

DEMONETIZATION: IMPACT ON CASHLESS PAYMENT SYSTEM IN INDIA

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ABSTRACT

This research paper examines the impact of India's 2016 demonetization policy on the adoption of cashless payment systems. The study analyses how the sudden withdrawal of high-denomination currency notes from circulation accelerated the transition toward digital financial transactions. Through secondary data analysis, the research reveals that while there was an immediate surge in digital payment volume (43% growth from November to December 2016), the sustained growth pattern is more significant, with digital transactions increasing by 33% in volume and 59% in value between November 2016 and March 2017.

The findings indicate a clear preference for mobile-based payment methods over traditional card payments, with solutions like the Immediate Mobile Payments System (IMPS) and United Payments Interface (UPI) showing remarkable growth. The paper also discusses various cashless payment options available in India, including e-wallets, UPI, plastic money and net banking, while identifying challenges to widespread adoption such as security concerns, connectivity issues, transaction costs and limited banking penetration. Despite these limitations, the research concludes that cashless transactions offer significant advantages including cost-effectiveness, time efficiency, enhanced security, technological advancement and better control over illegal financial activities, suggesting that digital payment systems represent the future of financial exchanges in India.

Keywords: Demonetization, E-wallets, UPI, IMPS, Plastic money, Net banking.

INTRODUCTION

Globally, policy makers, academicians and businesses show significant interest in transitioning toward cashless economies due to the widely perceived benefits of such systems. A research study examining electronic payment adoption across 51 countries indicates substantial economic impacts, with electronic card usage contributing to increased private consumption and GDP growth between 2003 and 2008. Analysis suggests that even modest increases in card transaction volume correlate with measurable improvements in consumption and overall economic growth.

India may experience similar advantages from increased cashless transactions. This paper examines potential benefits specific to the Indian context while addressing two critical questions: what is the current proportion of cashless transactions in terms of both volume and value and what factors most significantly influence these metrics? Understanding these elements provides a foundation for developing strategies to increase cashless transaction adoption throughout the economy.

Global trends demonstrate steady progression toward digital payment methods, with worldwide non-cash transactions showing significant year-over-year growth. Data from European financial authorities further confirms this gradual shift away from physical currency toward electronic payment systems across diverse economies.

REVIEW OF LITERATURE

According to Jain. P.M (2006), the implementation of electronic payment methods can help in reducing untaxed transactions in the economy. Electronic banking and payment technologies offer significant advantages, including faster transactions and more efficient use of financial resources for various stakeholders including financial institutions, businesses and individual citizens. The study has emphasized the importance of developing strong electronic payment infrastructure and communication networks to support these systems.

Annamalai and Iiakkuvan (2008) examined the future potential of plastic money in retail transactions. Their article "Retail Transaction: Future bright for plastic money" analysed the growing trends in debit and credit card usage while identifying key growth drivers contributing to their increasing popularity. The authors also discussed significant challenges faced by banking institutions and concluded by highlighting the promising outlook and opportunities for plastic money in the retail sector.

Alvares (2009) in his report "The problem regarding fake currency in India," highlighted the ongoing challenges in combating fake currency, noting that many fake notes remain undetected in circulation. "The report noted that in the past, counterfeiters had limited access to printing technology, making fake currency easier to detect."

Das and Agarwal (2010) advocated for a shift from cash-based to electronic payment system in their article "Cashless Payment System in India- A Roadmap." The authors argued that cash payments represent a significant cost burden for the government and suggested that moving toward cashless alternatives would deliver multiple benefits, including reduced currency management expenses, improved transaction tracking, decreased tax evasion and fraud, enhanced financial inclusion and better integration of the informal economy with the mainstream financial system.

OBJECTIVES OF THE STUDY

The objectives of the study are as under:-

- To study the Role and Impact of Demonetization on Cashless Payment System.
- To Examine Status of Electronic Payment System in India.

RESEARCH METHODOLOGY

This research study is based on secondary data collected from various academic resources including scholarly books, journals, news publications and relevant online sources. The comprehensive analysis of these materials supports the examination of India's cashless payment ecosystem and its development.

