

DEMONETIZATION AND ITS IMPACT ON INDIAN ACCOUNTING AS WELL AS ON INDIAN ECONOMY

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ABSTRACT

The demonetization drive initiated by the Indian Government is going to have far reaching impact on the Indian Economy. This paper also depicts that how accounting effected and what needs to know by accountants. It is being considered as one of the most significant step in tackling the black money issue that has gripped our country since many years. The justifications given for this move were disrupting proliferation of counterfeit notes, making cash hoarded from undeclared sources of income (black money) worthless, disrupting drug trade or terrorism activities which are mainly funded by black money and encouraging cashless transactions. But it came up with certain cons whose main victims were the general middle class people who were actually not the black money hoarders. The whole demonetization scheme was considered a good initiative but lacked in the implementation part..

KEYWORDS: *Demonetization, Accounting Practices, Creative Accounting, Black Money.*

Introduction

The demonetization drive initiated by the Indian Government is going to have far-reaching impact on the Indian Economy. It is being considered as one of the most significant step in tackling the black money issue that has gripped our country since many years. The proposal by the government involves the elimination of these existing notes from circulation and a gradual replacement with a new set of notes. The reasons offered for demonetization are two-fold: one, to control counterfeit notes that could be contributing to terrorism, in other words a national security concern and second, to undermine or eliminate the "black economy".

There are potentially two ways in which the pre-demonetization money supply will stand altered in the new regime: one, there would be agents in the economy who are holding cash which they cannot explain and hence they cannot deposit in the banking system. This part of the currency will be extinguished since it would not be replaced in any manner. Second, the government might choose to replace only a part of the currency, which was in circulation as cash. In the other words, the rest would be available only as electronic money. This could be a mechanism used to force a transition to cashless medium of exchange.

These two would have different effects on the economy in the short term and in the medium term, as will be explored below. To understand the effects of these dimensions, it is important to first understand what is it that cash does in the economy? There are broadly four kinds of transactions in the economy: accounted transactions, unaccounted transactions, those that belong to the informal sector and illegal transactions. The first two categories relate to whether transactions and the corresponding incomes are reported for tax purposes or not. The third category would consist largely of agents who earn incomes below the exemption threshold and therefore do not have any tax liabilities.

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Demonetization will render India on the path of being cashless economy. It will help to boost the digital payment system in India, as people will be lured to adopt e-payment systems, as the cash availability will be lowered. Given the sheer size - the decision to withdraw 85% of the cash in circulation has thrown India into disarray. Such a large and unexpected policy change naturally carries with it a large collateral damage at least in the short run. This is particularly true for India where a large section of the economy is comprised of the informal or unorganized sector (not registered with the government and hence not subject to taxation) which functions on cash but is not illegal.

Literature Review

- **Manpreet Kaur (2017)** opined that demonetization is a generations' memorable experience and is going to be one of the economic events of our time. Its impact felt by every Indian citizen. Demonetization affects the economy through the liquidity side. Demonetizing is Progressive shift to a cashless economy with a greater focus on electronic transactions is being envisaged. Rising use of credit/debit cards, net banking and other online payment mechanisms will be another positive effect of demonetization, as these would not only lower transaction costs but some of these could help earn some fee income as well.
- **Ashish Das, and Rakhi Agarwal, (2010)** in their article "Cashless Payment System in India- A Roadmap" Cash as a mode of payment is an expensive proposition for the Government. The country needs to move away from cash-based towards a cashless (electronic) payment system. This will help reduce currency management cost, track transactions, check tax avoidance / fraud etc. enhance financial inclusion and integrate the parallel economy with main stream.
- **Alvares, Clifford (2009)** in their reports "The problem regarding fake currency in India." It is said that the country's battle against fake currency is not getting easier and many fakes go undetected. It is also stated that counterfeiters hitherto had restricted printing facilities which made it easier to discover fakes.
- **Annamalai, S. and Muthu R. liakkuvan (2008)** in their article "Retail transaction: Future bright for plastic money" projected the growth of debit and credit cards in the retail transactions. They also mentioned the growth factors, which leads to its popularity, important constraints faced by banks and summarized with bright future and scope of plastic money.
- **Jain, P.M (2006)** in the article "E-payments and e-banking" opined that e- payments will be able to check black money. Taking fullest advantage of technology, quick payments and remittances will ensure optimal use of available funds for banks, financial institutions, business houses and common citizen of India. He also pointed out the need for e-payments and modes of epayments and communication networks.

