GOVERNMENT OF KERALA

KERALA STATE PLANNING BOARD

COMMITTEE TO STUDY THE IMPACT OF DEMONETISATION ON THE STATE ECONOMY OF KERALA

REPORT

FEBRUARY 2017

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CONTENTS

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STATEMENT BY THE CHAIRPERSON

I present the Report of the Committee appointed by the Kerala State Planning Board to study the impact of the policies of the Government of India regarding cancelling the legal-tender character of bank notes of Rs 500 and Rs 1000 denominations. In addition to cancelling the legal-tender character of bank notes, the Government of India also restricted the rupee value of withdrawals by persons from Automated Teller Machines, placed restrictions on the notes exchangeable at banks, and disallowed the banking functions of cooperative banks. The mandate of the Committee was to study the impact of these decisions on the economy of Kerala.

The Committee was appointed on November 23, 2016. Professor C. P. Chandrasekhar (Centre for Economic Studies and Planning, Jawaharlal Nehru University) is the Chairperson of the Committee. The other members are Professor D. Narayana (Director, Gulati Institute of Finance and Taxation), Professor Pinaki Chakraborty (National Institute of Public Finance and Policy), Dr. K. M. Abraham (Additional Chief Secretary, Finance), and Shri V. S. Senthil (Member Secretary, Planning Board).

The terms of reference of the Committee were to evaluate and report to the Kerala State Planning Board on the short- and long-term impact of the Government of India decisions with regard to:

(i) employment, income, and economic activity in the major sectors of the State economy and on the livelihoods of different sections of the labour force,

(ii) the cooperative sector in Kerala and on the banking sector and credit provision in general,

(iii) Government revenues, and

(iv) Gross State Domestic Product (in general and sector-wise).

The Committee held consultations from November 28, 2016 to December 1, 2016 and on January 19, 2017. Officials from the Departments of Finance and Cooperation, representatives from primary agricultural credit societies, production and marketing cooperative societies, and current and former officials of the Central Government, the Reserve Bank of India and the National Bank for Agriculture and Rural Development were invited to appear before the Committee to provide relevant data and speak on conditions existing in their respective fields of work. Representatives of the Committee visited Kollam to interview people working in the fisheries sector. Representatives and officials who could not attend the consultations sent written notes and other inputs, which were also considered by the Committee for the preparation of this report.

A list of persons met by the Committee is in Annexure 1. We are grateful to them for taking time off to meet us and share their knowledge and provide evidence on the impact of demonetisation in different domains.

The Government Order concerning the constitution of the Committee is in Annexure 2.

The Government Orders concerning the cooperative sector are in Annexure 3.

My colleagues and I would like to acknowledge the immense benefit we derived from discussions with Professor V. K. Ramachandran, Vice Chairperson, Kerala State Planning Board. Dr. P Rajasekharan, Chief, Agricultural Division, Kerala State Planning Board, worked closely with the Committee, providing it support in substantive and organisational matters. Deepak Mercy Johnson provided crucial support in strengthening the empirical foundations of the report and collating the inputs received from different sources. P. V. Aniyan played a similar role in the early stages of the work of the Committee and facilitated its consultative efforts in various ways. We must also acknowledge with thanks the contributions made by members and staff of the Kerala State Planning Board while we were working on this report.

C. P. Chandrasekhar
Chairperson

GOVERNMENT OF KERALA
KERALA STATE PLANNING BOARD

Committee to Study the Impact of Demonetisation on the State Economy of Kerala

SUMMARY OF THE FINAL REPORT

On November 8, 2016, the Government of India decided to cancel the legal-tender character of bank notes of Rs 500 and Rs 1000 denominations. In addition to cancelling the legal-tender character of bank notes, the Government of India also restricted the rupee value of withdrawals by persons from Automated Teller Machines, placed restrictions on the notes exchangeable at banks, and disallowed the banking functions of cooperative banks.

On November 23, the Kerala State Planning Board appointed a Committee to study the impact of demonetisation on the economy of the State of Kerala. This is a summary of the Report of the Committee.

DEMONETISATION 2016

Notes of 1000-rupee and 500-rupee denominations accounted for a little more than 20 per cent of all notes in circulation and around 85 per cent of the value of currency in circulation (of a total value of about Rs 15.44 lakh crore in November 2016). In one single action the Central Government, with the concurrence of the Reserve Bank of India (RBI), withdrew a huge amount of currency in circulation. Just replacing that volume of currency (that is, ignoring notes required to replace soiled ones and meet any increase in the demand for currency) required the infusion of around 22 billion pieces of currency notes into the system. That figure compares with the Government's indent for 2016-17 of 24.6 billion pieces of currency notes of all denominations from Rs 5 to Rs 1000 from the Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL) and the Security Printing and Minting Corporation of India Limited (SPMCIL). Actual supply from these sources of notes of all denominations in 2015-16 amounted to 21.2 billion pieces. Thus, demonetisation has meant a huge cash crunch, with severe restrictions on access to currency. The shortage had an enormous impact on an economy where the cash-to-GDP ratio was 12 per cent in 2015, and in which 98 per cent of transactions were estimated to have been in cash in 2013.

The Government wrongly presumed that, with the increase in Jan Dhan Yojana (JDY) accounts among the unbanked, the introduction of the indigenous RuPay debit card, and the widespread use of mobile telephony, a significant shift away from cash could be ensured. In reality, the transition to a cashless economy can only be slow, influenced substantially by the extent of banking spread.

In these circumstances, the Government had to ration the use of currency. The result was great and immediate hardship – long queues in front of banks and ATMs to withdraw cash, and queues even to wait for cash to arrive at the bank or ATM. Daily and weekly ceilings, which have been changed more than once, have been set on cash withdrawals from the accounts of citizens, whether these are direct withdrawals or withdrawals through ATMs. As of now, depositors in regular accounts are allowed to withdraw Rs 24,000 every week, but Jan Dhan Yojana account holders are permitted to withdraw only Rs 10,000 in a month because of the suspicion that they are being used by persons who are not account holders to deposit demonetised notes.

In his speech on December 31, 2016 – that is, on completion of the bank-mediated note exchange and deposit process – the Prime Minister acknowledged that the current demonetisation was an unprecedented and painful process. He recognised that "there is no precedent globally to what India has done." He said that "the Government is well aware that in this period, you (the people) had to queue up and face difficulty in withdrawing your own money." "I received letters from many people," he said. "They have shared their pain and sorrow with me."

Macroeconomic Consequences

The immediate consequence of the cash crunch was a severe curtailment of effective demand because people have little or no cash. As a result, transactions in many markets were reduced or brought to a halt, casual and temporary workers paid in cash either experienced a fall in employment or were forced to accept deferred payments or payments in now-demonetised specified bank notes (SBNs) that had to be exchanged, persons with limited access to banking services have not been able to meet their daily needs, farmers who have just harvested their crop have not been able to sell it and buy seeds and inputs for the next crop, many among India's sick have not been able to pay for medical services, and persons in need of cash for occasions such as weddings or other events have been unable to draw it from their accounts. With more than 90 per cent of India's employed labour force consisting of workers in the informal sector, often with no written contracts, let alone regular employment or social security benefits, wage payments are substantially in cash across the economy. So are a range of payments for transactions among the self-employed and between the self-employed and the formal economy. The adverse impact of demonetisation has thus been widespread, and has led to large-scale economic contraction.

Another important macroeconomic consequence of demonetisation is bound to be a worsening of the fiscal crunch facing the Centre and the States. The Union Government's fiscal deficit has already hit 79.3 per cent of the Budget Estimate for 2016-17 and the revenue deficit was in excess of 90 per cent by the end of October 2016. Because of the contraction in economic activity after demonetisation, it is unlikely that there will be growth in revenue in the next six months that can help maintain the Union Government's fiscal deficits at a manageable level. As a result, we can foresee a curtailment of capital and social expenditures, with adverse impacts on growth and welfare.

Impact of Demonetisation on Kerala

A number of features of Kerala's economy have made it particularly vulnerable to the poorly planned demonetisation exercise. First, cash transactions are predominant in the State's economy. Secondly, some of the major contributors by sector to the State's economy are in the informal or unorganised sector, where cash transactions dominate. Millions of people in Kerala are dependent on incomes gained in the traditional sectors of fisheries, coir, handlooms, and cashew processing as well as in crop and plantation agriculture. More than two and a half million migrant workers work as wage labourers in the State. Thirdly, the three-tiered cooperative banking structure, with PACS at the bottom of the pyramid, constitutes an overwhelmingly large part of the financial structure. Fourthly, outside the financial structure, Kerala has a cooperative sector that is an important component of manufacturing and services activity, since manufacturers and service organisations banks substantially with the cooperative banking sector. Fifthly, earnings from tourism constitute an important share of Kerala's State income. Lack of access to cash deals a blow to tourism. Sixthly, remittances play an important part in Kerala's economy, and the economic constraints caused by the present policy can cause disruption in the flow of remittances. These features, *inter alia*, contributed to the intensity of the impact of the demonetisation on the state's economy and its people.

Cash-intensive sectors such as retail trade, hotels, and restaurants and transportation account for over 40 per cent of the Kerala economy, and the primary sector accounts for another 16 per cent of the economy. Thus, 56 per cent of the economic activity of Kerala is immediately affected by the withdrawal of specified bank notes. Agriculture, whose growth has been slow and severely constrained for the last few years, will be affected directly by the new policy. Any turnaround in construction, transport, and storage, which have been decelerating in the recent past, will be delayed. The high-growth sector of trade and hotels has been seriously hit by the cash crunch. A significant section of workers in manufacturing are in traditional industries. Overall, both leading as well as struggling sectors of the economy have been hit hard by demonetisation, pulling the economy down and affecting potential resource mobilisation as well.

The impact of demonetisation in terms of the cash deficit and its consequences has been particularly severe in Kerala also because of the distinct character of its banking sector, in which the cooperative sector and the Primary Cooperative Societies play a central role. Kerala is one of the most developed States in India in terms of the spread of banking and financial institutions. The financial system of Kerala has four distinct components, each characterised by specific strengths: scheduled commercial banks (SCBs), cooperative banks and agricultural credit societies, non-banking financial companies (NBFCs), and micro-finance institutions (MFIs). According to one estimate, there are at present about 14,000 cooperative societies registered with the Registrar of Cooperative Societies in Kerala. Of these, 10,503 societies function satisfactorily. They include apex institutions like the State Cooperative Bank, the State Agricultural and Rural Development Bank, 14 District Cooperative Banks, 60 Urban Banks, 48 Primary Agricultural and Rural Development Banks, and 1602 Primary Lending Societies.

Around 60 per cent of all deposits are in the cooperatives in Kerala; the corresponding figure for India is less than 20 per cent. At the all-India level, for every 100 credit accounts in the banks there are only 35 borrowers in the PACS. In Kerala, for every 100 credit accounts with banks, there are 184 borrowers in the PACS. The average size of loan advanced by the commercial banks is about seven times the average size of loans advanced by PACS in Kerala, and sixteen times the average size of loan advanced by PACS at the all-India level. Overall, the cooperative banking sector is much more active and vibrant in Kerala than elsewhere. As a result, over 70 per cent of the deposits in PACS in India come from Kerala; over 70 per cent of the non-agricultural loans and advances made in India are made in Kerala; and over 15 per cent of the agricultural loans and advances in India are disbursed in Kerala. The provision of a rate of interest on deposits that exceeds the rate of interest offered by scheduled commercial banks is often offered as an explanation for the popularity of PACS among depositors. The fact, however, is that the great success of these institutions in Kerala is an indication of the trust these democratic and participatory institutions have earned for themselves.

Thus, the notifications issued by the Reserve Bank of India after November 8, particularly the notification of November 14, that have kept the cooperative banks and societies out of the note exchange process, were particularly damaging for Kerala. In the case of the PACS, the implicit reasoning was that they were nonbanking entities under the Banking Regulation Act of 1949. But the restriction on exchange and accepting deposits of SBNs was also imposed on district cooperative banks, despite their being licensed under the Banking Regulation Act, being compliant in the Know Your Customer (KYC) regulations, and working with core banking solutions. These banks also face difficulties in converting reserves of demonetised notes into legal tender.

Besides not being allowed to exchange specified bank notes, the access of PACS to currency was cut off, forcing these institutions – which are central to financial intermediation and inclusion in Kerala – to shut down their operations. As compared with an average outstanding deposit base of Rs 19.9 crore per branch and Rs 28,000 per individual member, each PACS was treated as an individual and its withdrawal limit set at Rs 24,000 a week. What was deliberately ignored was that it was not each PACS that was being denied access to cash, but that lakhs of members who held deposits in these institutions were being denied access to any of their money. There cannot be a single other instance of expropriation of the purchasing power of a population of this magnitude.

These actions resulted in the closure of banking activities at the level of the PACS. They also targeted the credibility of the PACS, which had served as democratically run, participatory financial institutions. Depositors in the PACS were being forced to migrate to the commercial banking sector with their money, thus undermining the role of some of the most successful examples of cooperative banking and financial inclusion. Representatives of the PACS met by the Committee stated that it was not true of all accounts that KYC norms were not met. In any case, this shortcoming could have been addressed directly, without causing extreme hardship and without threatening the viability of institutions with a record of financial inclusion unparalleled in the formal banking sector or in any other State.

In view of the hardship caused by PACS account holders, the State Government issued two circulars (Circular no.: 46/2016, 47/2016). These permitted account holders to open zero-balance, KYC-compliant accounts in district cooperative banks.

The evolution of the Reserve Bank of India's views on the cooperative credit system, especially after the 2006 report of the Task Force on Revival of Cooperative Institutions, explains in part the position it took with respect to the role of these institutions in the demonetisation process. The RBI does not adequately recognise that credit cooperatives have followed different trajectories in different States. The RBI seems to be set on making PACS – which are institutions designed to be different from conventional commercial banks – look and behave like the latter. Thus the Task Force was unhappy that:

a. PACS were excluded from the scope of the Banking Regulation Act 1949,
b. the minimum capital requirements for PACS were smaller than for commercial banks, and
c. the cash-reserve ratio requirements for PACS were lower than that for commercial banks.

Such features were part of the original design of institutions that, unlike commercial banks, were geared less to profit making and more to serving the interests of their members.

A case study of the geographical distribution of commercial bank offices and PACS in Kasaragod and Wayanad districts illustrates the limitations of the former and the role of the latter in reaching out to the rural population. Kasaragod district has 143 offices of commercial banks distributed over 50 banking centres. The distribution is highly uneven with a heavy concentration of 34 branches in Kasaragod town and 19 branches in Kanhangad. Thrikkaripur, Nileswar, Manjeshwar, and Udma account for another 30 branches. In all, six banking centres account for over 60 per cent of bank branches. PACS have a wider geographical spread than commercial banks. There are 64 PACS in the district, spread over 64 centres. The spread of PACS is much wider than that of the commercial banks. PACS are the sole service providers in 39 centres in the district. The picture is similar in Wayanad district.

As happened at the all-India level, the sudden retraction of liquidity and purchasing power had somewhat contrasting effects on the State's economy. With buyers unable to back their demands for commodities and services (including wage labour) with cash, demand and prices fell in many markets. The primary picture that emerged from discussions with different sections of the community was one of a demand slump and deflation. The effect of the cash crunch on employment and livelihoods was immediate principally because it affected the informal sector most severely.

The Committee met with or received representations from cooperative society representatives and others associated with the construction, dairy, vegetable and fruits, fisheries, and handloom sectors. It became clear that, given the multiple levels and varying values of the transactions involved in the informal sector, not all transactions can be made cashless, and definitely not in the short run. The result has been an inability to make payments, even for wages. Moreover, in sectors trading perishables such as vegetables and fruits, pressure to sell the product results in falling prices. Despite the decrease in prices, offtake remains low because of the cash crunch, leading to loss of produce because of spoilage. In the dairy industry, farmers are not being paid in time for milk supplied and are unable to buy adequate cattle feed because of the cash deficit. The fisheries sector has been particularly hard hit because, starting with payments for fish auctioned at the point of landing, most transactions, including payments of wages by boat owners, supply to wholesalers and retailers, etc., are in cash. As business has declined, workers get less work and lower earnings, and have had to get into debt to meet their daily expenses.

As noted earlier, tourism and remittances are important drivers of growth in Kerala's economy. But as news of the serpentine queues at money exchange counters in airports and outside and the limits on the amount of Indian currency that can be obtained in exchange for foreign currency spread, cancellations have been on the rise and tourist arrivals are falling. The cash shortage has affected domestic tourist arrivals as well. As per quick estimates from the Department of Tourism, Kerala, relative to the corresponding month of the previous year, domestic tourist arrivals fell by 17.7 per cent in November 2016 and foreign tourist arrivals by 8.7 per cent. The corresponding figures for October 2016 were a positive 5.2 per cent and 6 per cent respectively.

Fiscal Situation of Kerala in the Context of Demonetisation

As noted earlier, demonetisation will have extremely adverse implications for the Government's fiscal health at the national level. The weakening of the fiscal situation of the Union Government would affect state revenues adversely through a decline in Central grants. Apart from this, an imminent slowdown in the overall GDP growth rate would mean a slowdown in the growth of Union taxes, which would, in turn, mean lower devolution of taxes to the States.

In the case of Kerala, its own tax-to-GSDP ratio has declined from 7.06 per cent in 2011-12 to around 6.5 per cent by the end of 2015-16 (RE). In its Revised Budget, the present Government, which came to power in May 2016, proposed that the tax-to-GSDP ratio be increased to 6.85 per cent. If we translate this into growth rates, own tax revenue is expected to grow at the rate of 19.39 per cent. Given the post-demonetisation slump in economic activity, it is unlikely that own tax revenue of the State will grow enough to drive such a growth rate.

Analysis of monthly tax collection data shows that the growth of the state's own tax revenue has been negative for the month of December when compared with December 2015. If this trend continues, own tax revenue shortfall would be significant. Also Kerala's actual revenue mobilisation with a tax effort of 6.85 per cent of GSDP will be much lower if there is a fall in the GSDP growth rate. The IMF has already reduced India's growth forecast to 6.6 per cent. With an implicit inflation rate of 4 per cent, nominal GDP may not grow beyond 10 to 11 per cent in the fiscal year 2016-17. In all likelihood, after demonetisation, Kerala's GSDP growth rate will be much lower than 14.9 per cent (the annual average GSDP growth rate observed between 2011-12 and 2014-15). At a constant tax effort of 6.85, a decline in the GSDP growth rate by one percentage point means a shortfall in tax revenue to the tune of Rs 390 crore from the budget estimates (BE) of 2016-17. If Kerala's GSDP growth rate also hovers around the national GDP growth of 10 per cent, the own tax revenue shortfall will be to the tune of Rs 1950 crore when compared with 2016-17 BE. A combination of declining GSDP and slow revenue growth can result in a shortfall in tax revenue much higher than Rs 1950 crore. In fact if the tax to GSDP ratio is assumed to be 6.5 instead of 6.85, the shortfall in revenue due to a one percentage point decline in GDP would be more than Rs 2800 crore and aggregate own tax revenue shortfall in turn would be around Rs 11,000 crore if the GSDP growth plummets to 10-11 per cent.