DEMONETIZATION OF CURRENCY

Demonetization refers to the process in which a government officially withdraws the status of certain currency denominations as legal tender, effectively removing them from circulation as a valid form of payment. This process includes phasing out certain forms of money, typically during a transition to new currency. As the old currency is withdrawn from circulation, new currency takes its place.

Legal tender refers to money that is officially recognized by law as acceptable for paying debts. When a creditor accepts legal tender means currency legally recognized by a government, as payment for a debt then that debt is generally considered discharged under law. While physical coins and paper currency qualify as legal tender, other payment methods like cheques and credit cards don't have this status - the debt remains outstanding until these payments are clear.

In India, high-value currency notes (₹1,000, ₹5,000, and ₹10,000) were first issued in 1954 but later demonetized in January 1978. The 2016 demonetization represented India's first such action in nearly 36 years.

DEMONIZATION EFFECT ON ELECTRONIC PAYMENT SYSTEM

The government of India has a goal of becoming a cashless economy but significant challenges remain in its implementation. Cashless transactions have their downsides for consumers. However, for those with access to digital payments, rejecting cashless options or hesitating to embrace technology is not the answer, especially during the cash shortage caused by the government's demonetization initiative.

Keeping access issues aside, a cashless economy offers significant benefits. By adopting digital payment methods and becoming informed about available systems, consumers can experience more convenient and user-friendly transactions.

Traditionally, online payments required debit or credit card details or net banking interfaces. While security continued to improve even then these payment experiences were often cumbersome and primarily limited to computers with internet access. The smartphone revolution transformed this landscape completely. India has witnessed rapid growth in digital payment options, from e-Wallets to the Unified Payment Interface (UPI) and hybrid solutions. India now offers numerous cashless payment alternatives for consumers to choose from the four best cashless payment options in India.

1. E-Wallets E -Wallets have gained significant popularity in recent years. After demonetization, their usage expanded considerably across India. These digital wallets allow users to make payments either by using their mobile number or by scanning QR codes quickly.

The process simply requires downloading a wallet application such as Paytm to your smartphone.

2. Unified Payments Interface (UPI) - UPI is a widely used digital payment system that enables instant money transfers between bank accounts, making it an efficient method for cashless transactions. This payment system allows individuals to conduct transactions directly from their smartphones. To utilize UPI, users need only two essential components: a smartphone and an active bank account.

3. Plastic Money Plastic money refers to payment cards such as debit and credit cards used at ATMs for withdrawing cash and at Point of Sale (POS) terminals while shopping. Having these cards eliminates the necessity of carrying physical currency, providing convenience and security.

4. Net Banking Net banking offers another convenient approach to cashless transactions. This service requires a bank account with enabled online banking features. Users can transfer funds to other accounts from the comfort of their homes without visiting bank branches. This self-service platform allows users to handle payments and transfers independently, making it a practical option for cashless transactions in India.

FINDINGS OF THE STUDY

Digital Payments show Lasting Growth after Demonetization Era

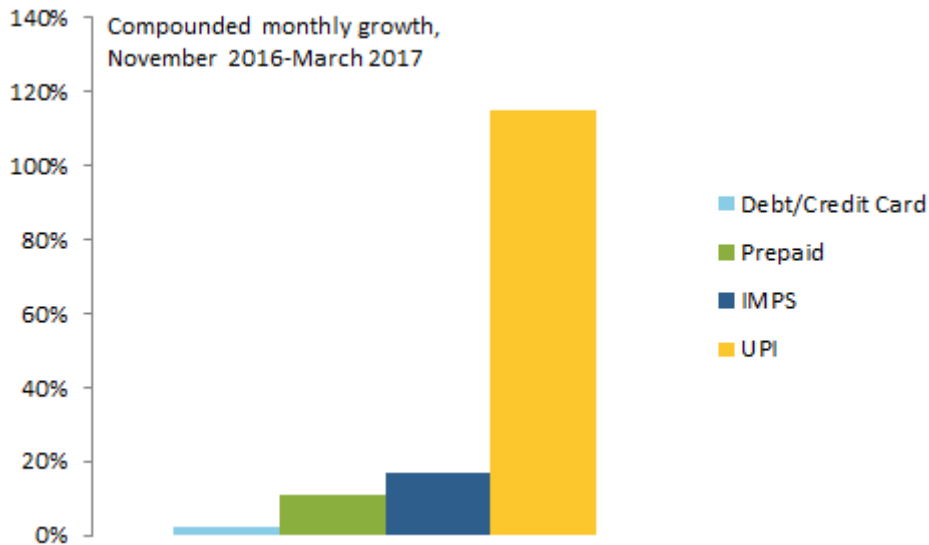
The implementation of India's demonetization policy in November 2016 led to a dramatic surge in digital payments as cash availability dropped by roughly 67%. Digital transaction volume grew 43% from November to December 2016, creating optimism that this monetary shock would accelerate India's transition toward digital financial systems.