Research Methodology

The study is based on secondary sources of data/ information. Different books, journals, newspapers and relevant websites have been consulted in order to make the study an effective one. The study attempts to examine the effect of demonetization on Indian economy as well the strategic decision of Indian economy to become cashless.

Impact of Demonetization on Key Sectors of Indian Market

Turning to the effects of demonetization, the first major and sustained effect of demonetization followed from the extent to which the currency was extinguished and what this currency was being used for. The impact of demonetization on the key sectors of Indian sectors has been explained below.

E-Commerce

It is mostly bad, some good. For the online retail market, gross merchandise value (GMV) of players fell by 40-50% in first few weeks after demonetization, in the middle of their biggest quarter for sales. Things may remain bleak till March. Even high-value items like expensive smart phones are selling less. Products returned are up by 50%.

Tourism

Peak tourism period of November-December was badly hit. For tourist destinations beyond metros, business was down by as much as 40%. Tourism in metro city has gone down by 10%.

Aviation

In world's fastest growing aviation market, passenger traffic growth fall below 20% from an average 23-24% growth recorded in previous years. Flight bookings dropped drastically in days after demonetization.

Real Estate and Construction

The real estate sector in India has traditionally involved a significant level of informal funding in the form of cash transactions. As the demonetization measures were taken to decrease the informal funding sources, the real estate sector was adversely affected. Cash transactions are most common in secondary sales, and resale transactions are expected to decline. Luxury property rates were therefore declined as a result of fewer purchasers with significant liquidity. These measures are expected to adversely affect investors in projects with insufficient audit and KYC funding procedures in near future.

Agriculture

Interestingly, villages have adapted in some ways better than cities. Government allowed tax free deposits of any amounts for farmers which led them in getting 20% premium from traders when transacting. Crop planting increased 20-35% every week after demonetization and remained higher than last year in all weeks after November 8. But a lot depends on cash supply.

Telecom

Telecom Minister Manoj Sinha has announced that telecom companies will be waiving off charges for mobile banking services till December 31 to help citizens struggling from the demonetization decision.

Impact of Demonetization on Accounting

Accounting, in the past, has been ignored by businesses – they felt that it was only required to fulfil some statutory compliance. The reality is that, going through the books, analysing the reports, seeing the stock statements, etc. can be such an eye-opener. It contains such a wealth of information, that people will be able to manage their businesses better, plan their future growth and take higher quality business decisions. This move will force people to maintain proper books of accounts.

Secondly, a lot of the businesses had this concept of 'kachcha' books and 'pakka' books which were maintained separately. It was a clumsy affair, with no real accounting happening – it was more of managing the books. But with this move and going by the speeches he has made since the demonetization announcement, generating money shall become more and more difficult – automatically, businesses will keep one set of books which will be maintained properly.

People will also be surprised to know that doing regular book-keeping is actually cheaper than the year-end book-keeping.

Firstly, we can extract informative reports which we can analyze and assess.

Secondly, we know the exact position of our receivables and payables and hence know who to follow up with.

Thirdly, all our compliance is up to date—no heavy penalties, scrutiny notices, etc. to deal with. We won't even have to manage government departments or worry about visits from the tax officer!

The excuse that the tax structure in India forces people to evade taxes is actually a myth. With more people evading taxes, the tax rate has to be kept on the higher side to ensure a certain threshold of taxes is collected. If tax collection is higher, then definitely taxes on items would reduce and lower the tax burden on the consumer basket.

Hence, it feels that this move will actually help businesses being managed more efficiently, make everyone more accountable and reduce costs.

Assuming that this cash shortage problem is resolved soon, people's spending habits would return back to normal. It's a matter of time before people get used to mobile wallets, plastic money and make the Prime Minister's vision of Digital India a reality.

We hope Real Books which is already championing this cause with its excellent accounting features and document digitizing capabilities is at the forefront of taking this to the next level.

Public Accountants Need to Know

Demonetization is good news for public accountants within and outside India, said Vikas Sekhri, CPA, Mergers and Acquisitions tax partner at RSM US LLP.

The most obvious reason is that more people will now use the finance and banking sector in India, meaning public accountants will have a greater role to play. "More of the population will become taxpayers and will join the mainstream finance and banking world, so the tax net will increase.

"This is the same with middle-market businesses, and that is why I think that there will be more opportunities for public accountants," he added. "Many middle-market businesses likely have been working in the cash economy." Public accountants can take steps to bring their clients up to speed about the changes in their financial world.