This level of own tax revenue contraction, if not compensated, can result in across the board cuts in plan expenditure of the state, which would have adverse growth and development implications. This can result in a vicious circle of lower growth, lower revenue, and lower level of development expenditure. In this context, the Committee emphasizes that additional central assistance in the form of a grant should be provided to the states. Also the Committee strongly recommends that states' borrowing limit of 3 per cent of GSDP should be relaxed for the year 2016-17 and 2017-18 by the Union Government. States should be allowed to borrow more so that public expenditure for development and growth is maintained at the existing level indicated in state budget 2016-17 and be enhanced wherever necessary as a counter cyclical fiscal measure to arrest the economic downturn that followed demonetisation.

Thus, to conclude, after demonetisation, Kerala's fiscal situation is grim. Apart from this, after demonetisation, day-to-day cash management has become a challenge at the State level. This includes the payment of salaries and pensions, a process that can snowball into a major crisis.

What Can be Done?

Despite the damage it has done, the Central Government is politically unwilling to reverse its demonetisation decision. On the other hand, full "remonetisation" of the economy is unlikely before the third quarter of 2017. As of now ceilings on withdrawals remain in place. So, Kerala, led by the State Government, must find ways to limit the adverse consequences of the policy, especially with regard to the livelihoods and welfare of the poorest among its people.

One priority is to ensure that Plan expenditures are maintained at targeted levels despite the budgetary difficulties created by the impact of demonetisation. To realise this joint effort by State Governments to demand compensation from the Centre in the form of discretionary transfers to support the Plan is called for. In addition to this, the Centre must be called upon to relax ceilings on borrowing by the States so that to the extent that compensation from the Centre is short of the stimulus needed to counter the recession, the required expenditure can be financed with loans from the market.

Another set of policy measures must address the problems of cooperative institutions, particularly in Kerala, where the cooperative credit societies and cooperative banks have played a crucial social and economic role. An immediate requirement is to consolidate and replicate experiments of the kind conducted in Kozhikode, where Government institutions, businesses, cooperating banking agencies, and citizens came together. Their objective was to work out systems that allow for settlements of transactions through means other than cash, in order to protect the employment and purchasing power of workers (especially in the informal sector), limit the adverse effect of demonetisation on economic activity, and support the revenue-generating capacity of the State Government. The issue here is not to replace cash settlements with digital payments by encouraging the use of mobile phones and digital wallets. Those who expect a transition to digital payments on a scale that will meet the problem created by demonetisation are making hugely overoptimistic assumptions on the state of connectivity, digital literacy, and the digital security infrastructure in the country. The method in Kerala is to use local networks that link people, businesses, institutions, and the Government and the trust between them to settle transactions through the existing financial framework but without cash. Cards, identity markers, information sources, and other instruments can build and consolidate the trust needed for the operation of such networks.

Medium and long-term policies are also necessary. Policies to reverse the standstill in business at the PACS are crucial. While legal recourse to reverse the decision that partly or fully freezes the operations of cooperative banking institutions at different levels in the State has been taken, other measures too are needed. Members of individuals PACS should be encouraged by PACS and district central cooperative banks (DCCBs) to open mirror versions of their accounts in the district cooperative banks to which the concerned PACS is linked, and use those mirror accounts to disburse cash against the deposits held by members in the PACS or against the loan accounts opened in the name of individual members in the PACS.

Another set of medium-term initiatives must be aimed at supporting the primary cooperative societies. Primary cooperative societies have been badly hit by the demonetisation and have been excluded from exchange and deposit of the specified bank notes (SBNs). This exclusion from cash transactions has challenged their viability and posed a threat to their survival. There are many ways in which support to counteract this can be provided. Public sector entities and Government agencies can be asked to bank with the PACS where possible so as to send out a message that PACS are trusted entities with Government backing. Some PACS claim that dues from the Government to the PACS, such as payments to compensate for loan waivers provided as part of past Government programmes, have not been disbursed as yet. These should be immediately cleared so as to give the concerned PACS financial support that is legitimately due to them. In addition, schemes to provide some subvention of interest rates for borrowers from cooperatives who have a good debt servicing record can enthuse members to continue their association with the cooperatives.

One issue that arises in this context is the regulatory jurisdiction of the Registrar of Cooperative Societies in the State. The Reserve Bank of India took a unilateral decision to exclude the PACS from SBN exchange or acceptance of SBN deposits, and chose to treat them as equivalent to individual depositors in the scheduled commercial banks when setting ceilings on withdrawals. In this situation, the State-level regulatory authority had no option other than to comply and issue the necessary order or notification. They had to do so despite the fact that such decisions froze operations in the PACS and damaged their credibility, since PACS were now seen as "different" from the banks and their operations as possibly suspect. It is necessary to make suitable changes in the 2006 Task Force regulatory framework to give a degree of autonomy to State-level regulators of the PACs, especially in States with a vibrant cooperative sector like Kerala, where the PACS play a crucial role in the rural credit infrastructure.

These initiatives from outside the cooperative sector should be accompanied by internal measures by cooperative credit organisations at the local level to strengthen their institutional basis. Technological modernisation should be accompanied by an effort to go beyond adopting core-banking solutions among branches belonging to individual cooperative credit societies. A shift to technological solutions that allow all PACS and their branches to be connected and networked and link that network to the larger world of the scheduled commercial banks are needed. This shift requires investment in electronic hardware. It also requires a common core-banking software platform that allows (1) cooperatives to link their banking with their chitty and other operations, (2) all cooperatives to integrate their operations, (3) PACS to connect to the DCBs and state cooperative banks, and (4) the cooperative banking sector as a whole to connect to the commercial banks.

Technological modernisation should be accompanied by managerial and operational reform. Central to such reform must be the introduction of practices such as ensuring KYC compliance, requiring PAN card registration, and deducting tax at source (TDS) on deposits that are eligible. This would imply information collection and reporting procedures that can prevent allegations that the PACS are vulnerable to exploitation by tax evaders, money launderers, counterfeiters, and those engaged in criminal activities.

Cooperation and primary cooperatives are Kerala's strength, a rich legacy of our freedom movement. People's confidence in these institutions is part of Kerala's historical heritage. More can be done to restore confidence in the PACS so that deposits held in accounts can be used for payments through transfers to payees. If there is a fear that some PACS are likely to fail because they are unable to undertake business and could face a run in the form of transfers to accounts held by members in commercial banks and elsewhere, counterparties may be unwilling to accept promises of payment through transfers, especially from those PACS that have not adopted electronic banking solutions. The State Government could consider the possibility of providing a Government guarantee for such transfers, making them a safe means of settlement for all.

Relief measures that aim to address the pain caused by unemployment and loss of livelihoods that have occurred as a result of demonetisation are needed urgently. All State Governments must be called upon to make an estimate of the loss incurred as a result of the demonetisation, which was a wholly Central initiative. Kerala must, as it has done by constituting this Committee, take the lead and conduct a comprehensive study to assess demonetisation-triggered losses and provide a template on how that is best done. A similar study across States should be followed by a conference of Chief Ministers that computes the size of the compensation that the Centre must provide the States and the principles and formulae that must be adopted for the allocation of compensation to different States.

It is clear from the Prime Minister's speech on December 31, 2016, that the Centre does not consider such measures necessary. His speech focused on special ameliorative programmes including: (i) an interest rate subvention of 4 per cent for housing loans of up to Rs 9 lakh and 3 per cent for loans up to Rs 12 lakh; (ii) a grace period of 60 days on interest on *rabi* loans to cultivators from DCBs and PACS; and (iii) an increase in the limit of loans taken by small-scale enterprises that are eligible for underwriting support from the Government of India from Rs 1 crore to Rs 2 crore. These are, in fact, not at all new, but mere restatements or enhancements of schemes already under way.

To implement more effective measures the Centre should be called upon to constitute a "National Demonetisation Impact Relief Fund" to which the States can address their demands. Transfers from the Fund can be used to finance direct benefits to the most severely affected sections of the populations, which, in the case of Kerala, would consist of informal and migrant workers in vulnerable sectors such as fisheries, vegetable and horticultural production, cashew and coir production, the brick and tile industries, and construction. They could also be used to finance Plan programmes that are targeted at the worst-affected in these sectors. The population targeted can be identified using data from the socio-economic and caste censuses that have been undertaken in the States, and other supporting information. The Government of Kerala, based on advice from the State Planning Board, should adjust appropriately chosen and funded Plan programmes to benefit these sections in particular.

The Centre has advocated measures aimed at making a quick transition to a "less cash" economy where digital transactions dominate. The declared objective is to shorten the unavoidable lag in remonetising the economy. Framing the policy in these terms ignores several costs of digitisation, which should not be forced on citizens. The first such cost is the cost of connectivity. The second cost is the charge imposed by banks and the financial technology (or "fintech") companies for hosting and facilitating digital transactions. The third cost is the danger of security breaches, which may result in losses for clients. And, finally, there is the potential for the invasion of privacy of various kinds. If a transactor voluntarily choses to go digital despite these costs there should be no difficulty. But if a transactor is forced to go digital by depriving her of currency or is persuaded to go digital without full knowledge of costs, the move must be resisted. The Centre should be encouraged to invest in the technological and security infrastructure for an increase in digitisation. But it is necessary to ensure that the transition does not end up facilitating the extraction of super profits by private fintech operators. Regulation should ensure that charges imposed by financial intermediaries are reasonable and minimal. And informed transactors should be left to either voluntarily go digital or refrain from doing so.

It needs to be noted here that even when digital payments are encouraged, a substantial cash economy will continue to exist, especially in large parts of the informal sector. Besides issues like connectivity and safety, the spread of digital payments in the informal economy will be constrained by cost factors. As elsewhere in the financial sector, a few firms demanding high payments for the services they offer will soon dominate digital payments. The informal sector survives because of low overheads and no or low taxes. For that reason, people in the informal sector may not be able to embrace the digital future. For them the ultimate solution is the return of cash. All the Government can do is to offer some support in the interim to prevent demonetisation from triggering a collapse of the informal economy.

GOVERNMENT OF KERALA
KERALA STATE PLANNING BOARD

Committee to Study the Impact of Demonetisation on the State Economy of Kerala

FINAL REPORT

DEMONETISATION 2016

1. In a move that came as a surprise to most Indians, Prime Minister Narendra Modi announced in a nationwide address televised after 8 pm on November 8, 2016 that as of 12 midnight that day, all currency notes of Rs 500 and Rs 1000 denomination then in circulation (now named specified bank notes or SBNs) would cease to be legal tender. Holders of such notes had two options: they could make a one-time exchange of the equivalent of Rs 4000 (Rs 4500 subsequently) worth of such notes for newly introduced Rs 2000 notes or existing and new notes of denomination of Rs 100 and below; and they could, initially, deposit any number of such notes into their bank accounts by December 31, 2016, though deposits of Rs 2.5 lakh were to be flagged and the source of such "large" volumes of cash with the depositor were to be scrutinised by the tax authorities.

2. The policy had far-reaching implications. The Government's case was that it would unearth black money, help root out corruption and address the problem of counterfeit currency (the Government sees counterfeit currency as an important means of financing cross-border terrorism). The secrecy that surrounded the move, the short time span within which the notes concerned were to lose their value, and the brief period in which those holding them were to exchange them directly or through their bank accounts, were all supposed to help achieve these objectives.

3. Notes of 1000-rupee and 500-rupee denominations accounted for a little more than 20 per cent of all notes in circulation and around 85 per cent of the value of currency in circulation (of a total value of about Rs 15.44 lakh crore in November 2016) in the country. In one single action the Central Government, with the concurrence of the Reserve Bank of India (RBI), had withdrawn a huge amount of currency in circulation. Just replacing that volume of currency required the infusion of around 22 billion pieces of currency notes into the system (that is, ignoring notes required to replace soiled ones and meet any increase in the demand for currency). That figure compares with the

Government's indent for 2016-17 of 24.6 billion pieces of currency notes of *all* denominations from Rs 5 to Rs 1000 from the Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL) and the Security Printing and Minting Corporation of India Limited (SPMCIL). Actual supply from these sources of notes of all denominations in 2015-16 amounted to 21.2 billion pieces. The supply of new Rs 500 and Rs 1000 currency notes has fluctuated in the range of 5-6 billion pieces in recent years. It would take a four- to five-fold increase in the production and supply of these notes to just replace the SBNs being taken out of circulation.

4. The Government claims that preparation for this exercise began six months prior to the announcement of the decision. But that seems to have been restricted to new currency notes of Rs 2000 in value. According to some, this was unavoidable on account of the need to maintain secrecy, since any sharp increase in the production of notes of Rs 500 and Rs 1000 value would have attracted attention, and could not have been kept secret given the large numbers of workers employed in the security presses. Nevertheless, there is ample reason to believe that the Government and the RBI underestimated the requirements of Rs 500 currency notes to replace the SBNs, which are not easily substituted with the higher-valued Rs 2000 notes in most day-to-day transactions.

5. The end result has been a huge cash crunch, with severe restrictions on access to currency. The availability of Rs 500 notes was, through the first month after the demonetisation, marginal at best. And the available notes of Rs 100 and lower and the newly supplied notes of Rs 2000 denomination failed to cover the shortage. The shortage has a significant impact in an economy where cash-to-GDP ratio was 12 per cent in 2015[1], and in which 98 per cent of transactions were estimated to have been in cash in 2013 (MasterCard Advisors 2013). The Government soon discovered that both the design of the demonetisation exercise, which targeted notes of Rs 500 denomination as well, was faulty, and that it was unprepared to deal with the fall-out of an exercise of this dimension.

6. The Central Government expected availability of the higher value Rs 2000 notes to reduce demand for currency in terms of the number of pieces. But that presumption

1 By way of comparison, the cash-to-GDP ratio was 3.9 per cent in Brazil, 5.3 per cent in Mexico, and 3.7 per cent in South Africa.

ignored the difficulties in using high value notes for routine day-to-day transactions when the low-value notes required to repay any balances due were in short supply, since low-value notes served as substitutes for Rs 500 and Rs 1000 notes in transactions that could have been settled with the latter.

7. The Government also presumed that citizens could be cajoled into making cashless payments, using cheques, debit and credit cards, and electronic payment systems. It was argued that cashless payments could be popularised rapidly, particularly on account of three factors: first, increase in the number of account holders from the hitherto unbanked population under the Jan Dhan Yojana (JDY) scheme; secondly, the launch of the indigenous RuPay debit card (which has been issued to JDY account holders and has lower transaction charges); and, thirdly, the widespread use of mobile telephony, which can serve as a carrier of payments.

8. It is indeed true that there are countries, such as Belgium, France, and Canada, where more than 90 per cent of transactions are reported to be settled without cash. But it is also true that 85 per cent of transactions globally are cash-based. Moreover, substantially cashless economies tend to have the following characteristics: they are more developed, with reasonably high per capita incomes even among the lower income deciles, more urbanised, and more banked. The transition to a cashless economy tends to be slow, influenced substantially by the extent of banking spread (though special efforts by the Government to facilitate and popularise cash-based transactions do help). Moreover, as illustrated by Kenya's M-Pesa mobile payments system, now available in India as well, even the unbanked or underbanked can shift to cashless transactions through contactless mobile payments and banking.

9. The prevalence of cashless transactions is not merely a technological issue. There are many complementary factors that matter. Even culture plays a role. Cultural factors are seen as explaining a preference for cash in countries like Japan and Italy, despite their higher per capita incomes, substantial banking spread, and adequate cashless infrastructure. This is of relevance when discussing the transition to cashlessness in a State like Kerala, where despite high literacy and education levels and considerable banking reach, cash-based transactions are much more preponderant than elsewhere.

10. At present, India cannot be counted among the countries that have gone far in the direction of cashless transactions. Prior to demonetisation, as mentioned, around 98 per cent of transactions were estimated to be settled in cash (as compared with 90 per cent in China, 85 per cent in Brazil and 55 per cent in the United States) (*The Economist* 2016). One reason for the prevalence of cash-based transactions is the inadequate reach of banking. According to the World Bank's 2014 Financial Inclusion Database, the percentage of Indians above the age of 15 who had a bank account was 53 per cent. The estimate for the same indicator for rural India was 50 per cent. If those estimates are correct, India was home to 21 per cent of the world's unbanked population. The percentage of debit card holders in the 15+ age group was just 8 per cent, and just 3 per cent of the population group had used a credit card in the year prior to the conduct of the survey.

11. It could be argued that the introduction of the Jan Dhan Yojana programme made a difference in 2014, which may not have been captured in the World Bank's Findex Database. Thus, a 2015 study by Price Waterhouse Coopers India for the Internet and Mobile Association of India and Payments Council of India estimated that while India's unbanked population had fallen by 324 million from 557 million to 233 million between 2011 and 2015, more than 55 per cent of the decline (or 182 million) occurred in 2014, which was the year in which the Jan Dhan Yojana was launched (on August 15). But with a large proportion of those accounts being zero-balance or near zero-balance accounts, the contribution they would have made to enhancing non-cash payments could not have been large. In any case, initiatives such as Jan Dhan Yojana cannot be expected to help deal with the immediate and large-scale cash crunch created by the poorly planned demonetisation drive of the Central Government.

12. In these circumstances, the Government has had to ration the use of currency. The result is long queues in front of banks and ATMs to withdraw cash, and even to wait for cash to arrive at the bank or ATM. Daily and weekly ceilings, which have been changed more than once, have been set on cash withdrawals from the accounts of citizens, whether these are direct withdrawals or withdrawals through ATMs. As of now, depositors in regular accounts are allowed to withdraw Rs 24,000 every week, but Jan Dhan Yojana account holders are permitted to withdraw only Rs 10,000 in a month because of

suspicion that they are being used by persons who are not account holders to deposit demonetised notes.

13. In fact, this major financial inclusion programme – the Pradhan Mantri Jan Dhan Yojana – has been hit hard by demonetisation. Many of the accounts created under the programme are seen as being misused to deposit unaccounted wealth held in the form of the demonetised notes. There are a total of 25.8 crore Jan Dhan accounts in India. The total deposit in these accounts since August 2014 when they were launched till the demonetisation on November 8, 2016 was around Rs 46,000 crore and many of these accounts had been inactive or maintained as zero-balance accounts. But large deposits in some of these accounts drew the attention of the Government whose expectation that large amounts of the demonetised currency would not return to the banks for fear of scrutiny was belied.

14. In the first week after the decision on currency notes was announced, November 8 to 15, the deposits in Jan Dhan accounts amounted to Rs 18,615.54 crore. The flow then moderated. In the second week (November 17 to 23), the flow was Rs 8,582.97 crore. In the third week (ending November), the flow fell to Rs 1,487 crore, and further to Rs 288 crore. As on December 7, total deposits in JDY accounts stood at Rs 74,609.50 crore.