Given that approximately 98 percent of consumer transactions were cash-based prior to demonetization, it was expected that most Indians would revert to cash once new currency notes became widely available. Growth in digital payments did slow during January and February 2017; however, March data indicates that the shift away from cash continues, with digital transactions increasing by 33 percent in volume and by 59 percent in terms of value since November 2016. While the government may not achieve its target of 25 billion cashless transactions for the fiscal year ending March 2018, sustained monthly growth above 7 percent could result in 2 billion monthly transactions by early 2018.

The data shows a clear preference for emerging mobile-based payment methods, with traditional non-cash options like debit and credit cards showing less growth (Figure 1). Card payments initially increased by 51 percent in December 2016 before declining in subsequent months, resulting in just a 10 percent overall increase since demonetization. Despite recent financial inclusion initiatives expanding payment card availability to 869 million by February, monthly card transactions averaged only 244 million in recent months, indicating most cards remain unused. For context, Americans conducted approximately 8.6 billion card transactions

monthly according to 2015 Federal Reserve data—more than 40 times India's average despite having about one-quarter of India's population.

Figure 1 – Select Digital Payment Growth Rates Following Demonetization



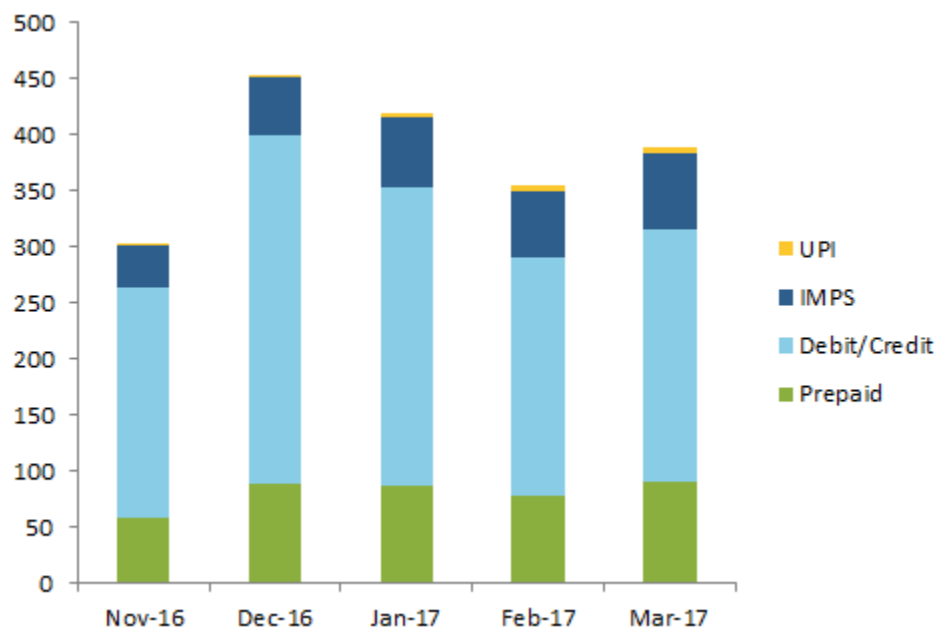
Source: Reserve Bank of India

Emerging Digital Payment Solutions Challenging Card Dominance

Recent years have witnessed significant growth in cashless transaction methods built on newly established infrastructure. Specifically, the Immediate Mobile Payments System (IMPS) and United Payments Interface (UPI) - both enabling instant mobile-based transactions - have experienced remarkable expansion following demonetization, despite cash returning to circulation throughout the economy.

