banks collectively it shows 1828081 CTRs reported with a increase in trend of 148.64 to 249.14 percent. During demonetization number of CTRs reported is comparatively low when compared to the previous year the foreign banks tops the list with 109.86 percent followed by public sector banks with 103.26 percent and then by private and other than banks respectively i.e. 95.55 and 67.20. After demonetization there is a clear decline in the number of CTRs by all banks and other than banks. From this observation it is clear that the demonetization brings up the stocked and staked money in to the system and it has also been reported.

#### 3.1.2 Suspicious Transaction Report (STRs)

Table 2. Suspicious Transaction Report

Reporting Entity Type	2013-14	2014-15	2015-16	2016-17	2017-18
Banks	51,765	45,858	61,361	361215	1343720
Trend		88.59	133.81	588.67	372.00
Financial Institutions	8,321	10,649	40,033	94,837	84,781
Trend		127.98	375.93	236.90	89.40
Intermediaries	1,867	2,139	4,579	16,954	7,839
Trend		114.57	214.07	370.26	46.24

Total	61,953	58,646	105,973	473006	1436340
Trend		94.66	180.70	446.35	303.66

Source: Annual Report of Financial Intelligence Unit (FIU)

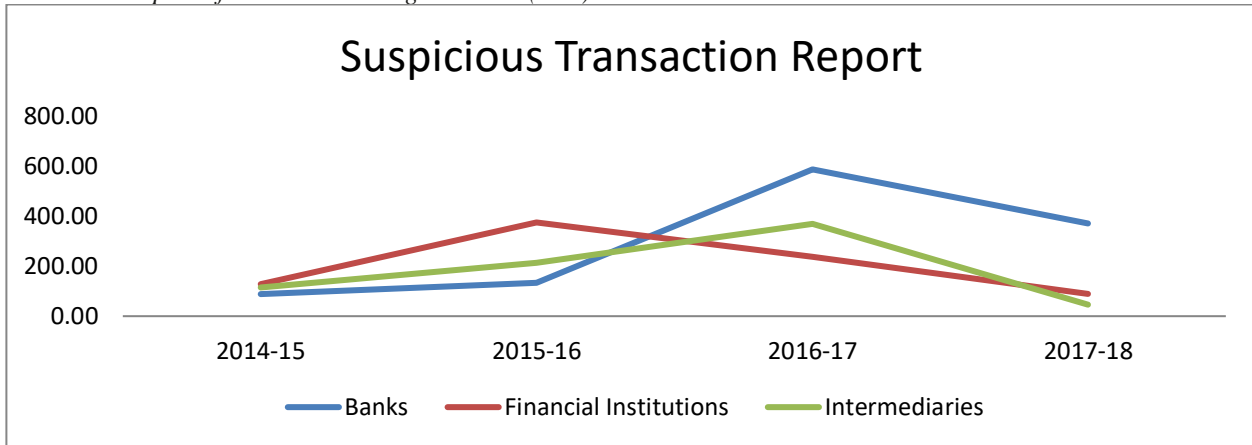


Figure 4. Suspicious Transaction Report

During the study period 2013-14 to 2017-18 the number of suspicious transaction report (STRs) received is topped by banks as from 51765 to 1343720 compliances registered. The year on year trend shows that there is an increase in filing of STRs from 88.59 percent to 372.00 per cent. In case of financial institutions the number of STRs filed is increased to 84781 from 8321 with a year on year trend as from 127.98 to 89.40. In case of intermediaries it is increased from 1867 to 7839 with a year on year trend as 114.57 to 46.24. During demonetization 2016-17 there is increase in the number of STRs filed by all the three entities i.e. banks it is from 61361 to 361215 year on year trend as 133.81 to 588.67 percent almost a double. In case of financial institutions it is comparatively less when compared to the previous year it is 236.90 from 375.93 percent. In case of intermediaries there is an increase in the year on year trend from 214.07 to 370.26. The overall trend shows there is an increase in trend 94.66 percent to 303.66 percent during the study period. Hence it is understandable that the demonetization has its effect on unaccounted money and there are many cases have been filed keeping STRs as evidence.