15. Given that there were ceilings of Rs 50,000 per JDY account, it need not be the case that all of the post-demonetisation deposit increase (around Rs 29,000 crore) was the result of "misuse". Demonetisation should be expected to increase deposits sharply in an economy where transactions are largely in cash, the exchange of demonetised notes was severely restricted, and where there are still many who do not have accounts of their own. In fact, even now close to 23 per cent of Jan Dhan accounts are zero-balance accounts. Yet, because of the suspicion raised by large deposits in a few accounts in the early days after demonetisation, the Government on November 30 restricted withdrawals from KYC-compliant JDY accounts to Rs 10,000 a month and non-KYC compliant accounts of Rs 5,000 a month.[2] The poor, who had been enticed into opening bank accounts, are now being denied access to their own cash. This U-turn on financial inclusion by the Centre, which is reflected in the policy with respect to PACS as well, is one more way in which those who have little to do with illegal money and counterfeit

2 KYC stands for Know Your Customer.

currency are being made to pay for a poorly designed and unsuccessful strike against those evils.

16. The actual liquidity crunch has been extremely severe with banks unable to provide even the permissible amounts in cash. According to reports, in the first week of December when salaries were credited to accounts, many branches were allowing one time withdrawals of only Rs 5000 or less, though the (weekly) limit was Rs 24,000.

17. The immediate consequence has been a severe curtailment of effective demand because people have little or no cash. As a result, transactions in many markets have been reduced or brought to a halt, casual and temporary workers paid in cash have either experienced a fall in employment or have been forced to accept deferred payments, persons with limited access to banking services have not been able to meet their daily needs, farmers who have just harvested their crop have not been able to sell all of it and buy seeds and inputs for the next crop, many among India's sick have not been able to pay for medical services, and persons in need of cash for occasions such as weddings or other events were unable to draw it from their accounts.

MACROECONOMIC CONSEQUENCES

18. Ordinary citizens have thus been put to immense hardship because they have had to forgo full access to their own savings. In addition, there is enough evidence to show that current policy is affecting the macroeconomic context and policy in the country and driving down production and employment in the economy.

19. An important consequence of the demonetisation is bound to be a worsening of the fiscal crunch facing the Centre and the States. The Union Government's fiscal deficit has already hit 79.3 per cent of the budget estimates (BE) for 2016-17 and the revenue deficit was in excess of 90 per cent by the end of October 2016. Because of the contraction in economic activity after demonetisation, it is unlikely that there will be a faster growth in revenue in the next six months that can help maintain the Union Government's fiscal deficits at a manageable level.

20. Another important macroeconomic consequence of demonetisation has been the pressure on the banking system caused by the large deposits that have flowed into it. On

November 28, 2016, the Reserve Bank of India declared in a press release that up to November 27, 2016, SBNs worth Rs 8.45 lakh crore had been returned to the banking system. Since then, the estimate has been revised to Rs 11.55 lakh crore, as reported in the Press Conference presenting the Fifth Bi-monthly Monetary Policy Statement 2016-17 held on December 7, 2016. That figure was updated to Rs 12.6 lakh crore by the middle of December. While no final figure has been provided by the Reserve Bank of India, it is likely that almost all of the SBNs returned to the banks and the RBI by December 31, 2016.

21. The inflow of large volumes of the SBNs in the form of deposits in the banking system implies a burden on the banks in the form of interest payments, which they have to cover with the return they can get either through lending or investment. Such lending against large deposits received over a short period of time can not only be risky for a banking system already overburdened with stressed assets but also extremely difficult to implement. It can thus be expected that the banks would seek to park this money in interest-earning instruments with the Reserve Bank of India. This should be possible since only the cash impounded to meet the cash-reserve ratio (CRR) requirements imposed on the bank cannot earn interest.

22. Any such transfer of the interest burden created by the inflow of SBNs from the banks to the Reserve Bank of India would affect not only the balance sheet of the Reserve Bank of India, but also its income-expenditure balance, with the likelihood that the Reserve Bank of India will not only see a fall in its profit, but also record a loss. To prevent such a peculiar possibility, the RBI decided to impose a temporary CRR of 100 per cent on the incremental deposits received by the banks. Banks would have to pay interest on deposits but could not earn any returns by lending or investing that money. This rule was in place for a brief period before the Government and the RBI agreed to increase the ceiling on Government securities that can be floated by the central banks under the Market Stabilisation Scheme (MSS) from Rs 30,000 crore to Rs 6 lakh crore.

23. The original rationale for the Market Stabilisation Scheme was the following. The RBI had to buy up foreign exchange coming into India in order to manage the exchange rate and prevent the rupee from appreciating. When the foreign exchange assets of the RBI rise, there is an equivalent increase in its liabilities. The result is an unplanned increase in

the supply of money. To neutralise the increase in the supply of money, the RBI would have to sell assets other than foreign exchange, mainly Government securities. But since fiscal reform had restricted Government borrowing from the RBI, the RBI began to run out of Government securities to sell.

24. Under the Market Stabilisation Scheme, which began in April 2004, the RBI may issue Government securities to conduct "sterilisation" operations. The timing, volume, tenure, and terms of these securities are set at the discretion of the RBI. The ceiling on these securities is set through periodic consultations between the RBI and Government. The securities are treated as deposits of the Government with the RBI. They thus appear as liabilities on the balance sheet of the RBI and reduce the volume of net credit from the RBI to the Government of India. By increasing such liabilities, the RBI can balance increases in its foreign exchange assets, and thus control the levels of its assets and liabilities. The RBI holds the money gained from the sale of these assets. That money cannot be used by Government to finance its expenditure. It can only be used to redeem or buy back the securities as part of the RBI's operations. As far as the Central Government is concerned, while these securities are a capital liability, its "deposits" with the central bank are an asset. Thus, these securities do not make any net difference to the Government's capital account and does not contribute to the fiscal deficit. However, the interest payable on these securities has to be met by the Central Government and appears in the budget as a part of the aggregate interest burden. Thus, the more the RBI resorts to sterilisation to neutralise the effects of capital inflows, the larger the cost that the Government have to bear, by diverting a part of its resources for the purpose.

25. When the scheme was launched in 2004, the ceiling on the outstanding obligations under the scheme was set at Rs 60,000 crore. Over time this ceiling has been revised both upwards and downwards. The ceiling touched Rs 2.5 lakh crore in November 2007. In order to deal with the completely different problem of excess deposits with the banks and give them a safe instrument in which they can invest those deposits, the Government has now enhanced the ceiling on the MSS to Rs 6 lakh crore. The RBI has rapidly been exhausting that level by issuing cash management bills and other securities under the Scheme and selling them through auctions. It is likely that the ceiling on the MSS will further be raised. From the point of view of the RBI, its purpose has been served, since it has been able to lift the unsustainable 100 per cent CRR on incremental deposits,

because those deposits can now be invested in these securities. The interest on those bills amounts to around 6 per cent, and this is the cost that the Government will have to carry as interest burden on the total amount of securities issued.

26. The increase in the burden of interest has far-reaching implications for the Government's fiscal health. If the Government adheres to its fiscal deficit targets, there could be a substantial cut in capital expenditures or social expenditures or both. The 100 per cent CRR is, of course, a temporary measure, since a large part (if not all) of the deposits in the form of SBNs would be converted back into currency in circulation as new notes become available.

27. While the Government has not spent much time in assessing the consequences of the fiscal impact of demonetisation, it has claimed that, to the extent that black money in the form of cash will not return to the banking system, since it cannot be accounted for, demonetisation will actually reduce the liabilities of the RBI. Assuming that this would allow the RBI to sell a part of its securities and record the receipts as profit, the Government had been claiming that the RBI can transfer the amount involved as dividend to the Government. It has been argued that demonetisation would thus improve the fiscal situation and allow the Government to increase its capital and social expenditures. In fact, the Prime Minister has declared that the money may be transferred to the poor through deposits in JDY accounts.

28. However, as noted above, by the middle of December, as much as Rs 12.6 lakh crore of the currency in circulation had come back to the system. So in all probability there would be little currency in circulation in the form of SBNs that would not have come into the banking system and which can thus be extinguished. Further, the legal basis for removing the extinguished notes from the liabilities of the RBI is not clear and is bound to be contested. In fact, in the press conference to announce the Fifth Bi-monthly Monetary Policy in December 2016, the RBI Governor said that there would be no adjustments made to the RBI's balance sheet on account of the announcement that older notes of some denominations are no longer legal tender.

29. One consequence of the fiscal policy effect of the demonetisation is that it would adversely affect Government expenditures and therefore GDP. Besides this, GDP is

likely to be affected by the fact that the liquidity crunch is resulting in a decline in expenditures that can be postponed or avoided, and some that cannot be postponed, especially among the poor. When expenditure is held back because of the cash crunch, however temporary it is, it results in a fall in sales, an increase in inventories, and a fall in production. Declining incomes of workers who are either retrenched or not paid and declining earnings of traders and producers will have second- and subsequent-order spending effects. With more than 90 per cent of India's employed labour force consisting of informal-sector workers, often with no written contracts and no employment or social security benefits, wage payments are substantially in cash across the economy. So are a range of payments for transactions between the self-employed and the self-employed and the formal economy.

30. One section affected severely is the farming community, for which the demonetisation experiment could not have been launched at a more inopportune time. A crop recently harvested must be sold, and seeds and other inputs for the next season need to be bought and sowing begun. Most of these transactions are settled in cash, and the limited availability or non-availability of legal tender after the demonetisation has foreclosed transactions and squeezed the peasantry by affecting the access to inputs and the opportunity to sell produce. Marginal and small farmers are especially hard hit. Large farmers who have long-term relationships with traders have been advanced cash in SBNs to be deposited in their bank accounts for future supply of produce to be harvested. The explicit understanding is that cash balances after accounting for the value of produce will be returned to the trader as the cash supplies in the banks improve. Marginal and small farmers do not have such opportunities.

31. Turnover in much of this cash economy is such that there is often little intermediation of the banking system. Any sudden withdrawal of cash would just freeze activity, throw people out of work, and reduce earnings. Contraction caused by the absence of cash alone can be severe.

32. Investment, consumption, and production will also be affected by the credit crunch that follows the cash squeeze. Banks faced with uncertainty will be unwilling to give loans even to those who can engage in non-cash transactions. In any case, most banks were so overburdened with exchanging notes, accepting deposits, and rationing cash to crowds of

customers waiting to make withdrawals that they would have had little time to undertake the due diligence to go through the procedures needed to lend. If the cash crunch forces small firms without access to credit to shut down, even the resumption of the flow will not restore pre-demonetisation levels of activity.

33. When output and employment fall, so will tax revenues. This can only aggravate the fiscal contraction resulting from the use of the MSS to address the problems created by the deposit surge, contributing to another major mechanism through which demand will be squeezed and output and employment reduced. Estimates of the actual likely fall in GDP growth that will ensue are bound to be controversial, but they have ranged from 1 to 2 percentage points and more. Growth deceleration can be significant. Ambit Capital, an oft-quoted Mumbai-based equity research firm, has officially estimated that the demonetisation-driven cash crunch will result in GDP growth crashing to 0.5 per cent in the second half of financial year 2016-17. This means the GDP growth over October 2016 to March 2017 could decelerate to 0.5 per cent, down from 6.4 per cent in first half of financial year 2016-17.

34. The Union Budget 2016-17 assumed a nominal GDP growth rate of 11 per cent for the country for the financial year. Since the Central Bank is targeting an inflation rate of 4 per cent, it was expected that real GDP would grow at 7 to 7.5 per cent in the current fiscal year. However, it is now not clear whether India will be able, after demonetisation, to achieve even a 5 per cent plus real GDP growth rate.

IMPACT OF DEMONETISATION ON KERALA

35. A number of features of Kerala's economy have made it particularly vulnerable to the poorly planned and implemented demonetisation exercise. First, cash transactions are predominant in the State's economy. Secondly, some of the major contributors by sector to the State's economy are in the informal or unorganised sector, where cash transactions dominate. Millions of people in Kerala are dependent on incomes gained in the traditional sectors of fisheries, coir, handlooms, and cashew processing as well as in crop and plantation agriculture. More than two and a half million migrant workers work as wage labourers in the State. Thirdly, the three-tiered cooperative banking structure, with PACS at the bottom of the pyramid, is an overwhelmingly large part of the financial structure. Fourthly, outside of the financial structure, Kerala has a cooperative sector that

is an important component of manufacturing and services activity, which banks substantially with the cooperative banking sector. Fifthly, earnings from tourism are an important share of Kerala's State income. Lack of access to cash deals a blow to tourism. Sixthly, remittances play an important part in Kerala's economy, and the economic constraints caused by the present policy can cause disruption in the flow of remittances. These features, *inter alia*, contribute to the intensity of the impact of the demonetisation on the state's economy and its people.

36. As evident from Table 1, cash-intensive sectors such as retail trade, hotels and restaurants and transportation account for over 40 per cent of the Kerala economy, and the primary sector accounts for another 16 per cent of the economy. Thus 56 per cent of the economic activity of Kerala is immediately affected by the withdrawal of specified bank notes. Agriculture, whose growth has been low and constrained over the last few years, will be affected directly by the new policy. Any turnaround in construction, transport and storage, which have been decelerating in the recent past, will be delayed. The high-growth sector of trade and hotels has been seriously hit by the cash crunch. As mentioned, a significant section of workers in manufacturing are in traditional industries. Overall, both leading as well as struggling sectors of the economy have been hit hard by demonetisation, pulling the economy down and affecting potential resource mobilisation as well.

Table 1 *Income from individual sectors as a proportion of total Gross State Domestic Product (GSDP), and annual rates of growth in sectoral incomes (at constant prices), Kerala* in per cent

Sector	Share of sector in GSDP	Annual rates of sectoral growth (at constant prices)		
		2012-13	2013-14	2014-15
Agriculture, forestry, and fishing	14.38	1.43	-2.14	-4.68
Crops	8.63	-1.22	-3.44	-10.97
Livestock	3.34	9.33	-1.49	4.30
Forestry and logging	1.27	0.10	-0.76	-1.20
Fishing	1.12	-0.26	4.11	8.17
Primary	**15.19**	**0.50**	**-2.97**	**-3.71**
Manufacturing	10.17	12.47	1.97	8.92
Electricity, gas, water supply, and other utility services	1.39	-1.01	3.79	-1.43
Construction	15.78	-3.10	0.18	0.28
Secondary	**27.34**	**2.80**	**1.08**	**3.74**
Trade, hotels, and restaurants	15.82	13.81	7.10	14.71
Transport storage Communication	8.32	5.14	7.20	6.03
Financial services	4.25	6.78	6.74	1.51
Real estate, ownership of dwellings, and professional services	12.55	13.56	10.04	7.75
Public administration	4.71	-0.58	-3.21	8.84
Other services*	11.79	4.63	10.09	9.18
Tertiary	**57.44**	**8.92**	**7.58**	**9.42**
State value added at basic prices	100	5.97	4.34	6.24
SDP at market prices		6.50	4.54	6.67

Source: Department of Economics and Statistics (2016).
Note: *Includes health and education services.

The Cash Deficit in Kerala

37. The impact of demonetisation in terms of the cash deficit and its consequences has been particularly severe in Kerala. This is because of the distinct character of its banking sector, in which the cooperative sector and the primary cooperative societies play a central role. Kerala is one of the most developed States in India in terms of the spread of banking and financial institutions. The financial system of Kerala has four distinct components, each characterised by specific strengths: scheduled commercial banks

(SCBs), cooperative banks and agricultural credit societies, non-banking financial companies (NBFCs), and micro-finance institutions (MFIs). According to one estimate, there are at present about 14,000 cooperative societies registered with the Registrar of Cooperative Societies in Kerala. Of these, 10,503 societies function satisfactorily. They include apex institutions like the State Cooperative Bank, the State Agricultural and Rural Development Bank, 14 district cooperative banks, 60 urban banks, 48 primary agricultural and rural development banks, and 1602 primary lending societies. Since micro-finance institutions in the form of self-help groups operate on a daily basis with a flow of very small deposits and advances, cashlessness and contraction in economic activity can destroy these institutions, which have played very effective role in empowering women in the State.

38. Kerala accounts for 3 per cent of the country's population and almost a little short of 5 per cent of branches of both scheduled commercial banks and urban cooperative banks (Table 2). Kerala's share in the deposits of these institutions stood at around 3.5 per cent and loans at 3 per cent of the all-India totals. However, Table 3 suggests that the distribution of branches of district cooperative banks places that sector almost on par with the scheduled commercial banking sector in rural areas, though it has a much smaller presence when compared to the latter in semi-urban and urban areas.

Table 2 *Size and structure of scheduled commercial banks and urban cooperative banks, Kerala, Q2 2014-15*

Item	Kerala	India
Bank Branches (number)	5793 (4.81)	1,20,344
Deposit (million Rs)	29,05,130 (3.58)	8,11,42,957
Credit (million Rs)	18,99,632 (3.09)	6,15,75,652
Urban Cooperative Bank Branches (number)	414 (4.35)	9526
Deposit (million Rs)	1,02,000 (3.23)	31,55,000
Credit (million Rs)	63,000 (3.15)	19,97,000

Source: RBI (2016).
Notes: Figures within brackets are the share of Kerala in the Indian total.

39. The number of branches of district cooperative banks in Kerala at 721 accounts for 5.04 per cent of the total in India at 14,305. This total for Kerala is different from the total shown in Table 3 as the sources of data are different.

Table 3 *Distribution of branches of scheduled commercial banks and district cooperative banks, by population group, Kerala, 2014-15*

Region	Scheduled Commercial Banks	District Cooperative Banks
Rural	445 (343)	384 (101)
Semi-Urban	3974 (1127)	275 (92)
Urban	1374 (11)	132 (39)
Total	5793 (1481)	791 (232)

Source: RBI (2016), NAFSCOB (2016).
Notes: Figures within brackets are the number of banking centres.

40. There are 7000 branches of commercial and cooperative banks in the State, or an average of one branch office for every 4800. However, the average hides the fact that these offices are confined to less than 1700 banking centres, of which only about 450 are in rural areas, the rest being in semi-urban and urban areas. As regards the rural areas, commercial bank branches cover only 340 rural centres. It is in this context that the primary agricultural credit societies (PACS) serve a very important function in the State. The PACS are spread over 1642 rural centres. That number is almost equal to the number of banking centres covered by commercial banks and cooperative banks.

41. In terms of average size of deposit in commercial banks, there is hardly any difference between Kerala and India; in the former it was Rs 57,000 per person and in the latter, Rs 61,000 in 2014-15. But the number of deposit accounts per person, which was 1.72 in Kerala, was significantly higher than that in India (1.12). The inclusion of deposits of cooperative banks changes the situation, with the average size zooming to Rs 35,000, compared to Rs 10,000 at the all-India level (we arrived at these numbers by dividing the totals in Table 4 by population). It is understandable that Kerala shows such an increase relative to India because 60 per cent of all deposits are in the cooperatives in Kerala compared to less than 20 per cent in India. The spread of cooperative institutions, especially PACS in the rural areas, the relatively high levels of per capita income levels in the State, and the relatively low difference in income levels between the rural and urban areas are all factors that have led to the emergence of the specific pattern of deposit holdings in Kerala.

Table 4 *Distribution of deposits by bank type, Kerala and India, 2014-15*

Bank Type	Kerala		India		% Share of Kerala in the Indian Total
	Amount (Rs lakh)	% Share	Amount (Rs lakh)	% Share	
Scheduled Commercial Bank	46,80,638	39.88	9,66,38,999	78.45	4.84
State Cooperative Bank	33,789	0.29	31,75,783	2.58	1.06
District Central Cooperative Bank	11,32,727	9.65	1,49,14,175	12.11	7.59
PACS	58,90,841	50.19	84,61,633	6.87	69.62
Total	1,17,37,995	100	12,31,90,589	100	9.53

Source: RBI (2016), NAFSCOB (2016).