From income tax matters to cash flow issues, and from governance and compliance best practices to company tax and value-added tax concerns, Indian businesses will require guidance about how they can best operate in the new environment. Previously, particularly in the small and medium business space, they may not have considered such advice a priority.

"Accounting was not previously very strictly taken by small traders. "They'll now need help of accountants to keep the books and to see that things are in order and compliant."

Management Accountants Need to Know

Management accountants in large businesses will likely not experience great change. But those working in middle-market businesses will find their roles becoming broader and more demanding as a result of the fact that many more businesses will now be entering the tax environment. Add to this the fact that customers, clients, suppliers, and other businesses will also be entering the same arena, and it becomes clear that the work of accountants will be central to the success of the process.

"There will be a greater need for accountants as organizations deal with more businesses and individuals outside of the cash economy. Every individual and business that previously operated within the cash economy, he said, will likely require some form of accounting advice.

There will be short- and medium-term challenges for management accountants are like, ACMA, CGMA.

"Liquidity has taken a hit," he said. "The money businesses held in the old currency will have to be replaced. That is the first impact. The second, of course, is all the transactions that they carried out in cash will slow down. The whole cash cycle is going to slow down.

"A medium-term impact is around whether or not the business has embedded e-payment options in their systems," he added. "If the businesses are not fast enough to provide their customers with options to pay online, it will lead to loss of business and customer loyalty."

E-commerce has been identified as a major opportunity for fast-moving businesses in India as the temporary cash drought has introduced much of the population to online payment systems.

An economy that was previously mired in a cash-on-delivery mentality may well be forced into the online payment world by the demonetization process.

Management accountants also should be aware that India's experience with demonetization could have an important impact in other countries with similar issues, which will likely watch India closely over the next few years to help inform their own decisions around making a similar move.

Demonetisation Hacks
 Consultants are said to be doing a brisk trade in finding how best the newly demonetised ₹500 and ₹1,000 notes can be banked without too many questions being asked

- 1 THE THRIFTY HOMEMAKER** Put the cash down as savings from the monthly household budget
Caution: The tax department could get suspicious if the amount saved exceeds 20-25% of the household budget
- 2 GIFTS FROM RELATIVES** The amounts should be reasonable and commensurate with overall economic status
Caution: Excessive amounts could invite scrutiny of donors
- 3 EARNINGS ON THE SIDE** This could be for non-salaried family members from tuitions, cookery classes, beauty treatments, tailoring, etc. An income of up to ₹2.5 lakh a year is tax exempt
Caution: If the income reported is too high, the tax department may start looking closer; ask for names of students, etc.
- 4 WEDDINGS, MUNDAN CEREMONIES** Cash gifts on such occasions are tax exempt
Caution: If the amount exceeds reasonable limits, the tax department may ask for names of donors and scrutinise their source of income
- 5 ADVANCE PAYMENTS, LOANS TO STAFF, VENDORS** There is no limit to how much cash can be given out, like this but it should be reasonable, lest it gets the recipient into trouble
Caution: Staff could switch jobs, so ensure proper paperwork for loans, etc.

ILLUSTRATION: AIRBRAN BOOKS

Impact of demonetization on digital, telecom, payments, Internet, and ecommerce businesses

Telecom operators, ISPs, Cable operators and vendors

- **Airtel:** Airtel noticed “some immediate impact in the few days post demonetization”, which “was there for a few weeks, but like we saw in some of our other businesses, like DTH, that recovery was reasonably quick. There were some postponement of purchases, but it was quite quick.” Airtel was hurt largely by Reliance Jio’s “Welcome Offer” of giving data free.
- **Idea Cellular:** Idea reported “minor effects of demonetization”, saying, “first and foremost, the impact of demonetization has been very minimum. So, most of the revenue decline is primarily on account of new entrant (Jio).”
- **On mobile Global (Mobile VAS):** “There was deterioration in revenues from India, mainly due to the reduced re-charge rates triggered by demonetization in November and December 2016.”
- **Dish TV (cable operator):** “Limited cash supply made people defers their DTH recharges by a few days or weeks depending on the urgency of other basic necessities. The impact was stronger in the second tier and below towns and cities as most of the economy in these areas runs on cash. Our subscription revenues during the quarter could have been higher by around 8% in a non-adverse scenario. Lower growth eventually resulted in lower average revenues per user as well.”

Strategic Decision to Become a Cashless Economy

Why Should India Move Towards a Cashless Economy? Was Demonetization the Step to Move Towards the Cashless Economy?