### 3.1.3 Counterfeit Currency Reports (CCRs)

Table 3. Counterfeit Currency Reports (CCRs)

Types of Banking Companies	2013-14	2014-15	2015-16	2016-17	2017-18
Public Sector Banks	14,186	16,224	29,026	1,01,167	60,768
Trend		114.37	178.91	348.54	60.07
Private Sector Banks	2,78,240	3,17,791	3,64,009	5,92,677	2,52,213
Trend		114.21	114.54	162.82	42.55
Foreign Banks	8,331	16,018	10,934	14,361	2,127
Trend		192.27	68.26	131.34	14.81
Others	1,047	3,804	6,930	25,303	38,687
Trend		363.32	182.18	365.12	152.89
Total	3,01,804	3,53,837	4,10,899	7,33,508	3,53,795
Trend		117.24	116.13	178.51	48.23

Source: Annual Report of Financial Intelligence Unit (FIU)

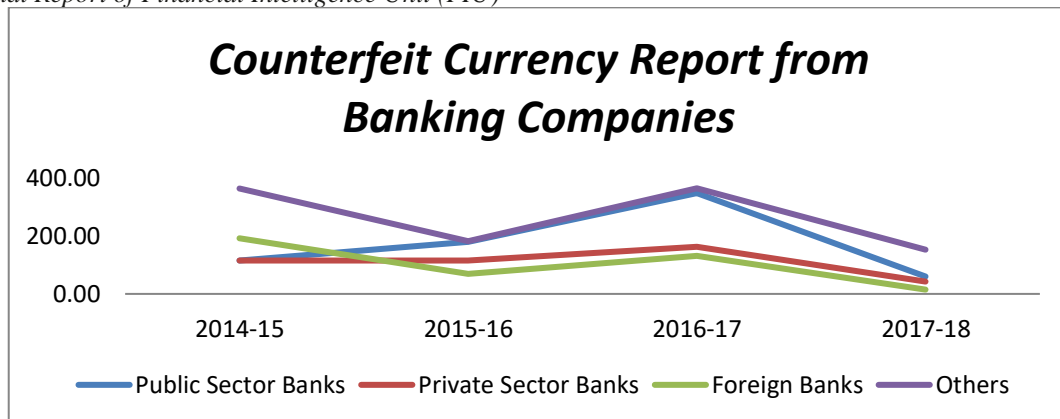


Figure 5. Counterfeit Currency Reports (CCRs)

During the study period 2013-14 to 2017-18 the overall Counterfeit Currency Reports (CCRs) received shows there is an increase from 301804 till demonetization it is 733508 reports with year on year percentage as 178.51 from 117.24 and thereafter it declines to 353795 CCRs filed with a year on year trend of 48.23. After demonetization there is a decrease in number of CCRs reports when compared to before and during demonetization. Hence there is clear indication that the demonetization has reduced the counterfeit currency circulation in the economy.

### 3.1.4 Digital Payment and Settlement Indicators

Table 4. Digital Payment and Settlement Indicators

Indicators	2013-14	2014-15	2015-16	2016-17	2017-18
RTGS	734252	754032	824578	981904	1167125
Trend		102.69	109.36	119.08	118.86
NEFT	43786	59804	83273	120040	172229
Trend		136.58	139.24	144.15	143.48
IMPS	96	582	1622	4116	8925
Trend		606.25	278.69	253.76	216.84
Credit Cards	1540	1899	2407	3284	4590
Trend		123.31	126.75	136.44	139.77
Debit Cards	955	1213	1589	3299	4601
Trend		127.02	131.00	207.61	139.47
Prepaid Payment Instruments (PPIs)	81	212	488	838	1416
Trend		261.73	230.19	171.72	168.97
Total	780710	817742	913957	1113481	1358886

Source: RBI annual report (Payment and Settlement Systems)