42. As regards loans and advances, the limited data readily available on the number of credit accounts in the scheduled commercial banks and the number of borrowers in PACS indicates that, at the all-India level, for every 100 credit accounts in the banks there are only 35 borrowers in the PACS. But in Kerala, for every 100 credit accounts with banks, there are 184 borrowers in the PACS (Table 5). It may also be seen that the average size of loans advanced by the commercial banks is about seven times the average size of loans advanced by PACS in Kerala, and sixteen times the average size of loans advanced by PACS at the all-India level. PACS obviously cater to the "small" person in the rural areas, whether Dalit, Adivasi, rural artisan, or other sections of the rural poor. It is evident that PACS meet the credit needs of the rural households in a way in Kerala that is obviously not the case elsewhere in India.

Table 5 *Loan accounts and advances of scheduled commercial banks and PACS, Kerala and India, 2014-15*

Bank Type	Kerala		India	
	Number of Accounts	Amount (Average)	Number of Accounts	Amount (Average)
Scheduled Commercial Bank	88,13,485 (100)	2,12,16,078.0 lakh (240720)	14,42,39,636 (100)	68,78,47,252.0 lakh (476860)
PACS	1,62,09,940 (183.9)	57,80,148.8 lakh (35650)	4,98,57,650 (34.6)	1,47,22,557.4 lakh (29,520)

Source: RBI (2016), NAFSCOB (2016).
Note: Figures reflect the amounts outstanding as of end-March 2015.

43. Thus, what distinguishes Kerala is the spread of primary agricultural credit societies (PACS). In 2014-15, 62 per cent of the population in Kerala was registered as members of PACS as compared with just ten per cent in India. As the composition of membership corresponds with the composition of population in terms of Scheduled Castes and Scheduled Tribes, it may not be wrong to surmise that while in Kerala almost all the eligible SC and ST obtain membership in PACS, only about ten per cent of them obtain membership at the all-India level (Table 6).

Table 6 *Membership of PACS by social group, Kerala and India, 2014-15*

Social Group	Kerala		India	
	Number	Percentage	Number	Percentage
Scheduled Caste	19,78,430	9.51	1,67,15,630	13.80
Scheduled Tribe	2,02,330	0.97	93,00,970	7.68
Small farmers	68,77,130	33.07	4,04,01,530	33.37
Rural artisans	15,52,150	7.46	66,49,040	5.49
Other farmers	1,01,87,450	48.98	4,80,20,640	39.66
Total	2,07,97,490	100	12,10,87,810	100
Number of members as % of population	62.26		10.00	

Source: NAFSCOB (2016)

44. Overall, the cooperative banking sector is much more active and vibrant in Kerala than elsewhere. As a result, over 70 per cent of the deposits in PACS in India are in Kerala; over 70 per cent of the non-agricultural loans and advances are in Kerala; and over 15 per cent of the agricultural loans and advances are disbursed in Kerala. Though the provision of a rate of interest on deposits that exceeds that offered by scheduled commercial banks is often offered as an explanation for the popularity of PACS among depositors, the much greater success of these institutions in Kerala when compared to the rest of India is an indication of the trust these democratic and participative institutions have earned for themselves, and for the reputation that many of them have built because of their larger role (beyond just banking) in the community.

Table 7 *Characteristics of primary agricultural credit societies, Kerala and India, 2014*

Item	Kerala	India
Number of branches	2909 (3.13%)	93,042
Deposit (million Rs)	5,79,678 (70.78%)	8,18,949
Working capital (million Rs)	7,96,281 (37.48%)	21,24,293
Loans and advances outstanding – agricultural (million Rs)	93,886 (15.30%)	6,13,760
Non-agriculture (million Rs)	3,59,926 (72.44%)	4,96,793

Source: NAFSCOB (2016).
Note: Figures in brackets represent the share of Kerala in the all-India total.

45. PACS are considered an important instrument to ensure financial inclusion. For example, in its Annual Report 2015-16 NABARD noted that

> "To leverage the institution of cooperative societies in increasing touch points in remote rural areas, NABARD in 2014-15 launched a pilot programme of non-deposit mobilising PACS/other societies as Deposit Mobilising Agents (DMAs) for DCCBs in the three-tier and StCBs (State Cooperative Banks) in the two-tier cooperative structures. The intention of the programme was to help customers of cooperative banks to do their basic banking activities through micro ATMs placed in the PACS and other societies. This would encourage financial inclusion for members of such groups while also aid financial literacy through learning by doing. As on 31 March 2016, proposals worth Rs 70.92 crore for 5405 PACS across 16 states and 1 union territory have been sanctioned. To incentivise the banks, they are provided support for installing one ATM in one of their branches for every five micro ATMs placed in PACS / other societies" (p. 89).

46. NABARD's statement thus calls for protecting and nurturing successful cooperative banking institutions at different levels. It is surprising, therefore, that notifications issued by the Reserve Bank of India after the November 8 withdrawal of 500- and 1000- rupee notes (especially on November 14), kept the cooperative banks and societies out of the note exchange process, whether through direct exchange or deposits. In the case of the PACS, the implicit reasoning was that they were nonbanking entities under the Banking Regulation Act of 1949. But the restriction on exchange and accepting deposits of SBNs was also imposed on district central cooperative banks (DCCBs), despite their being licensed under the Banking Regulation Act, being KYC-compliant, and working with core-banking solutions. These banks also face difficulties in converting reserves of

demonetised notes they held into legal tender. Only the urban cooperative banks were treated on par with commercial banks. The implications of these measures were that DCCBs could carry out all core banking operations, but exchange of SBNs was not possible and cash withdrawal per account holder had to be within the set limits, revised to Rs 24,000 per week.

47. There has been severe discrimination against PACS by means of notifications with even more stringent restrictions. Besides being excluded from engaging in exchange of SBNs, the access of PACS to currency was cut off, forcing these institutions – which are central to financial intermediation and inclusion in Kerala – to shut down their operations. As compared with an *average* outstanding deposit base of Rs 19.9 crore per branch and Rs 28,000 per individual member, each PACS was treated as an individual and its withdrawal limit set at Rs 24,000 a week. What was deliberately ignored was that it was not each PACS that was being denied access to cash, but that lakhs of members who held deposits in these institutions were being denied access to any of their money. There cannot be a single other instance of expropriation of the purchasing power of a population of this magnitude.

48. Representatives of the PACS met by the Committee stated that it was not true that all PACS did not meet KYC norms. Moreover, since most members of a PACS are from the same village or area as the one in which the unit is located and PACS are staffed by local persons, members are closely known to PACS functionaries, precluding the need for a formal KYC process. In any case, this shortcoming could have been addressed directly, without precipitating the extreme hardship that has been caused and without threatening the viability of institutions with a record of financial inclusion unparalleled in the formal banking sector or in any other State.

49. In addition, lack of clarity resulted in the fact that the cooperative banks were left saddled with SBNs they could not convert. Initially, the RBI excluded cooperative banks from the list of institutions that could exchange or accept deposits of demonetised notes. This amounted to declaring to depositors that cooperative institutions were not on par with regular commercial banks, spurring speculation that the credibility of these institutions was suspect, and that they were locations for illegal transactions. But following the intervention of Government of Kerala, the RBI on November 11, 2016

permitted cooperative institutions in the State to accept demonetised notes as deposits. But, three days later, on 14.11.2016 (RBI vide ref. RBI/2016-17/130 DCM (Plg) No.1273/10.27.00/2016-17) the RBI withdrew the permission. This resulted in both PACS and district cooperative banks being saddled with SBNs that they had accumulated but could not exchange.

50. These actions resulted in the closure of banking activities at the level of the PACS. They also targeted the credibility of the PACS, which had served as democratically run, participatory financial institutions. Depositors in the PACS were being forced to migrate to the commercial banking sector with their money, thus undermining the role of some of the most successful examples of cooperative banking and financial inclusion.

51. The experience of a leading primary cooperative in Thiruvananthapuram illustrates the damage that has been inflicted. The cooperative concerned is 90 years old, and its standing in the community reflects the trust it has built among the people. When it began functioning there was no commercial bank anywhere in the neighbourhood. The relationship it built with members from the community remained even after the scheduled commercial banks arrived. But the activities of the PACS have come to a standstill after November 8. The President reported that no transaction is being carried out now. Loans are being granted but there is no cash to dispense. Monthly deposit schemes and chitties cannot be disbursed. Moreover, there are signs of a kind of run on the bank. Earlier, only those who needed cash used to come to the PACS; now there is a tendency to collect whatever cash is available. The PACS runs medical laboratories, consumer-good ("Neethi") stores and also has collection agents. Cash collected by all of them till November 8 that was with the PACS was deposited at the DCB. The organisation is at present unable to withdraw any of the money it had deposited. The daily transactions of the PACS which were of the order of Rs 3 crore earlier is now limited to Rs 24,000 a week. Another PACS reported that transactions fell from Rs 9.5 crore to Rs 1.6 crore a month. People wanting to gain access to their savings are seeking to transfer deposits to commercial banks through electronic transactions. Trends such as these will ruin the primary cooperative institutions. A pillar of the cooperative movement is being demolished.

52. In view of the hardship caused by PACS account holders, the State Government issued two circulars. These permitted account holders to open zero-balance, KYC-compliant accounts in district cooperative banks[3]. The submissions to the Committee by two prominent primary cooperative societies (Vallichira Pattikajathi Service Cooperative Society and Peroorkada Service Cooperative Bank) indicate that there was some diffidence in this regard. In one case, in a service cooperative bank with over 95,000 deposit accounts, no one opened mirror accounts. The staff of the society/bank were worried that people would migrate to district cooperative banks and commercial banks and would not come back to PACS after the crisis.

53. The evolution of the Reserve Bank of India's views on the cooperative credit system, especially after the 2006 report of the Task Force on Revival of Cooperative Institutions, explains in part the position it took with respect to the role of these institutions in the demonetisation process. The RBI does not adequately recognise that credit cooperatives have followed different trajectories in different States. The RBI seems to be set on making PACS – which are institutions designed to be different from conventional commercial banks – look and behave like the latter. Thus the Task Force was unhappy that:

    a) PACS were excluded from the scope of the Banking Regulation Act 1949,
    b) the minimum capital requirements for PACS were smaller than for commercial banks, and
    c) the cash-reserve ratio requirements for PACS were lower than that for commercial banks.

    Such features were part of the original design of institutions that, unlike commercial banks, were geared less to profit making and more to serving the interests of their members.

54. Kerala is one state where the cooperative banking movement, with a long history, has been extremely successful. Table 8 shows that the proportion of PACS members who are borrowers is substantially higher in Kerala than elsewhere. The proportion is 78 per cent in Kerala and 41 per cent in India. Taken together with the fact that the coverage of the poor by PACS is greater in Kerala than elsewhere, Table 8 shows the importance of PACS as credit institutions for the poor and socially disadvantaged in Kerala.

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3 Circulars are in Annexure 3.

Table 8 *Distribution of borrowers in PACS by social group, Kerala and India, 2014-15*

Social Group	Borrowers as percentage of total members	
	Kerala	India
Scheduled Caste	71	38
Scheduled Tribe	43	37
Small farmers	62	44
Rural artisans	100	53
Other farmers	88	39
Total	78	41

Source: NAFSCOB (2016).

55. A case study of the geographical distribution of commercial bank offices and PACS in Kasaragod and Wayanad districts illustrates the limitations of the former and the role of the latter in reaching out to the rural population. Kasaragod district has 143 offices of commercial banks distributed over 50 banking centres (Figure 1). The distribution is highly uneven with a heavy concentration of 34 branches in Kasaragod town and 19 branches in Kanhangad. Thrikkaripur, Nileswar, Manjeshwar, and Udma account for another 30 branches. In all, six banking centres account for over 60 per cent of bank branches. PACS have a wider geographical spread than commercial banks. There are 64 PACS in the district, spread over 64 centres. The spread of PACS is much wider than that of the commercial banks. PACS are the sole service providers in 39 centres in the district.

56. The picture is no different in Wayanad district (Figure 3), which has 68 branch offices of commercial banks distributed over 23 banking centres. Three urban centres, namely, Kalpetta, Mananthavady, and Sultan Bathery, account for 40 branches (that is, almost 60 per cent of the total). The district has 31 PACS. In 15 of the 23 banking centres, both PACS and commercial bank branches co-exist. Thus in 16 centres, PACS are the only institutions that provide banking services. Overall, PACS play a very important role in the provision of banking services in the two districts. The pattern may not be very different in other districts of the State. The analysis does not take into account branches of the Kerala Gramin Bank or district cooperative banks.

57. Figures 2 and 4 present the distribution of ATMs of the commercial banks in Kasaragod and Wayanad respectively. In Kasaragod, 62 ATMs are distributed in 18 centres and in Wayanad 47 ATMS are distributed in 14 centres. The presence of commercial bank branches and ATMs are largely confined to large villages and urban centres. It is evident that a vast geographical area is still catered to by PACS, with only a skeleton presence of commercial bank branches in both the districts. It is no wonder that a large proportion of the population depend on PACS for their banking needs: they are close at hand, participatory, and managed by people who are known to them for many years. It may be pertinent here to point out that some of the PACS have been in existence for over 100 years in Kasaragod and close to 100 years in Wayanad. About 14 per cent and 6 per cent of all PACS were registered before 1920 in Kasaragod and Wayanad respectively. It may be remembered that the Cooperative Societies Act was passed in 1912. As is evident from the Table 9, over 75 per cent of the PACS in Kasaragod and close to 50 per cent in Wayanad are over 65 years old. PACS were in existence in both districts long before commercial banks.

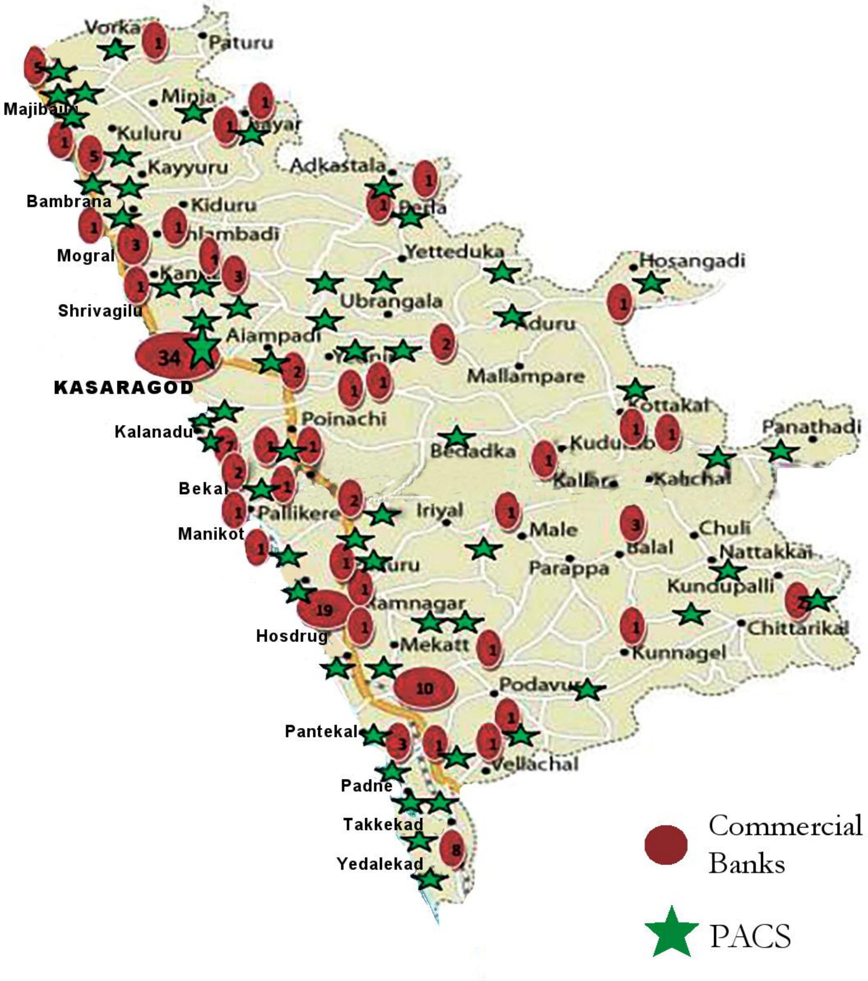

Figure 1 *Distribution of commercial bank branches (2016) and PACS (2013) in Kasaragod District*
Source: Department of Cooperation (2013), websites of different banks.

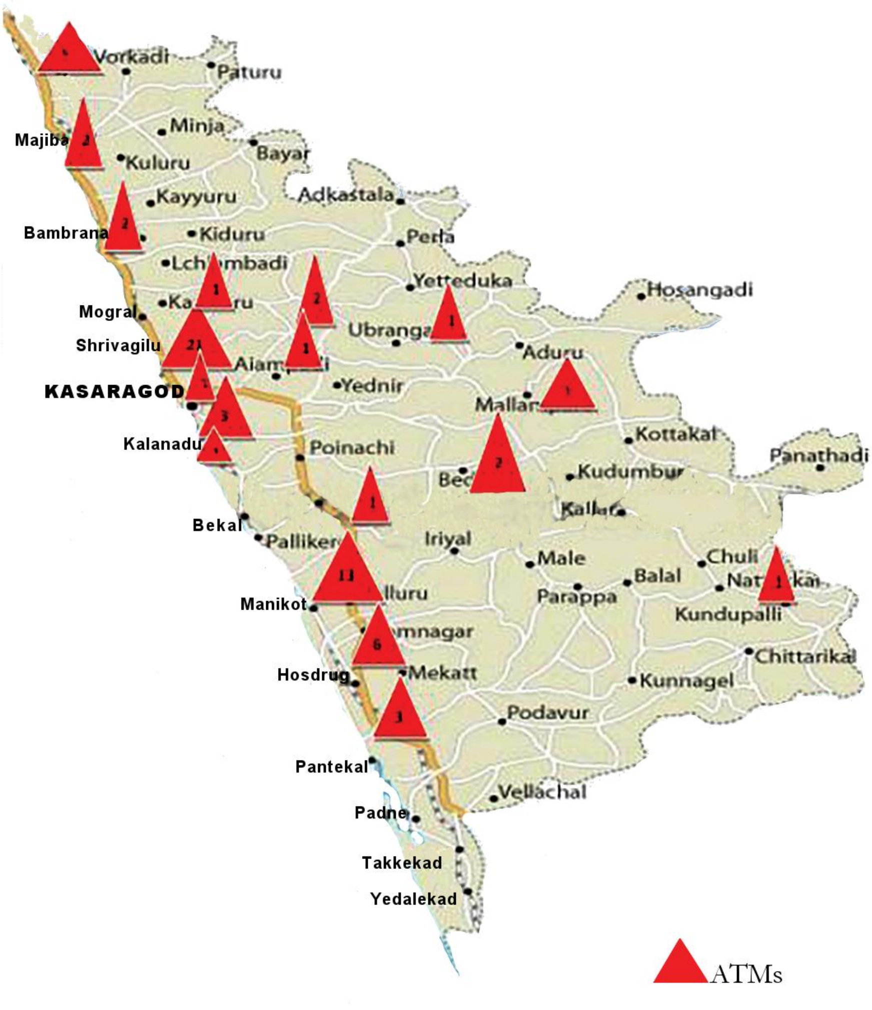

Figure 2 *Distribution of commercial bank ATMs in Kasaragod District, 2016*
Source: Websites of the different banks.