Cash is anonymous. This is a safeguard for the privacy of their users, a privacy that can be a benefit but also a hazard to the society. This anonymity is used both by criminals, but also by illegal immigrants and tax payers. A society where all transactions are recorded will be a society with less crime but also less freedom.

Advantages of Cashless Economy

- **Reduced Tax Evasion:** Reduced instances of tax avoidance because it is financial institutions based economy where transaction trails are left. Reducing use of cash would also strangle the grey economy, prevent money laundering and even increase tax compliance, which will ultimately benefit the customers at large.
- **Curbs Black Money:** It will curb generation of black money and will reduce real estate prices because of curbs on black money as most of black money is invested in Real estate markets. Usage of cashless mechanisms would also ensure that loopholes in public systems get plugged, and the intended beneficiaries are able to avail the benefits due to them.
- **Lower Cost of Running Cash Economy:** In Financial year 2015, RBI spent Rs 27 billion on just the activity of currency issuance and management. This could be avoided if we become cashless society. There will be efficiency gains as transaction costs across the economy should also come down. (source: RBI Report)
- **Reduced Threat of Fake Note, Soiled Currency:** 1 in 7 notes is supposed to be fake, which has a huge negative impact on economy, by going cashless, that can be avoided.

Cashless Economy will Eventually have the following Chain Effect

- Improvement in credit access and financial inclusion, which will benefit the growth of SMEs in the medium/long run.
- Reduce tax avoidance and money laundering thanks to the higher traceability of all the transactions.
- The increased use of credit cards will definitely reduce the amount of cash that people will carry and as a consequence, reduce the risk and the cost associated with that.

Though a cashless economy provides with the above benefits, abolishing cash altogether may not result to a more efficient system, but it will possibly increase social exclusion and will constrain further the private sphere. However, the benefits of increased growth cannot be ignored and hence India should move on the path to become cashless.

People moving towards Digital India and this is exactly how Digital Marketing can be assumed as a great future in India in coming years.

Conclusion

The demonetization drive initiated by the Indian Government is going to have far reaching impact on the Indian Economy. It is being considered as one of the most significant step in tackling the black money issue that has gripped our country since many years. Hence, it feels that this move will actually help businesses being managed more efficiently, make everyone more accountable and reduce costs.

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This impacted the whole of Indian market especially consisting of unorganised sector where majority of dealings takes place in cash. There was huge fall in the demand due to illiquidity and unawareness of digital payments. Organisations benefiting from this scheme were the payment intermediaries like Paytm and e wallet apps as there was no option left for the customers and retailers to make the dealings. It was also a good initiative to make India move towards the cashless economy and curb the problem of unaccounted incomes, counterfeit notes and illegal transactions.

The cashless transaction system is reaching its growth day by day , as soon as the market become globalised and the growth of banking sector more and more the people moves from cash to cashless system. The cashless system is not only requirement but also a need of today society. All the online market basically depends on cashless transaction system. The cashless transition is not only safer than the cash transaction but is less time consuming and not a trouble of carrying and trouble of wear and tear like paper money. It also helps in record of the all the transaction done. So, it is without doubt said that future transaction system is cashless transaction system.

A number of agents in the economy would be required to move from the informal sector to the formal sector. For these agents as well as for agents who have been operating through the medium of cash and find the transition difficult, certain informal cash substitutes might emerge. For instance, even at present, there are coupons like the SODEXO coupons which are used for paying for certain purchases. These are accepted by a range of establishments in place of formal currency. It is, therefore, possible to see an expanded use of these coupons. The change might induce the generation of other tokens as substitutes for money as well-the agency collecting MCD's green tax has started issuing tokens in place of change. Similarly, for high value transactions one can think of bit coins and other such crypto currencies on one side and foreign exchange on the other as a mechanism for settling transactions. Perhaps these would not take on a dimension large enough to challenge the official currency, but it can disturb the expectation that the unaccounted economy would be brought into the formal sector since there might exist alternatives to the formal currency. Here it is important to explore the possibility and acceptability of peer to peer payment instruments—a category which has been evolving in recent times.

In spite of the initial hiccups and disruptions in the system, eventually this change will be well assimilated and will prove positive for the economy in the long run.

- Black money hoarders will definitely lose out, eventually boosting the formal economy in the long run.
- Short term fall in real estate prices might benefit middle class citizens.
- This move by the Government along with the implementation of the GST will eventually make the system more accountable and efficient.

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