While a comprehensive evaluation of demonetization's effects on digital payment adoption requires additional data over extended timeframes, initial findings indicate the policy may serve as a timely accelerator for the growth of non-cash payment methods.

Figure 2: Select Digital Payment Volumes (Millions of Transactions)



Source: Reserve Bank of India

LIMITATIONS OF INDIA IN CASHLESS SOCIETY

- Computer systems face security vulnerabilities that can lead to unauthorized access and financial fraud,
- Lack of adequate network connectivity in rural and remote areas,
- Cost of internet services remains prohibitively expensive for many households,
- Digital payment methods often include transaction fees that create additional financial barriers for users,
- Limited smartphone affordability for lower income groups,
- Internet disruptions and occasional government-imposed blockages,
- Insufficient banking penetration and account ownership.

ADVANTAGES OF CASHLESS TRANSACTIONS

The shift to cashless transactions offers significant long-term benefits and has the potential to transform deeply established financial behaviour among people.

1. **Cost-Effective for Banks:** A manual transaction at a bank branch costs approximately ₹ 40-45, while the same transaction performed online costs only about ₹ 7-8. This substantially reduces operational costs for banks while improving convenience for both bankers and customers.
2. **Time Efficiency:** Cashless transactions significantly reduce time requirements for customers and minimize customers' complaints. Users can transfer or receive funds within minutes through various digital payment options, eliminating the need to visit physical bank branches.
3. **Enhanced Security:** Digital transactions offer strong security features through biometric authentication methods like fingerprint verification and One Time Passwords (OTP) for transaction validation.
4. **Technological Advancement:** The shifting from conventional banking to digital transactions drives technological progress. Banks continuously expand their ATM networks, point-of-sale (PoS) machine availability and regularly enhance their e-banking capabilities.
5. **Control of Illegal Finance:** Unlike cash transactions, digital payments leave an audit trail that helps authorities to monitor and prevent money laundering and black money circulation. This improved financial transparency reduces financial fraud and promotes legitimate economic development.

EFFORTS TOWARDS CASHLESS ECONOMY

The RBI and government have initiated several measures to promote electronic and non-cash settlement systems. The RBI's Vision-2018 for Payment and Settlement Systems in India, released in June 2016, emphasizes encouraging greater use of electronic payments across all segments of society to achieve a "less-cash" society. According to the RBI, "The broad outlines

of Vision-2018 revolve around five Cs — coverage, convenience, confidence, convergence, and cost. To achieve these, Vision-2018 will focus on four strategic initiatives such as responsive regulation, strong infrastructure, effective supervision and customer-centricity."

KEY INITIATIVES INCLUDE:

1. Banning cash transactions above specified limits,
2. Implementing caps on cash holdings,
3. Providing incentives for electronic payment adoption,
4. Eliminating charges on electronic transactions,
5. Establishing the Bharat Bill Payment System for unified bill payments,
6. Encouraging public willingness to embrace new payment methods,
7. Enhancing awareness about payment technologies,
8. Implementing strong cybersecurity measures,
9. Promoting mobile money wallet solutions.

CONCLUSION

The movement toward cashless transactions continues to accelerate with market globalisation and banking sector growth, driving society from cash-based to cashless systems. This shift represents both a requirement and necessity for contemporary society. Online marketplaces fundamentally rely on cashless transaction capabilities. Beyond being safer than cash transactions, electronic payments save time and eliminate concerns about carrying physical money or its deterioration. Additionally, digital transactions create comprehensive transaction records. The evidence clearly indicates that cashless transaction systems represent the future of financial exchanges.

"To accomplish these goals, Vision-2018 will prioritize four key strategies: adaptive regulation, strong infrastructure, efficient oversight, and a focus on customer needs."

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