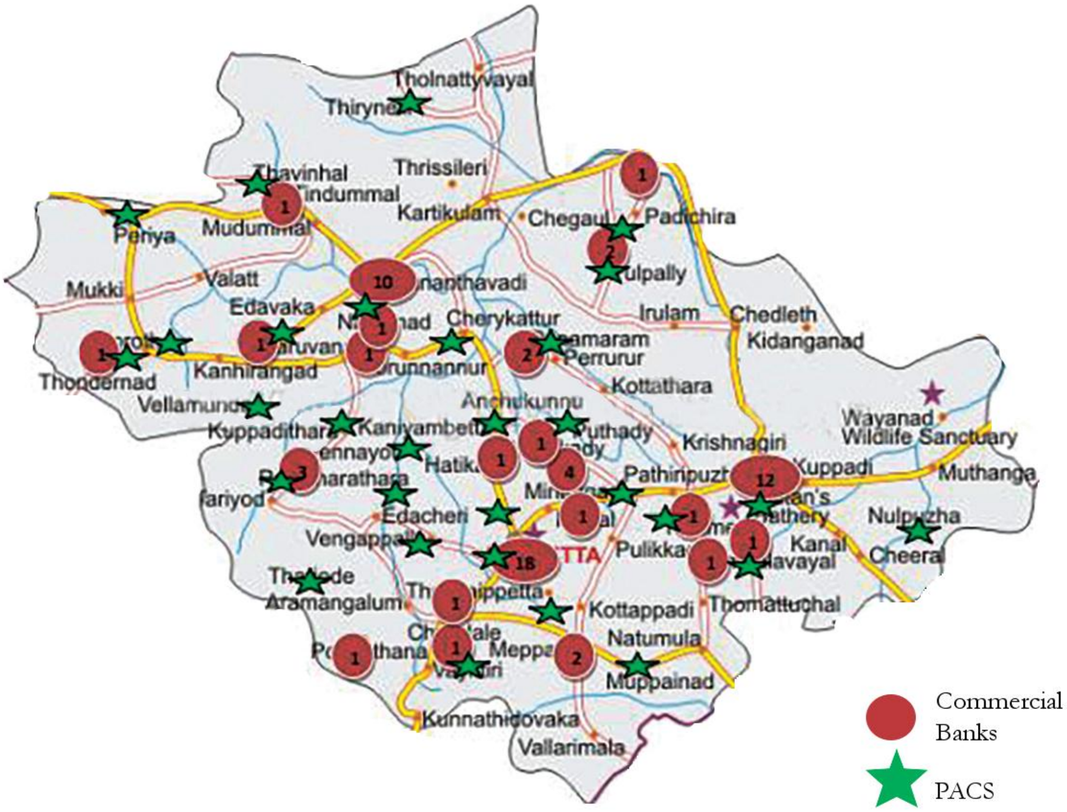

Figure 3 *Distribution of commercial bank branches (2016) and PACS (2013) in Wayanad district*
Source: Department of Cooperation (2013), websites of different banks.

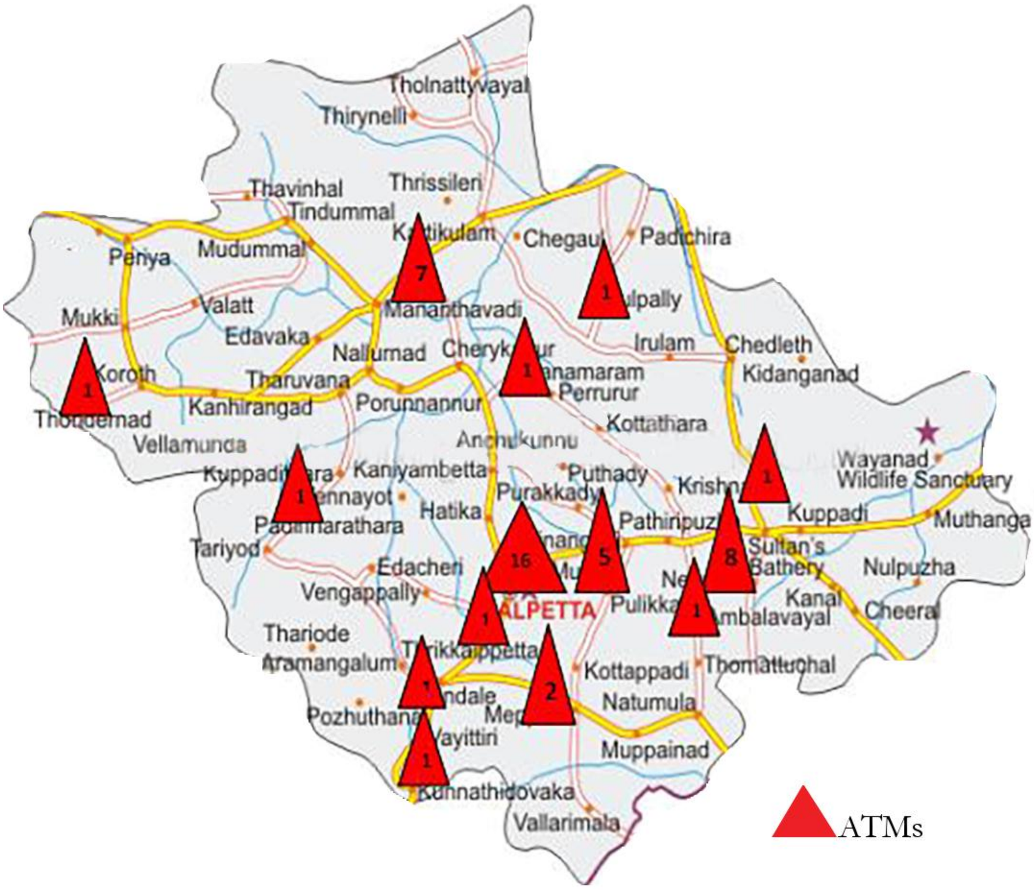

Figure 4 *Distribution of commercial bank ATMs in Wayanad District, 2016*
Source: Websites of different banks.

Table 9 *Distribution of PACS by year of registration, Kasaragod and Wayanad districts, 2013*

Year of Registration	Kasaragod		Wayanad	
	Number	Percentage	Number	Percentage
Before 1920	9	14.29	2	6.45
1920-1939	7	11.11	11	35.48
1940-1959	32	50.79	2	6.45
1960-1979	10	15.87	10	32.26
1980 -	5	7.94	6	19.36
Total	63	100	31	100

Source: Department of Cooperation (2013)

58. The trust in the PACS of the population has translated into large deposits in them. As is evident from Table 10, the average deposit per PACS in the Kasaragod circle was Rs 16.95 crore and Rs 11.52 crore in Wayanad district in 2012. It may be recalled that the deposit per branch of the scheduled commercial banks in March 2013 was only Rs 21.36 crore in Kasaragod and Rs 14.72 crore in Wayanad[4].

Table 10 *Distribution of PACS by deposit, Kasaragod circle and Wayanad district, 2011-12*

Deposit class (Rs crore)	Kasaragod circle		Wayanad district	
	Number	Average Deposit (Rs crore)	Number	Average Deposit (Rs crore)
Less than 2	1	1.34	4	0.81
2-4	3	2.98	2	2.87
4-6	6	4.76	6	5.17
6-8	4	7.11	1	6.22
8-10	1	9.29	2	8.78
10 and Above	19	26.30	12	20.60
Total	34	16.95	27	11.52

Source: Department of Cooperation (2016).

4 Calculations made from Statement No. 4A of Quarterly Statistics on Deposits and Credit of Scheduled Commercial Banks published by RBI, available at https://www.rbi.org.in/Scripts/Publications.aspx?Publication=Quarterly

59. The Committee is of the view that, building on this base, technological and organisation modernisation and reform can strengthen PACS and realise the full potential of the cooperative credit structure in Kerala. Most important among the required changes is technical upgradation of PACS. Technological modernisation should be accompanied by a shift to technological solutions that allow all PACS and their branches to be connected and networked. That network should connect to the larger world of the scheduled commercial banks. This shift requires investment in electronic hardware. It also requires common core-banking software. This should be accompanied by managerial and operational reform, involving KYC compliance, PAN card registration, and deduction of tax at source (TDS) on deposits that are eligible. This would help counter allegations that the PACS are more vulnerable to exploitation by tax evaders, money launderers, counterfeiters, and those engaged in criminal activities than other segments of the banking system.

Performance of NBFCs

60. The credit sector in Kerala has a range of non-banking financial institutions that most other States do not. There are 156 non-banking finance companies headquartered in Kerala and they have 4236 branches spread across the districts of the State. These do not include branches of NBFCs headquartered in other States. Out of the 156 companies, 26 are asset financing and 130 loan companies. They reported 1,43,67,558 loan accounts with loans outstanding of 5,02,239.76 million rupees on March 31, 2015. In addition, Kerala State Financial Enterprises Limited (KSFE) and private chit funds run about 15,000 chits, and about 35,000 monthly deposit schemes are run by cooperative societies. Kudumbasree Neighbourhood Groups (NHGs) make internal loans numbering 2,60,000 annually and the amount involved is around Rs 2000 crore (Kerala State Planning Board 2015).

61. The business of the KSFE was affected quite significantly, with remittances and daily collections on account of chitty instalments, loan repayments, and default/ recovery collections in cash having dropped by over 40 per cent in the first week after the Prime Minister's announcement. Details are in Table 11.

Table 11 *Amount collected by the KSFE for the month of November 2016* Rs crore

Period	Cash	Cheque/Demand Draft/RTGS	Total
01.11.2016 to 08.11.2016	309	60	369
09.11.2016 to 16.11.2016	81	135	216
17.11.2016 to 24.11.2016	134	160	294

Source: Communication from the Managing Director of KSFE.

62. The gross collection in October 2016 was Rs 1291.55 crore, out of which Rs 1032.04 crore was in cash and Rs 259.50 crore was in Cheque/DD/RTGS (as shown in Table 12). The gross collection for the month of November 2016 at Rs 1007.77 crore (including the first 7 days of November 2016, which was free from the effects of demonetisation) was 21.97 per cent lower than October 2016. While the collection in December improved with a 13.41 per cent increase compared to November, it was still about 12 per cent lower than that in October indicating that normalcy had not been restored. There was considerable variation in the decline in collection among the regions of the State. Compared to the State average decline of 21 per cent in November in relation to October, Kollam region showed 40 per cent reduction and Thrissur and Kannur, reduction of 30 per cent each. The improvement in December was also disparate among the regions. Alappuzha and Ernakulam showed over 30 per cent improvement in December compared to November whereas Kannur, Attingal, and Kottayam showed hardly any improvement in December.

Table 12 *Collections of KSFE from October to December 2016* Rs crore

Region	Collection for the Month of October 2016			Collection for the month of November 2016			Collection for the month of December 2016		
	Cash	Cheque	Total	Cash	Cheque	Total	Cash	Cheque	Total
Thiruvananthapuram	124.01	27.44	151.45	82.06	47.98	130.04	81.93	50.21	132.14
Attingal	90.36	14.19	104.55	52.55	28.48	81.03	47.43	28.07	75.50
Kollam	134.89	26.43	161.32	53.14	47.69	100.83	70.03	50.36	120.39
Kottayam	93.71	26.52	120.24	57.94	45.55	103.50	58.53	42.09	100.62
Kattappana	43.20	9.05	52.25	27.00	17.16	44.16	27.42	18.38	45.80
Alappuzha	55.17	40.06	95.23	50.67	27.84	78.51	66.52	38.86	105.38
Ernakulam	108.86	57.82	166.68	65.58	75.68	141.26	57.68	142.72	200.40
Thrissur	136.16	20.33	156.49	61.51	49.56	111.07	75.48	54.04	129.52
Malappuram	60.90	14.10	75.00	31.88	27.12	59.00	34.36	34.77	69.13
Kozhikode	107.37	14.13	121.50	61.82	36.14	97.96	56.41	48.51	104.92
Kannur	77.41	9.43	86.84	42.03	18.38	60.41	36.14	22.92	59.06
Total	**1032.04**	**259.50**	**1291.55**	**586.18**	**421.58**	**1007.77**	**611.93**	**530.93**	**1142.86**

Source: Communication from the Managing Director of KSFE.

Implications for the Growth of Kerala's Economy

63. As happened at the all-India level, the sudden retraction of liquidity and purchasing power had somewhat contrasting effects on the state's economy. With buyers unable to back their demands for commodities and services (including wage labour) with cash, demand fell in many markets and prices followed. But there were others where, because some traders were unable to ensure adequate supplies because of the cash crunch, there was a shortage that pushed up prices. But the primary picture as emerged from discussions with different sections of the community was one of a demand slump and deflation.

64. The effect of the cash crunch on employment and livelihoods was immediate principally because it affected the informal sector most severely. Representatives of a cooperative society of growers of fruits and vegetables spoke to us of the threat to their viability because of the absence of cash. While the cooperative society was committed to lifting the supplies delivered by producer members, demand from traders from the market fell because of a reported collapse in consumer offtake as a result of the cash crunch. This

has meant a fall in prices, increased unsold inventories leading to losses because of the perishable nature of the commodities involved, and demand for longer credit lines from buyers. This is not just threatening the viability of the cooperative society but is also resulting in delays in payments to members, affecting their earnings, day-to-day expenditures, and ability to keep production operations going. The cooperative's representatives could only express their helplessness to the Committee and declare that they just did not know what the future holds.

Travails of a Successful Cooperative

65. Even extremely successful cooperatives are facing extreme hardship. A typical example is the Uralungal Labour Contract Cooperative Society Ltd. (ULCCS), a well-known labour cooperative society based in Kozhikode, Kerala. Established in 1925, this member-owned and member-controlled cooperative has been in the forefront of infrastructure development in Kerala and prides itself as "the builder of choice for Government departments and private clients, for the construction of roads, bridges and buildings" because of its record of quality and timely execution.

66. In his written testimony, Mr. S. Shaju, Managing Director of the ULCCS, briefed the committee as follows:

Payment of wages and miscellaneous allowances: ULCCS supports the creation of a cashless economy to improve transparency and accountability. We have been using electronic means of transfer wherever possible, for example, for payments to most suppliers. But we are facing great difficulty in paying wages to workers. We have nearly 2000 migrant workers who are paid weekly wages in cash. Since there is a high rate of attrition among this group, it is not practical to maintain bank accounts for each of them. In addition to wages, workers are paid travelling allowance, refreshment allowance, etc. All of this has to be paid in cash. Because of the withdrawal limit restrictions, we have not been able to make these payments and face severe problems, including stoppage of several projects.

Cooperative bank crisis: Being a primary cooperative society, ULCCS depends on cooperative banks for a major part of its financing needs. Most of our deposits are with cooperative banks. We take cash credit loans from Kozhikode District Cooperative Bank. We also transact regularly with primary cooperatives. On November 14, the RBI stopped primary cooperative banks and district cooperative banks from accepting and exchanging the demonetised banknotes. This has effectively stopped our cash transactions with these banks.

Purchase of raw materials from local suppliers: We are facing a lot of difficulty while making payments for low-value, locally sourced raw materials such as sand, stone aggregates, bricks, etc., for which suppliers are not equipped to accept electronic payments.

Expenses incurred for hospitalisation, weddings, etc.: Because of the drastic decrease in the availability of cash, our members have faced difficulties during events such as hospitalisation, weddings, etc.

In short, our daily operations have been severely affected by demonetisation. We fear that if remedial measures and relaxation in withdrawal limits are not implemented soon, it will pose a threat to the livelihood of thousands of workers and cause great financial loss to society and delays in critical infrastructure projects.

The Dairy Sector

67. In recent years, the livestock economy and dairy sector have assumed an important position in Kerala. In 2015-16, livestock accounted for 27.6 per cent of the contribution of agriculture to the State's GDP. When the agriculture and allied sectors registered a negative growth rate of 4.6 per cent, the livestock sector grew by a 4.3 per cent.

68. The cooperative sector plays an important part in the milk production. At the end of March 2016 there were 3683 dairy cooperative societies (DCSs) registered in the State with the Registrar of Dairy Cooperative Societies. Around 3 lakh farmers deliver milk to the DCSs in the State every day. While the dairy sector in the State meets around 80 per cent of the milk requirement of the State, the DCSs account for around a fifth of the milk produced within the State.

69. According to a note submitted by the Director, Department of Dairy Development to the Committee, an average DCS in the State procures around 400 litres of milk per day. Payments are made every 7 days, so at an average procurement price (which varies with the quality of milk) of Rs 30 per litre, a DCS would require around Rs 85,000 for

procurement every week. The DCS receives payments from the regional unions once in 10 days. With a ceiling on withdrawals of Rs 24,000 per DCS per week after demonetisation, the cooperatives are finding it extremely difficult to make payments to the farmers, whose earnings after meeting costs are so low that they cannot make ends meet without receiving payments regularly. Moreover, as per the rules governing the DCSs, they are placing/investing their receipts in service cooperative banks and district cooperative banks. The operational difficulties facing the cooperative banks have only made things more difficult for the dairy cooperatives.

70. Another major problem is access to cattle feed. With green fodder meeting only about half of the requirements of feed, farmers are heavily dependent on feed concentrate supplied by organisations like Milma Feeds and Kerala Feeds. Because of restricted access to cash, farmers have not been able to acquire adequate feed for their cattle. Further, since sales of cattle feed are an important source of revenue and profit for the DCSs, their sales and viability are also adversely affected by the cash crunch.

71. In response to these difficulties faced by the sector, the Director, Department of Dairy Development, Government of Kerala, who is also the Registrar of Dairy Cooperatives, has been forced to issue a circular directing the primary DCSs to route their financial transactions through scheduled commercial banks so that the direct benefits platform being currently used for disbursing cattle feed subsidies can also be used to make "cashless" milk payments to farmers. The regional unions have, in turn, been asked to make their payments to the DCSs through their accounts in scheduled commercial banks rather than through cooperative banks. "Unavoidable" measures like this generate feedback loops, which only worsen the situation in the cooperative banking structure in the State.

Fisheries

72. The fisheries sector in Kerala relies heavily on cash transactions at every level. The bidders (wholesale buyers) obtain their supplies at auctions of the catch at harbours and pay the required amount to the boat owners and operators who use the money to meet their various expenses. The bidders are not able to carry out business in high volumes as the amount that one person can withdraw from banks has been restricted. The expected price for the fish is not realised as the fish are sold to the bidders for cash rather than to

the highest bidder, who often offers to pay by cheque or against credit.