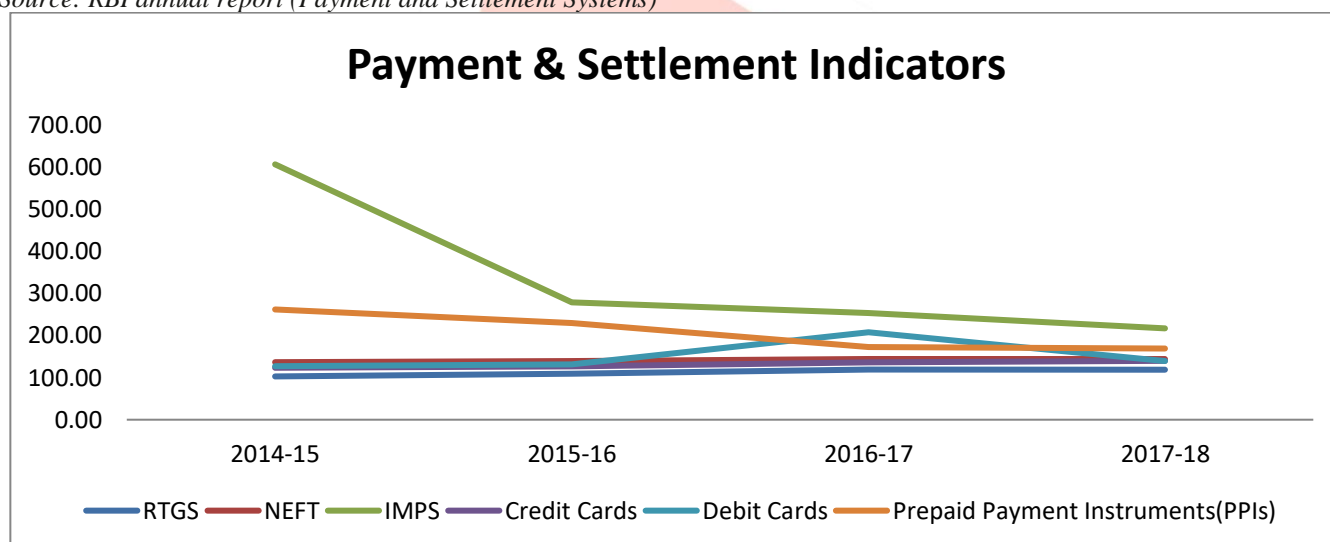


Figure 5. Counterfeit Currency Reports (CCRs)

During the study period 2013-14 to 2017-18 the overall usage of digital banking products increased dramatically especially during and after the demonetization compared to the before demonetization period. In case of Real Time Gross Settlements (RTGS) shows there is an increase amounting to Rs. 734252 billion to Rs. 1167125 billion with a year on year trend as 102.69 to 118.08. National Electronic fund Transfer (NEFT) it is amounting Rs. 43786 billion to 172229 billion with a year on year trend as 136.58 percent to 143.48 percent. In case of Immediate Payment Service (IMPS) it is increased from Rs.96 billion to Rs. 8925 billion with a year on year trend shows 606.25 percent to 216.84 percent. In case of usage of credit cards it shows a increase in value amounting Rs. 1540 billion to Rs. 4590 billion with an year on year trend as steady increase from 123.31 percent to 139.77 percent. The usage of debit cards during study period increased to Rs. 955 billion to Rs. 4601 billion with a gradual increase in year on year trend as from 127.02 percent to 139.47 percent. The final digital payment and settlement indicator Prepaid Instruments (PPIs) increases from Rs 81 billion to Rs1416 billion with a year on year trend as 261.73 percent to 168.97 percent there is a sharp decline in the usage of PPIs during the study period. Hence the study result reveals that the demonetization has increased the usage of digital mode of transaction to the next level and also it encourages to moving towards achieving cashless economy.

## 4. Conclusion

Demonetizing legal tenders in a developing economy is a tough decision to take because it may have multiple effects on country's economy. The purpose of demonetization is to reduce poverty by unearthing the unaccounted money or otherwise black money.



And by eliminating the counterfeit currency circulation of higher denomination will also end the terror financing. The study result reveals that, at the macro level the number of CTRs, STRs and CCRs compliance registered during demonetization shows a drastic increase. Hence it ensures that the demonetization gears up the proper functioning of AML in India. At the micro level the demonetization pushes the digital banking effectively. The results show during demonetization there is an increase in usage of digital mode of banking. Overall the demonetization in India has a positive effect on both macro levels by reducing black money, terror funding and in the micro level it creates the space for digital banking. Hence the study concludes that the demonetization has served its purpose effectively in both macro and micro level.

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