73. A survey by the Central Marine Fisheries Research Institute found that small scale retailers who purchased 5-10 boxes of fish per day were affected because of lower effective demand for fish from consumers and a shortage of the lower denominations of money to be provided as change. Retailers also reported that they needed longer selling hours to sell the fish, and that they sometimes had to resort to distress sales. According to the study, the consumption of fish by consumers had declined by 30-40 per cent during the demonetisation period. 70 per cent of consumers reported some reduction in consumption on account of the non-availability of lower denomination notes while purchasing fish. 35 per cent of the respondents reported having reduced their consumption due to lower expenditure on fish following prioritisation and reallocation of consumption expenditure necessitated by limited access to currency.

74. Many boat owners had stopped going to sea because of these effects. More than 50 per cent of the boats registered in Kollam (1179, source: Fisheries Department) had not been at sea according to Peter Mathias, President of the State Boat Owners Association. The workers – those who work in the boats and at the harbours – have been relying on small loans or credit for their consumption needs. Some of them reported loss of jobs in the first week following demonetisation. According to Peter Mathias and two other boat owners who spoke to the Committee's representatives, for the 1000 boats registered, the number of owners (including part owners and owners who own multiple boats) is around 800 in Kollam. The owners claimed that workers would only come for work if given prior assurance that their payment would be made in cash. This happened because workers were not paid in cash in the first few days after demonetisation. Similarly, the diesel pump owners demand cash at the time of filling fuel. Diesel costs are substantial, amounting to around Rs 40,000 for a boat that has a capacity of 500 to 700 litres. The bidders who collect the fish from the boats do not have cash to pay owners. As a result, some people have started settling transactions with the diesel pumps through RTGS transfers. The boats go to the pumps and someone else makes the deposit and upon information of receipt the pump owner fills diesel in the boats. The boat goes out to sea for 4 -5 days, carrying around 12 – 15 workers. The food, nets for fishing, and equipment spare parts are also carried in the boat. The bank now permits a withdrawal of up to only Rs 24,000 for all these operations.

75. The bidders rely on the trade unions for packing and stacking fish, and for unloading and crushing ice. The wages (per box) for these operations are given below:

Rs 30 – Packing

Rs 15 – Stacking

Rs 40 – Head load

76. The cost of ice for 10 boxes is Rs 800. There is a toll collected at the gate of the harbour from the bidders. This varies according to the vehicle type. On an average, the cost incurred on one box (in addition to the bid) is around Rs 165.

77. After demonetisation, on an average only about 20 to 30 boats come to the harbour for business. The number of boats that did business prior to November was about 200 to 300. The number of boats registered in Kollam is 1179. Only around 500 boats are in operation after demonetisation.

78. A bidder can withdraw only Rs 24,000 per week. So the amount of fish sold in the harbour is very low. The sum of Rs 24,000 is enough to cover the cost of only one or two heaps of shrimp. Workers were first given the wages in the old notes. Since they were in need of money, some workers had to change these notes at the rate of Rs 400 or Rs 300 per 500-rupee note. Although the trade unions had decided on November 8, 2016 to not accept the old notes, they had to reverse the decision because of the fear of losing jobs. The bidders also held most of their cash in the form of old notes.

79. There was no currency to pay workers. Before demonetisation, no one asked for a delay in making payments. A packing worker gets a wage of Rs 15 to Rs 18 per box. But the expenditure every day is around Rs 200. As business has declined, a worker who used to get work for 50 to 60 boxes a day now gets work for 5 to 6 boxes a day, and workers have had to get into debt to meet their daily expenses.

80. There is a fall in market value of the fish. On an average fish worth Rs 1000 are sold for Rs 800. Those who generally buy fish for Rs 50,000 are now making total bids of Rs 10,000 to Rs 15,000. Payments are made to the people who are at the harbour with cash and boat owners are unwilling to sell fish for a deferred payment. The owners have to

transact with different sets of people and as they change every day, they do not accept credit. Even if cheques were in use, clearing cheques takes two to three days, and affects the sector as a whole adversely.

Other Sectors

81. The effect of current policy on migrant workers has been adverse and severe. Economic activity has slowed down, work is more difficult to come by, and wages are lower. Moreover, there are widespread reports that migrant workers are forced to accept payment in the demonetised currency, which they then must exchange. Given the ceiling on exchange of demonetised notes they need to deposit the demonetised notes in bank accounts, which most of them do not have. Given the problems being faced by their families at home, to whom they cannot now send remittances, and given the difficulties they themselves face, many migrants are going home to take up whatever means of earning they may get there.

82. There have been many reports in the Press on the difficulties faced by migrant workers in Kerala as a result of the current policy. *Deshabhimani* reported on November 19 that the construction industry in the State has come to a standstill because of demonetisation. There are about 20 lakh construction workers in the State; most of them are migrants from other parts of India. Construction workers who have been laid off are unable to buy food from local shops. *Mathrubhumi* carried a report on December 1 on migrant workers in plywood industries in Perumbavoor. The industry is facing a crisis because of the decrease in the demand for plywood from other States after demonetisation. The workers were not paid wages in the two weeks that followed the demonetisation announcement. Because of this, many workers are going back to their native places. Another report from November 28 in *Mathrubhumi* says that about 500 tickets were booked on November 27 for Guwahati Express from Kollam railway station. According to the Railway officers, they have not seen such a quantity of bulk booking to other States in the recent past.

83. An important sector of production in Kerala that has been severely hit by demonetisation is the handloom sector. The sector provides workers with daily earnings linked to production in the range of Rs 175 to Rs 250 a day. Every earning day is thus crucial for families dependent on hand weaving. Handloom textiles are marketed through

Hantex, Hanveev, or private traders, who conduct a large part of their transactions through the cooperative banking sector. Wages constitute around 70 per cent of the cost of cloth produced, with the cost of yarn and other materials accounting for the rest. According to representatives from the handloom cooperative sector who met the Committee, the cash shortage and the operational constraints imposed on the cooperative banking sector have made the relevant agencies/agents in the cooperative and private sectors (master weavers) unable to compensate workers in the industry in time. As a result, as many as 520 primary handloom societies have had to suspend operations.

84. As noted earlier, tourism and remittances are important drivers of growth in Kerala's economy. But as news of the serpentine queues at money exchange counters in airports and outside and the limits on the amount of Indian currency that can be obtained in exchange for foreign currency spread, cancellations have been on the rise and tourist arrivals are falling. The cash shortage has affected domestic tourist arrivals as well. As per quick estimates from the Department of Tourism, Kerala, relative to the corresponding month of the previous year, domestic tourist arrivals fell by 17.7 per cent in November 2016 and foreign tourist arrivals by 8.7 per cent (Table 13). The corresponding figures for October 2016 were a positive 5.2 per cent and 6 per cent respectively.

Table 13 *Foreign and domestic tourist arrivals in Kerala, by district* numbers

Sl No	District	Oct. 2015		Nov. 2015		Quick Estimate			
						Oct. 2016		Nov. 2016	
		Foreign	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
1	Alappuzha	4512	22713	4899	21363	4987	24088	4554	17865
2	Ernakulam	31758	309982	37193	311473	33295	324539	33319	260678
3	Idukki	6958	68806	5762	74673	7174	71498	5437	62062
4	Kannur	568	52397	853	50211	584	55558	863	41121
5	Kasaragod	121	20136	344	19287	133	21402	310	15840
6	Kollam	1005	22558	1170	22737	1073	24215	1110	18769
7	Kottayam	4875	42629	4653	43047	5371	45946	4302	36565
8	Kozhikode	793	76211	1174	67338	858	78555	1101	55034
9	Malappuram	2545	42504	2687	43290	2833	44783	2494	36428
10	Palakkad	162	51507	112	40760	169	55964	118	32793
11	Pathanamthitta	156	17077	221	9571	177	18127	208	7942
12	Thiruvananthapuram	21246	166322	29307	173852	22602	177078	26912	142455
13	Thrissur	502	274967	543	252176	538	286413	500	202944
14	Wayanad	918	67937	965	63805	978	72707	907	52312
	Kerala total	76119	1235746	89883	1193583	80712	1300519	82079	982369

85. Similarly, because of the difficulties in withdrawing rupees from banks and the inability of instant transfer agents to provide rupees at local counters, remittances too have reportedly fallen. This is despite the substantial benefit that can be reaped from the depreciation of the value of the rupee against international currencies. The magnitude of these trends and the impact they have had on economic activity will become clear only as more information comes in.

Impact on Vegetable Producers and Traders: A Case Study of Inchakkad VFPCK Market

86. Vegetable production and marketing faced a setback after demonetisation. Total vegetable production grew by 64 per cent from 2011-12 (8.25 lakh MT) to 2014-15 (13.55 lakh MT). The markets organised by the Vegetable and Fruit Promotion Council Keralam (VFPCK), a company established in 2001 by the Government of Kerala, have been the centres through which a large part of the vegetable trade is facilitated. A field

visit undertaken by the representatives of Kerala State Planning Board to the VFPCK market at Inchakkad, Kollam district, illustrated some effects of demonetisation in this sector.

87. VFPCK market at Inchakkad was established on November 27, 2003. It now serves farmers from Mylom, Kulakkada, Thalavoor, Pattazhy Vadakkekkara, and Pattazhy Thekkekkara village panchayats. The society that operates the market has 20 farmer groups and 368 member farmers at present. The market at Inchakkad is one of the major markets of VFPCK in Kollam district with a turnover of Rs 1.47 crore and with a volume of 570 tonnes of vegetables and fruits traded in the year 2014-15.

88. On an average, around 100 farmers bring various crops, including, 1) fruits such as *nendran*, *palayanthodan* varieties of plantain and banana; 2) vegetables such as cow pea, snake gourd, bitter gourd, brinjal, bottle gourd; 3) tubers such as tapioca, *kaachil* (purple yam); and 4) other products like coconut and arecanut to the market on the market day (Thursday) morning. The traders, around 60, arrive at Inchakkad market before mid-day and participate in the auction for purchasing the produce brought to the market by the farmers.

89. Normally, the farmers receive payment for their produce with one week's delay as most of the traders settle their purchase bills within this time period. The farmers at the market reported an increase in the outstanding amount to be paid to them after demonetisation. They pointed out that the settlements were taking up to three weeks' time. When the traders pay at different intervals, the outstanding amount generally fluctuates between the weeks. After demonetisation, the outstanding amounts to be paid to the farmers have increased.

Table 14 *Cumulative outstanding amount payable to farmers at Inchakkad VFPCK market* rupees lakh

2015		2016	
Date	Amount	Date	Amount
20/10/2015	2.4	18/10/2016	2.5
10/11/2015	3.8	8/11/2016	3.6
17/11/2015	4.1	15/11/2016	3.7
22/12/2015	3.6	20/12/2016	5.6

Source: Database of the VFPCK Market, Inchakkad.

90. Table 14 shows the outstanding amount payable to the farmers from October 20 to December 22, 2015 and from October 18 to December 20, 2016. If we examine the period from November 15 to December 20, 2016, the period after demonetisation, the outstanding amount increased from Rs 3.7 lakh to Rs 5.6 lakh, at a compounded growth rate of 7 per cent per week. For the corresponding period in 2015, from November 17 to December 22, 2015, the amount decreased from Rs 4.1 lakhs to Rs 3.6 lakhs with a compounded growth rate of -1.8 per cent per week.

91. The farmers reported a fall in prices for vegetables and fruits after demonetisaion. Table 15 shows the movement of wholesale prices for *nendran*, tapioca, *palayanthodan*, *kaachil,* and ginger for two periods – from October 4 to November 8, 2016 (before demonetisation) and from November 15 to December 22, 2016 (after demonetisation). The weighted average of the prices for these weeks was calculated. The prices for *nendran,* tapioca, *palayanthodan, kaachil,* and ginger recorded a fall in the second period compared to the first period. The products traded in larger volumes are *nendran,* tapioca, and *palayanthodan* and these have recorded a decline of 10 per cent, 9 per cent, and 4 per cent in average prices between the two periods.

Table 15 *Wholesale price per kilogram quantity of fruits and vegetables at Inchakkad VFPCK market* rupees

Period	*Nendran*	Tapioca	*Palayanthodan*	*Kaachil*	Ginger
1. October 4 – November 8, 2016	46.5	44.6	14	40	54.2
2. November 15 – December 22, 2016	41.8	40.7	13.4	30.2	35.1

Source: Database of the VFPCK Market, Inchakkad.

92. The non-availability of currency has affected the payment of wages to the hired workers. Inputs for the crops have been given on credit by the traders and therefore, this has not been hit particularly after demonetisation. As per the reports from the farmers, some migrant workers have left their job as farmers are not able to pay workers and there have been delays in making payments to them. This along with the decline in prices has resulted in farmers delaying harvests of plantain by a day or two.

93. The delays in settling transactions at the market and the fall in prices were confirmed by a small sample of retail traders selected from around Inchakkad. After demonetisation, the traders have reduced the frequency of visits made to the markets (including other

VFPCK markets) and reduced the quantity bought from the markets. The traders with a business of around Rs 10,000 per day have seen it reduce to Rs 3000 to Rs 4000 per day. The fall in business has been over 50 per cent for some traders. The fall in demand for vegetables and fruits, created by severe shortfall of currency in circulation, has led to decline in wholesale prices obtained by the farmers for their produce.

94. All told, therefore, the impact of demonetisation in terms of forgone growth opportunities, lost livelihoods and institutional damage has been substantial in Kerala. Moreover, demonetisation has partly crippled the State Government's ability to be able to address these difficulties with countercyclical fiscal policy. We turn to this issue below.

Fiscal Situation of Kerala in the Context of Demonetisation

95. As noted earlier, demonetisation will have extremely adverse implications for the Government's fiscal health at the national level. In order to tackle this increasing fiscal imbalance, the easiest route for Government of India would certainly be to cut its own discretionary fiscal space. This discretionary fiscal space largely comprises of central grants (non-finance commission grants) to States and the Centre's own development spending. If we consider the composition of Central transfers to the state of Kerala, 44 per cent of the total transfer is in the form of grants and the remaining is tax devolution. Thus, the weakening of the fiscal situation of the Union Government would affect state revenues adversely through a decline in central grants. Apart from this, an imminent slowdown in the overall GDP growth rate would mean a slowdown in the growth of Union taxes, which would in-turn mean lower devolution of taxes to the states.

96. The self-inflicted economic crisis through demonetisation may also have important implications for Centre-State relations. Two on-going policy deliberations in this context are worth noting: (a) The Fiscal Responsibility and Budget Management (FRBM) Committee appointed by the Union Government to relook at the operation of the FRBM Act and to provide flexibility for countercyclical fiscal policy in terms of the general Government deficit; and (b) the future of Goods and Services Tax (GST) implementation given demonetisation and associated economic uncertainties. As far as the on-going FRBM Committee's recommendations are concerned, the view the committee will take when it comes to the State Governments' deficit is unclear. There is a framework of borrowing in place for States recommended by successive Finance

Commissions (FC). In fact, during the rule-based fiscal regime of the last 12 years, states have over-adjusted their deficits while the Central Government remained fiscally profligate. If, in the name of flexibility, the Centre is allowed a higher borrowing limit with a corresponding reduction in States' borrowing, the State's economy will contract further. When it comes to GST, if it is implemented in an economy that is contracting after demonetisation, the revenue outcome may be sub-optimal and all stakeholders may suffer in the process. Since Kerala is a consumption driven economy, implementation of GST may have helped the State. But the revenue outcome of GST is now utterly uncertain.

97. An overview of Kerala's finances is presented in Table 16. As evident, the own tax to GSDP ratio declined from 7.06 per cent in 2011-12 to around 6.5 per cent by the end of 2015-16 (RE). In its Revised Budget, the present Government, which came to power in May 2016, proposed that the tax-to-GSDP ratio be increased to 6.85 per cent. If we translate this in terms of growth rates, own tax revenue is expected to grow at the rate of 19.39 per cent when the GSDP growth rate is 14.90 per cent (Table 17), with an implicit buoyancy of taxes at 1.375. Given the post-demonetisation slump in economic activity and the revenue loss already seen in the real estate sector on account of stamp-duty collection and in motor vehicle tax collection, it is unlikely that own tax revenue of the state would grow at more than the assumed 19 per cent in 2016-17.

98. A fall in revenue coupled with a decline in central transfers would either mean a bigger deficit or a contraction in expenditure at the state level. As per the 2016-17 (BE), total expenditure was expected to grow at the rate of 21.83 per cent compared to 15.84 per cent in 2015-16 (RE). This level of expansion in expenditure would be difficult to realize given the macro-fiscal situation in the state. This contraction in public expenditure can also further contribute to a process of slowdown that has already begun in the state as a result of demonetisation.

Table 16 *Kerala State finances from 2011-12 to 2016-17 (Budget Estimate) as percentage share of GSDP, 2011-12 to 2016-17*

	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016 RE	2016-2017 BE
Total Revenue Receipt	10.44	10.70	10.57	11.00	11.73	12.17
Own Revenue Receipt	7.78	8.31	8.08	8.07	8.06	8.48
Own Tax Revenue	7.06	7.29	6.88	6.69	6.59	6.85
Own Non-Tax Revenue	0.71	1.02	1.20	1.38	1.47	1.63
Central Transfers (through State Budget)	2.66	2.39	2.50	2.93	3.67	3.69
Share in Central Taxes	1.65	1.66	1.61	1.50	2.17	2.05
Grants-in-aid	1.02	0.73	0.89	1.43	1.50	1.63
Central Transfers (outside State Budget)	0.55	0.05	0.06	0.13	0.00	0.00
Total Central Transfers	3.21	2.44	2.55	3.06	3.67	3.69
Revenue Expenditure	12.65	12.97	13.01	13.62	13.52	14.05
Capital Expenditure	1.06	1.12	0.92	0.81	1.03	1.38
Total Expenditure	13.71	14.09	13.93	14.43	14.55	15.42

Note: RE=Revised Estimate, BE=Budget Estimate.

Table 17 *Annual growths of different components of revenues and expenditures in year-on-year growth rates, Kerala*

	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016 RE	2016-2017 BE
Total Revenue Receipt	22.65	16.12	11.42	17.84	22.55	19.15
Own Revenue Receipt	19.69	21.07	9.61	13.16	14.76	20.86
Own Tax Revenue	18.40	16.94	6.38	10.12	13.20	19.39
Own Non-Tax Revenue	34.25	61.97	32.79	30.65	22.34	27.48
Central Transfers (through State Budget)	32.17	1.68	17.69	32.98	44.01	15.37
Share in Central Taxes	16.50	14.19	9.18	6.13	65.55	8.84
Grants-in-aid	68.86	-18.54	36.96	81.43	21.27	24.78
Central Transfers (outside State Budget)	15.30	-89.35	23.94	168.71	-	-
Total Central Transfers	28.97	-13.80	17.82	35.98	37.72	15.37
Revenue Expenditure	32.83	16.17	13.08	18.62	14.06	19.37
Capital Expenditure	14.54	19.48	-6.71	-0.93	45.87	54.25
Total Expenditure	31.21	16.42	11.51	17.32	15.84	21.83
GSDP (2011-12 Series)	17.49	13.26	12.79	13.28	14.90	14.90

Note: RE=Revised Estimate, BE=Budget Estimate.

99. Analysis of monthly tax collection data shows that the growth of State's own tax revenue was lower by -0.49 per cent in December 2016 than December 2015. Commercial tax collection, comprising around two-thirds of State taxes, witnessed a negative growth rate of -1.69 per cent in December 2016 over December 2015 (see Table 18). Stamp duty and registration in November 2016 and December 2016 were -17.52 per cent and -10.60 per cent lower than the corresponding figures for November 2015 and December 2015. Excise duty and motor vehicle revenues have shown positive growth during this period. If this trend continues, the own tax revenue shortfall will be significant. It is evident from Table 19 that average growth of tax revenue during July to October was positive, while the average for November and December 2016 is -7.83 per cent.

100. Kerala's actual revenue mobilisation with a tax effort of 6.85 per cent of GSDP will be much lower if there is a fall in the GSDP growth rate. The IMF has already reduced India's growth forecast to 6.6 per cent. With an implicit inflation rate of 4 per cent, the nominal GDP may not grow beyond 10 to 11 per cent in the fiscal year 2016-17. In all likelihood, after demonetisation, Kerala's GSDP growth rate will be substantially lower than 14.9 per cent (at current prices). At a constant tax effort of 6.85, decline in GSDP growth rate by one percentage point means, shortfall in tax revenue to the tune of Rs 390 crore relative to the 2016-17 BE. If Kerala's GSDP growth rate also hovers around the national GDP growth of 10 per cent, the own tax revenue shortfall will be to the tune of Rs 1950 crore for the year 2016-17. A combination of declining GSDP and slow revenue growth can result in a loss of tax revenue that is greater than Rs 1950 crore.

101. Given the decline in growth in revenues, as evident from monthly data, it is unlikely that the state can realize the targeted tax effort of 6.85 per cent. In fact, if the tax to GSDP ratio is assumed to be 6.5 instead of 6.85, shortfall in revenue caused by a one percentage point decline in GSDP would be more than Rs 2800 crore in 2016-17, and aggregate own tax revenue loss in turn would be around Rs 11,000 crore if the GSDP growth plummets to 10-11 per cent.

102. This level of own tax revenue contraction, if not compensated, can result in across-the-board cuts in the Plan expenditure of the State, which would have adverse growth and development implications. This can result in a vicious circle of lower growth, lower revenue, and lower level of development expenditure. In this context, the Committee emphasizes that additional central assistance in the form of a grant should be provided

to the States. Also the Committee strongly recommends that States' borrowing limit of 3 per cent of GSDP should be relaxed for the year 2016-17 and 2017-18 by the Union Government immediately. States should be allowed to borrow more so that public expenditure for development and growth is maintained at the level indicated in state budget 2016-17 and be enhanced wherever necessary as a countercyclical fiscal measure to arrest the economic downturn that followed demonetisation.

Table 18 *Growth of tax revenues: month-wise details of 2016 over 2015* in per cent

Department	June 2016	July 2016	August 2016	September 2016	October 2016	November 2016	December 2016
Commercial Taxes	19.79	2.95	8.61	8.52	17.4	13.77	-1.69
Excise	4.7	50.77	17.61	2.49	2.18	2.72	15.74
Registration	1.65	29.35	-1.69	-7.22	18.92	-17.52	-10.6
Motor Vehicle	13.17	13.17	32.77	18.1	15.76	15.57	12.01
Total	17.3	7.81	9.9	7.88	16.64	11.32	-0.49

Table 19 *Month-wise growth of tax revenues: July 2016 to December 2016* in per cent

Department	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Average: July-October	Average: November-December
Commercial Taxes	-8.56	4.19	12.47	-0.34	-8.86	-8.15	1.94	-8.5
Lotteries	12.12	10.9	-0.49	0.45	-49.32	39.91	5.74	-4.7
Excise	54.13	-26.44	-0.16	-6.35	0.39	6.88	5.3	3.63
Registration	25.69	-17.75	-5.74	21.41	-39.48	24.52	5.9	-7.48
Motor Vehicle	15.41	-0.11	4.48	-2.2	-34.03	38.95	4.4	2.46
Total	**0**	**1.81**	**8.12**	**0.45**	**-18.51**	**1.19**	**2.6**	**-8.66**
Total Excluding Lottery	-2.09	0.02	10.01	0.45	-12.41	-3.24	2.1	-7.83

103. Thus, to conclude, after demonetisation, Kerala's fiscal situation is grim. On the budgetary front, the entire fiscal arithmetic for the fiscal year 2016-17 for the state has been based on an estimated nominal GDP growth rate of around 15 per cent. The revenue growth is assumed to be around 20 per cent. These levels of growth of GDP and revenue are highly unlikely given the contraction in economic activity. There has already been a slowdown in economic activity in key economic sectors, which will adversely impact revenue mobilisation. Thus, the fiscal situation in the state will be adversely affected through multiple channels. If this slowdown in revenue needs to be managed, the only options are to borrow more or to cut much needed development expenditure in the state. Since Kerala has large committed expenditure in terms of salary, pension, and interest liabilities on the non-Plan side, a drastic cut in Plan expenditure is the only possibility. Special effort is needed to prevent that. Apart from this, after demonetisation, day-to-day cash management has become a challenge at the State level. This includes the payment of salaries and pensions, a process that can snowball into a major crisis.

The Timing

104. The recent period has seen a significant change in the growth trajectory of Kerala. The growth rate of Kerala's economy fell sharply in 2010-11 and has continued to remain low since then. While the all-India GDP growth rate picked up following a mild dip in 2012-13 and has been over 7 per cent, such a rebound is not to be seen in Kerala's GSDP, with average growth over the five years ending 2014-15 having fallen well below 6 per cent.

105. Why has GSDP growth in Kerala suffered in recent years? The sectors that led Kerala's growth during the two decades preceding 2010 were construction, transport, storage, and communication, trade, hotel and restaurants, real estate ownership, and business and legal services. Remittances, tourism, and welfare expenditures were the drivers of growth. As is evident from the sectoral growth rates presented in Table 1, most of these sectors have shown poor growth rates in recent years.

106. The drivers of growth seem to have changed in recent years. Foreign tourist arrivals had been growing at close to 20 per cent a year till 2010 (despite a dip in 2009). The growth of tourism has decelerated significantly since then. It has fallen below 10 per cent after

2012, with growth below the national average in 2014 for the first time in recent history. The deceleration continued into 2015.

107. Annual data on remittances into India are available from the World Bank's *Migration and Remittances Factbook* and *Migration and Development Brief*. Data suggest that remittances into India in US dollar terms stagnated after 2012 and fell for the first time in 2015 after the global financial crisis in 2009. As the remittances-to-GSDP ratio for Kerala is over 25 per cent, any significant fall in remittances will have a substantial impact on economic growth.

108. A factor that has gained significance in the last three years is the slump in agricultural prices. The period since 2011 has witnessed terms of trade movements adverse to agriculture. The prices of natural rubber and coconut, which together account for over half the cropped area in the State, have declined sharply in the last few years. The price of natural rubber, which was around Rs 56 per kg in 2004-05, increased to over Rs 208 in 2011-12. It has declined steadily since then, touching a low of Rs 90 in 2015-16. Production of natural rubber declined from over 9 lakh tonnes in 2011-12 to less than 6 lakh tonnes in 2015-16. The price and volume effect together resulted in the value of output declining by over 60 per cent in four years. The price of coconut and coconut oil too declined by about 30 per cent from 2014-15 to 2015-16.

109. Thus, three distinct sets of factors have had a severe adverse impact on the economy of Kerala in the last four years. It is in this context of low economic growth that the State has had to face the experience of demonetisation, a policy measure where effort is to push growth further down.

The State-Level Response

110. Given the ways in which the demonetisation has affected the State, the principal effort of the Government and others has been to find ways to ease the cash crunch for the poorest and seek to limit the damage that will be inflicted on the cooperative sector, especially the cooperative banking sector.

111. While an unprecedented protest by the Government in power was expressed on the streets and in legislative forums, it was clear that the Centre was not willing to retract,

despite evidence from across the country of the hardship it had inflicted on the people. The focus thus has had to be on mitigating the effects of the crisis that has been precipitated.

112. One example of the kind of immediate measures taken to mitigate the crisis is the order issued to district collectors (G.O.(Rt) No.9140/2015/Fin dated November 22, 2016 and G.O.(Rt) No.9214/2015/Fin dated November 24, 2016) to distribute wages of plantation workers through their treasury savings bank (TSB) account, in the wake of non-availability of bulk cash consequent on demonetisation. The concerned District Collectors were permitted to open non-interest bearing special TSB accounts in the concerned treasury exclusively to handle transactions relating to disbursement of wages to plantation workers. The cheques presented by the management on account of wages of their employees were to be credited into these accounts. On receipt of confirmation or credit received from the banks, the money was to be disbursed in cash from the respective treasuries to the authorised representative of the management.

113. A more significant measure was to facilitate access to their deposits to account holders in PACS, which were unable to service demands for withdrawals because of the Rs 24,000 per week limit on their own access to cash. Following a decision taken by the Government of Tamil Nadu with regard to loans to farmers, the Kerala Government sought a way out through a special window created in the district cooperative banks (DCBs) to which individual PACS were linked. To facilitate access to cash, all PACS members were allowed to open a "mirror account" in the concerned DCB, and the PACS was to provide a debit note to the DCB against sums due to the account holder. Against that the PACS account holder was permitted to gain access to the equivalent of Rs 24,000 per week – the limit applicable to account holders in the "formal" banking system. While some PACS did express the fear that this would result in account migration to the DCBs and away from the PACS, affecting the latter adversely, the Government sought to assure them that the present arrangement needed only to be a temporary measure.

114. Besides seeking ways in which Government policies could mitigate the hardship, the Government has sought to facilitate independent efforts to enhance cashless transactions among holders of accounts in cooperative and scheduled commercial banks. An

interesting example is the joint action taken by the Kerala Government, the Kozhikode District Cooperative Bank, and PACS in Kozhikode District.

On November 16, 2016 in Kozhikode, the District Association of Primary Cooperative Banks and Board Members of the District Cooperative Bank met to evaluate the impact of demonetisation and decided to conduct an awareness campaign among different sections of the public in association with the PACS to popularise measures to address the problems of different sections of the people and agencies. An important initiative was a scheme entitled "Sahakarana-Vyapari Koottayma" (cooperative-trader joint effort), which was aimed at sustaining confidence in the cooperative banks and facilitating transactions without cash. The component parts of the scheme included:

- getting the DCB to make payments by cheques and NEFT/RTGS transfers that were debited against the deposits of the PACS with the District Cooperative Bank to meet the commercial requirements of members of the PACS;
- having the DCB issue bank guarantees so that traders would accept the cheques issued by customers of the PACS;
- making settlement arrangements with State-Government-owned entities like the Civil Supplies Corporation, Maveli stores, HORTICORP, CONSUMERFED etc. to facilitate day-to-day purchases of PACS depositors;
- opening mirror accounts in the District Cooperative Bank for account holders of Primary Societies who are KYC/AML (anti-money laundering) compliant to disburse cash as per RBI guidelines and ceilings;
- issuing photo identity cards with details of the account numbers, and withdrawal limits of customers in order to enable customers to make purchases for their daily needs.

115. Initiatives such as these have helped mitigate the hardships created by the demonetisation decision, though difficulties remain and the adverse impact on production and livelihoods is still visible.

116. There is good reason to believe that despite all the pain, the stated objectives of the demonetisation exercise are unlikely to be achieved. The fact of the matter is that illegal wealth is not held in the form of currency notes, but is quickly converted into assets like gold, real estate, and financial instruments, or is spent and transformed into money

circulating in the "legal" economy. Only a small component that has either been generated in recent transactions and has as yet not been converted, or is held by those who expect to make a transaction that needs a large hoard of illegal money remains in the form of currency. In past seizures of illegal wealth, only between 3.5 and 7.3 per cent was found to be kept in cash. The current policy may deter new transactions for a short time, but other measures are needed to curtail the illegal economy. Similarly, while counterfeit versions of the demonetised denominations would be cleaned out, new counterfeiting would have to be dealt with separately. All in all, from the point of view of Kerala, demonetisation of such unprecedented intensity was completely unwarranted and came at a time when economic conditions make it difficult to address its adverse impact.

What Can be Done?

117. Despite the damage it has done, the Central Government is politically unwilling to reverse its demonetisation decision. On the other hand, full "remonetisation" of the economy is unlikely before the third quarter of 2017. As of now ceilings on withdrawals remain in place. So, Kerala, led by the State Government, must find ways to limit the adverse consequences of the policy, especially with regard to the livelihoods and welfare of the poorest among its people.

118. One priority is to ensure that Plan expenditures are maintained at targeted levels despite the budgetary difficulties created by the impact of demonetisation. To realise this, joint effort by State Governments to demand compensation from the Centre in the form of discretionary transfers to support the Plan is called for. In addition to this, the Centre must be called upon to relax ceilings on borrowing by the States so that to the extent that compensation from the Centre is short of the stimulus needed to counter the recession, the required expenditure can be financed with loans from the market.

119. Another set of policy measures must address the problems of cooperative institutions, particularly in Kerala, where the cooperative credit societies and cooperative banks have played a crucial social and economic role. An immediate requirement is to consolidate and replicate experiments of the kind conducted in Kozhikode (reported above), where Government institutions, businesses, cooperating banking agencies, and citizens came together. Their objective was to work out systems that allow for settlements of

transactions through means other than cash, in order to protect the employment and purchasing power of workers (especially in the informal sector), limit the adverse effect of demonetisation on economic activity, and support the revenue-generating capacity of the State Government. The issue here is not to replace cash settlements with digital payments by encouraging the use of mobile phones and digital wallets. Those who expect a transition to digital payments on a scale that will meet the problem created by demonetisation are making hugely overoptimistic assumptions on the state of connectivity, digital literacy, and the digital security infrastructure in the country. The method in Kerala is to use local networks that link people, businesses, institutions, and the Government and the trust between them to settle transactions through the existing financial framework but without cash. Cards, identity markers, information sources, and other instruments can build and consolidate the trust needed for the operation of such networks.

120. Medium and long-term policies are also necessary. Policies to reverse the standstill in business at the PACS are crucial. While legal recourse to reverse the decision that partly or fully freezes the operations of cooperative banking institutions at different levels in the State has been taken, other measures too are needed. Members of individuals PACS should be encouraged by PACS and DCCBs to open mirror versions of their accounts in the district cooperative banks to which the concerned PACS is linked, and use those mirror accounts to disburse cash against the deposits held by members in the PACS or against the loan accounts opened in the name of individual members in the PACS.

121. Another set of medium-term initiatives must be aimed at supporting the primary cooperative societies. Primary cooperative societies have been badly hit by the demonetisation and have been excluded from exchange and deposit of the specified bank notes (SBNs). This exclusion from cash transactions has challenged their viability and posed a threat to their survival. There are many ways in which support to counteract this can be provided. Public sector entities and Government agencies can be asked to bank with the PACS where possible so as to send out a message that PACS are trusted entities with Government backing. Some PACS claim that dues from the Government to the PACS, such as payments to compensate for loan waivers provided as part of past Government programmes, have not been disbursed as yet. These should be immediately cleared so as to give the concerned PACS financial support that is legitimately due to

them. In addition, schemes to provide some subvention of interest rates for borrowers from cooperatives who have a good debt servicing record can enthuse members to continue their association with the cooperatives.

122. One issue that arises in this context is the regulatory jurisdiction of the Registrar of Cooperative Societies in the State. The Reserve Bank of India took a unilateral decision to exclude the PACS from SBN exchange or acceptance of SBN deposits, and chose to treat them as equivalent to individual depositors in the scheduled commercial banks when setting ceilings on withdrawals. In this situation, the State-level regulatory authority had no option other than to comply and issue the necessary order or notification. They had to so despite the fact that such decisions froze operations in the PACS and damaged their credibility, since PACS were now seen as "different" from the banks and their operations as possibly suspect. It is necessary to make suitable changes in the post-2006 Task Force regulatory framework to give a degree of autonomy to State-level regulators of the PACs, especially in States with a vibrant cooperative sector like Kerala, where the PACS play a crucial role in the rural credit infrastructure.

123. These initiatives from outside the cooperative sector should be accompanied by internal measures by cooperative credit organisations at the local level to strengthen their institutional basis. Technological modernisation should be accompanied by an effort to go beyond adopting core-banking solutions among branches belonging to individual cooperative credit societies. Shifts to technological solutions that allow all PACS and their branches to be connected and networked and link that network to the larger world of the scheduled commercial banks are needed. This shift requires investment in electronic hardware. It also requires a common core-banking software platform that allows (1) cooperatives to link their banking with their chitty and other operations, (2) all cooperatives to integrate their operations, (3) PACS to connect to the DCBs and State Cooperative Banks, and (4) the cooperative banking sector as a whole to connect to the commercial banks.

124. Technological modernisation should be accompanied by managerial and operational reform. Central to such reform must be the introduction of practices such as ensuring KYC compliance, requiring PAN card registration, and deducting tax at source (TDS) on deposits that are eligible. This would imply information collection and reporting

procedures that can prevent allegations that the PACS are vulnerable to exploitation by tax evaders, money launderers, counterfeiters, and those engaged in criminal activities.

125. Cooperation and primary cooperatives are Kerala's strength, a rich legacy of our freedom movement. People's confidence in these institutions is part of Kerala's historical heritage. More can be done to restore confidence in the PACS so that deposits held in accounts can be used for payments through transfers to payees. If there is a fear that some PACS are likely to fail because they are unable to undertake business and could face a run in the form of transfers to accounts held by members in commercial banks and elsewhere, counterparties may be unwilling to accept promises of payment through transfers, especially from those PACS that have not adopted electronic banking solutions. The State Government could consider the possibility of providing a Government guarantee for such transfers, making them a safe means of settlement for all.

126. Relief measures that aim to address the pain caused by unemployment and loss of livelihoods that have occurred as a result of demonetisation are needed urgently. All State Governments must be called upon to make an estimate of the loss incurred as a result of the demonetisation, which was a wholly Central initiative. Kerala must, as it has done by constituting this Committee, take the lead and conduct a comprehensive study to assess demonetisation-triggered losses and provide a template on how that is best done. A similar study across States should be followed by a conference of Chief Ministers that computes the size of the compensation that the Centre must provide the States and the principles and formulae that must be adopted for the allocation of compensation to different States.

127. It is clear from the Prime Minister's speech on December 31, 2016, that the Centre does not consider such measures necessary. His speech focused on special ameliorative programmes including: (i) an interest rate subvention of 4 per cent for housing loans of up to Rs 9 lakh and 3 per cent for loans up to Rs 12 lakh; (ii) a grace period of 60 days on interest on *rabi* loans to cultivators from DCBs and PACS; and (iii) an increase in the limit of loans taken by small-scale enterprises that are eligible for underwriting support from the Government of India from Rs 1 crore to Rs 2 crore. These are, in fact, not at all new, but mere restatements or enhancements of schemes already under way.

128. To implement more effective measures the Centre should be called upon to constitute a "National Demonetisation Impact Relief Fund" to which the States can address their demands. Transfers from the Fund can be used to finance direct benefits to the most severely affected sections of the populations, which, in the case of Kerala, would consist of informal and migrant workers in vulnerable sectors such as fisheries, vegetable and horticultural production, cashew and coir production, the brick and tile industries, and construction. They could also be used to finance Plan programmes that are targeted at the worst-affected in these sectors. The population targeted can be identified using data from the socio-economic and caste censuses that have been undertaken in the States, and other supporting information. The Government of Kerala, based on advice from the State Planning Board, should adjust appropriately chosen and funded Plan programmes to benefit these sections in particular.

129. The Centre has advocated measures aimed at making a quick transition to a "less cash" economy where digital transactions dominate. The declared objective is to shorten the unavoidable lag in remonetising the economy. Framing the policy in these terms ignores several costs of digitisation, which should not be forced on citizens. The first such cost is the cost of connectivity. The second cost is the charge imposed by banks and the financial technology (or "fintech") companies for hosting and facilitating digital transactions. The third cost is the danger of security breaches, which may result in losses for clients. And, finally, there is the potential for the invasion of privacy of various kinds. If a transactor voluntarily choses to go digital despite these costs there should be no difficulty. But if a transactor is forced to go digital by depriving her of currency or is persuaded to go digital without full knowledge of costs, the move must be resisted. The Centre should be encouraged to invest in the technological and security infrastructure for an increase in digitisation. But it is necessary to ensure that the transition does not end up facilitating the extraction of super profits by private fintech operators. Regulation should ensure that charges imposed by financial intermediaries are reasonable and minimal. And informed transactors should be left to either voluntarily go digital or refrain from doing so.

130. It needs to be noted here that even when digital payments are encouraged, a substantial cash economy will continue to exist, especially in large parts of the informal sector. Besides issues like connectivity and safety, the spread of digital payments in the informal

economy will be constrained by cost factors. As elsewhere in the financial sector, a few firms demanding high payments for the services they offer will soon dominate digital payments. The informal sector survives because of low overheads and no or low taxes. For that reason, people in the informal sector may not be able to embrace the digital future. For them the ultimate solution is the return of cash. All the Government can do is to offer some support in the interim to prevent demonetisation from triggering a collapse of the informal economy.

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Annexure 1

Note on Meetings Conducted by the Committee

November 29, 2016

11:00 am to 1:00 pm

Cooperative Sector

1. C. Deepu, Assistant General Manager, Karamana Cooperative Urban Bank
2. S. Lalithambika, Registrar, Cooperative Societes
3. Jose, Additional Registrar (Cr), Cooperative Societes
4. Dr. R. Shivakumar, Deputy General Manager II, Trivandrum District Cooperative Bank
5. K. Sreekumar, Deputy General Manager, Kerala State Cooperative Bank
6. M. Shajahan, Aruvikkara Farmers State Cooperative Bank
7. B. Rajan Nair, Aruvikkara Farmers State Cooperative Bank
8. B. Prasannan, President, Peroorkada Service Cooperative Bank
9. B. Jafarkhan, Balaramapuram Service Cooperative Bank
10. K. C. Sahadevan, Chief General Manager, Kerala State Cooperative Bank

Banking Sector

11. K. Harikumar, Bank Employees Federation of India
12. V. B. Padmakumar, District Bank Employees Federation
13. V. Sureshkumar, District Bank Employees Federation
14. K. Vijayan, Secretary, Trivandrum District Cooperative Bank Employees Federation
15. B. Hari, Trivandrum Cooperative Urban Bank
16. K. Harish, Kerala Cooperative Employees Union (CITU)

November 29, 2016

2:00 pm to 5:00 pm

National Bank for Agriculture and Rural Development (NABARD)

1. V. R. Raveendranath, Chief General Manager, NABARD
2. B. Swaminathan, General Manager, NABARD

Reserve Bank of India

3. S. M. N. Swamy, Regional Director, Reserve Bank of India
4. C. Saravanan, Deputy General Manager, Reserve Bank of India

Commercial Banks

5. N. Sivasankaran, General Manager, Canara Bank, State Level Bankers Committee
6. V. S. Santhosh, Divisional Manager, Canara Bank, State Level Bankers Committee
7. G. Nandakumar, Senior Manager, Canara Bank, State Level Bankers Committee

7:00 pm to 7:30 pm

Meeting with Shri Pinarayi Vijayan, Hon'ble Chief Minister, Government of Kerala

November 30, 2016

Forenoon

Participation in State-level meeting of district cooperative banks organised by Hon'ble Minister for Cooperation at Co-Bank Towers, Thiruvananthapuram

2:00 pm to 4:45 pm

Dairy Department and Dairy Cooperatives

1. Isaac K. Thayil, Deputy Director, Dairy Development Department, Thiruvananthapuram
2. E. M. Rasheed, President, Kudavoor MPCS

Coconut Producers' Organisation and Cooperatives

3. E. S. James, President, Service Cooperative Bank, Chakkittapara

Vegetable and Fruits Producers

4. T. Priya, VFPCK Swasraya Karshaka Samithy, Kattakada
5. Sasidharan Nair, VFPCK Swasraya Karshaka Samithy, Kattakada

Handloom Sector

6. V. Velayudhanpillai, President, District Apex Body
7. Parakuzhi Surendran, Member, Handloom Council State Committee
8. D. Rajasekharan, Kerala Handloom Weavers Cooperative Societies Association

5:00 pm to 7:00 pm

Meeting with Dr. T. M. Thomas Isaac, Hon'ble Finance Minister, Government of Kerala

December 1, 2016

10:00 am to 1:00 pm

1. Salim Gangadharan, Regional Director (Retired), Reserve Bank India, Thiruvananthapuram

Employees' Cooperatives

2. J. Josephine, President, State Planning Board Employees Cooperative Society, Thiruvananthapuram
3. Dr. C. Anilkumar, Member, State Planning Board Employees Cooperative Society, Thiruvananthapuram
4. K. Jaimon, Member, State Planning Board Employees Cooperative Society, Thiruvananthapuram
5. S. Latha, Staff, State Planning Board Employees Cooperative Society, Thiruvananthapuram

January 19, 2017

10:00 am to 1:00 pm

1. U. Viswakumar, Secretary, Peroorkada Service Cooperative Bank, Thiruvananthapuram
2. S. Krishnamoorthy, Labour Lawyer, Migrant Workers' Union, and Member, Kerala State Committee, CITU
3. R. Sankarankutty, Representative, Bank Employees Federation of India
4. Joseph K. Chandy, Chief Marketing Officer, Thoughtripples Technologies, Thiruvananthapuram
5. M. L. Udaya, Secretary, Vallichira Pattikajathi Service Cooperative Society, Thiruvananthapuram

ANNEXURE 2

PROCEEDINGS OF THE MEMBER SECRETARY, STATE PLANNING BOARD

(Present: Shri V. S. Senthil IAS)

Sub: Committee on the Impact of Demonetisation on the State Economy

Ref: Note of the Chairperson, Kerala State Planning Board. dated 23-11-2016

ORDER NO.35458/16/PCD/SPB. Dated: 23-11-2016

1. In the light of the decision of the Government of India to

- cancel the legal-tender character of bank notes of Rs 500 and Rs 1000 denominations;
- restrict the rupee value of withdrawals by persons from Automated Teller Machines;
- restrict the rupees amount exchangeable at banks; and
- disallow the banking functions of cooperative banks,

the Kerala State Planning Board has decided to appoint a Committee to study the impact of these decisions on the economy of the State.

2. The Members of the Committee are:

Professor C P Chandrasekhar, Centre for Economic Studies and Planning, Jawaharlal Nehru University (Chair)
Professor D Narayana, Director, Gulati Institute of Finance and Taxation
Professor Pinaki Chakraborty, National Institute of Public Finance and Policy
Dr K M Abraham, ACS (Finance), and
Member Secretary, Planning Board (Member Secretary)

3. The terms of reference of this Committee are to evaluate and report to the Planning Board on the short- and long-term impact of the policy decisions mentioned in (1) above on

(i) employment, income, and economic activity in the major sectors of the State economy and on the livelihoods of different sections of the labour force;

(ii) the cooperative sector in Kerala and on the banking sector and credit provision in general;
(iii) Government revenues; and
(iv) Gross State Domestic Product (in general and sector-wise).

4. The Committee will meet on Monday, November 28, 2016.

5. It will submit its first report in a week.

6. The Members of the Committee will be entitled to travelling allowances as are applicable to class I officers of the Government of Kerala.

Sd/-
V.S.Senthil IAS
Member Secretary

To
Chairperson, all Committee Members, and Member Secretary
Copy to:

1. PS to VC
2. PA to MS
3. The Principal Accountant General (A&E) Kerala, Thiruvananthapuram
4. The Sub Treasury Officer, Vellayambalam
5. The Senior Administrative Officer, SPB
6. The Finance Officer, SPB.
7. Office copy/Stock file.

Forwarded/By order
Chief (i/c)

ANNEXURE 3

C.B (1)48328/16 | Office of the Registrar of Cooperative Societies
Thiruvananthapuram, Dated:05/12/2016

Email : keralarcs.coop@kerala.gov.in
Website : www.cooperation.kerala.gov.in
Fax : 0471-2331513, 0471-2331136

CIRCULAR NO. 46/2016

Subject:- Issuing guidelines to address the crisis in cooperative sector due to the ceasing of legal tender of Rs.500/- and Rs.1000/- denominations – reg.

Reference:- 1) Notification No. S.O. 3407(E) Dated.08/11/2016
2) Government Order, G.O(K) Dated. 03/12/2016

The legal tender character of Rs.500/- and Rs.1000/- was withdrawn through the notification given in reference (1). Subsequently, weekly withdrawal limit for customers has been restricted to Rs 24,000/-. This action has created severe crisis in the cooperative sector. Primary cooperative societies, as consumers in the district cooperative banks, were permitted to only withdraw Rs 24,000/- per week. Central bank conference held on 30/11/2016 had discussed about this situation in detail and on the basis of the ideas discussed, certain guidelines were approved and a government order was issued as per reference (2) for temporary redressal of the crisis. In the above circumstances, following instructions are issued:

1. The account holders in primary cooperative societies/banks are allowed to start zero-balance account in the district cooperative bank, in compliance with Know Your Customer (KYC) regulations, where the primary cooperative society/bank of the account holder has its account.

2. The amount requested by the account holder from his/her account in the primary cooperative societies shall be transferred to the customer's account in the district cooperative bank. The customer then may withdraw Rs 24,000/- a week or the limits prescribed by the Reserve Bank of India through cheques, draft exchanges, electronic transfer systems such as RTGS, NEFT and may use this facility to transfer any amount to different agencies.

3. Agricultural loans demanded by the farmers may be issued without any interruption through primary agricultural service cooperative societies and the loan amount to farmers/members may

be transferred to their accounts started as above mentioned in the district cooperative banks. Members/farmers may also be allowed to withdraw loan amount from those accounts.

4. Members shall be allowed to operate through their existing accounts in the primary cooperatives regularly. They may also be allowed to receive deposit or repay loans through these accounts.

5. The expenses incurred to start such accounts in district cooperative bank by account holders in the primary agricultural cooperative society should be borne by the district cooperative banks. This system will be a temporary arrangement for redressing currency deficiency faced by the primary agricultural cooperative societies/banks. This temporary arrangement may only be provided to needy members in the primary agricultural cooperative society.

Sd/-
S. Lalithambika I.A.S.
Registrar, Cooperative Society

1. Cooperative Audit Registrars
2. District Joint Registrars (General)
3. District Joint Registrars
4. Assistant Registrars (General)
5. Assistant Directors
6. Managing Director, State Cooperative Bank
7. Managers, District Cooperative Banks
8. Primary Cooperative Societies (through Joint Registrars (General))
9. Website
10. Stock file

By Order

Assistant Registrar (C.B)

C.G. (1) 52475/16

Office of the Registrar, Cooperative
Thiruvananthapuram, 7.12.2016

CIRCULAR NO. 47/2016

Subject:- Department of Cooperation – Cooperative Sector Save Campaign – Terms of Reference issuing – reg.

Reference:- The Decision of the Central Bank Conference held on 30.11.2016 at the presidency of Hon.ble Chief Minister.

The cooperative movement is widespread and influences all sectors related to the lives of the people in Kerala's economy. Common people depend on cooperative sector for credit, consumer, marketing, processing, health, and education needs. Women, scheduled caste/scheduled tribe, and people from construction sector, dairy, coir, are dependent on cooperative sector to fulfil their necessities. The cooperative sector in the State is a model to the whole country. The trust and attachment of the functionaries in the cooperative sector and the public are behind this achievement.

The legal tender character of Rs 500/- and Rs 1000/- currency denominations was cancelled from November 9, 2016 as per the central government order No. S.O. 3407(E) dated 8.11.2016. Subsequently, various activities have been planned to overcome the contraction resulted in the functioning of the cooperative societies/banks.

The central bank conference held on 30.11.2016 analysed the problem and formulated steps to overcome the crisis. It decided to organise a "Save Cooperative Sector Campaign" from December 10, 2016 to January 10, 2017. The following programmes have been decided to be implemented as a part of this:

1. Save Cooperative Sector Campaign
2. Deposit Mobilisation Mission
3. Save Cooperative Day

Save Cooperative Sector Campaign:
State, District, Primary Society Level Conventions

A State-level convention will be held at Ernakulam Town Hall on December 11, Sunday at 3.00 p.m. as part of the "Save Cooperative Sector Campaign 2016". Joint Registrar (General) Ernakulam shall form the reception committee and take further steps for conducting the convention. Measures should be taken to maximise the participation of people's representatives, major cooperative functionaries, state/district/urban/primary societies/banks representatives, and representatives from apex institutions in the state level convention. District level conventions and primary cooperative society/bank level conventions should be organised in the same manner. District level, primary level conventions, and bank level conventions should be organised between December 12 and 17. Respective Joint Registrars (General) should organise district level conventions and Assistant Registrar (General) should organise primary society level conventions and should take necessary steps for conducting these conventions. The taluk level monitoring committee should meet and decide on society level conventions and house visits to ensure timely implementation of the programme with mass participation. Discussions and awareness sessions, analysing the merits and demerits of the cooperative sector, in order to strengthen and provide new vigour to the cooperative movement must be part of these campaigns. For the successful organisation of house visit campaign as a part of the cooperative protection day, necessary framework should be formulated at the bank level convention.

2. Deposit Mobilisation Campaign

1. The duration of the deposit mobilisation campaign is from December 10, 2016 to January 10, 2017.

2. All cooperative societies or banks that are eligible to receive deposits, such as Kerala State Cooperative Bank, district cooperative banks, primary agricultural and rural development banks, primary agricultural credit societies, employees cooperative societies, and other credit cooperative societies, should be part of this campaign. While selecting cooperative societies, care should be taken to avoid cooperative societies that are dysfunctional or those which have engaged in embezzlements/irregularities.

3. Rate of interest provided for deposits should be as per instructions in the circular issued by the Registrar of Cooperative Societies. No other interest rate should be charged on deposits.

4. Joint Registrars (General) at the district level and Assistant Registrars (General) at the taluk level will be responsible for the coordination and successful implementation of the campaign. All officers of the Cooperation Department including Assistant Director (Audit), Assistant Registrar/Valuation Officer, Unit Inspector, and Auditor should take up frontline roles in the campaign.

5. Deputy Registrar (Administration) from the office of Joint Registrar (General) is appointed as the district level nodal officer for the campaign. The responsibility of sending required information and daily progress reports to the Registrar of Cooperative Societies vests with the nodal officers under the control of Joint Registrar (General).

6. Assistant Registrar (General) who holds the charge at the circle level should compile the deposit information of all cooperative societies within the circle. Information from individual cooperative societies should be collected through unit inspectors. The Assistant Registrar (General) should submit the information collected to the district level nodal officer, Deputy Registrar (Administration). Information should be made available for December 17, 24, 31, and January 10. At the circle level, deposit information from cooperative societies/banks may be collected using the unit inspectors in charge of individual cooperative societies and for compiling these information an inspector may be given charge at the circle level.

7. Extensive campaign activities should be organised through the State Cooperative Bank, district cooperative banks, urban cooperative banks, primary cooperative societies/banks, other credit cooperative societies, or the non-credit cooperative societies that accept deposits from members.

8. Deposit information from district cooperative banks should be collected by the corresponding district Joint Registrars and submitted according to the instructions given in paragraph 6. State Cooperative Bank and State Cooperative Agricultural and Rural Development Bank should submit the deposit information as per paragraph 6 to the office of the Registrar of Cooperative Societies. Arrangements for these should be made by the general managers and nodal officers should be appointed for the same.

9. Balance sheet of deposits and weekly progress reports should be sent in proforma provided with this order.

3. Save Cooperatives Day

It has been decided to celebrate December 18, 2016 as "Save Cooperatives Day." As part of this, it is decided that, on that day, one lakh cooperators and one lakh employees will visit 67 lakh households of Kerala to create awareness and resolve apprehensions among people regarding the following matters. For this purpose, the following should be publicized and focussed on during the campaign.

- The crisis faced by banks/societies due to cancelling the legal tender character of 500/- and 1000/- notes is only a problem of unavailability of adequate amount of currency notes and it is only a temporary issue.
- Depositors will not lose their deposits in any case.
- Deposit Insurance and Credit Guarantee Corporation's (which is under the Reserve Bank of India) Deposit Insurance Scheme is applicable to all the deposits in cooperative banks that comes under the Banking Regulation Act.
- Government of Kerala's Deposit Insurance Scheme is applicable to deposits in all primary agricultural cooperative societies.
- Cooperative Banks which are operating based on the Banking Regulation Act are mandated to follow KYC norms instructed by Reserve Bank of India.
- It is mandatory for the primary agricultural cooperative societies to follow KYC norms as instructed by the Registrar of Cooperatives.
- There are rumours spreading about deposits in cooperative banks and societies. To overcome the current crisis, people should keep faith in the measures announced by Government of Kerala.
- Spread awareness about the importance and relevance of the cooperative sector which is the democratic institutions of people's movements.
- To execute the process, squads shall be created at panchayat ward level for each society and maximum numbers of cooperators and employees shall be made members of these squads.
- Persuade each family to make a new deposit worth of Rs 1000 with cooperative bank.

- Prepare necessary pamphlets based on the decisions taken at the State/district/society level conventions and distribute them among people.
- Boards and other publicity materials can be used at the society level.

Review meetings should be conducted at the bank level before December 22. Detailed statistical analysis based on the collected data is to be done at the review meetings. Bank level review meeting reports should be made available to the concerned Assistant Registrar before 5 PM, December 23. Review meetings at the taluk level should be held before December 24 and assessment reports should be made available with the respective Joint Registrar (General) before December 26.

District level review meetings should be organised before December 28. Joint Registrars (General) have to submit the reports of district level review meetings before December 30 to the Registrar of cooperative societies.

Joint Registrar (General) has to take necessary actions regarding the campaign to protect cooperative sector by deploying departmental staff, dividing responsibilities in consultation with Joint Director (Audit).

Sd/-

S. Lalithambika I.A.S

Registrar of Cooperative Societies

// By Order //

Deputy Registrar (Credit)

Structure of State, District, Taluk Society Level Monitoring Committee

State Level Committee

1.	Hon.ble Minister for Cooperation	Patron
2.	Chairman, State Cooperative Union	Patron
3.	President, State Cooperative Bank	Chairman
4.	Government Secretary	Member
5.	President, State Cooperative Agriculture and Rural Development Bank	Member
6.	Cooperative Audit Director	Member
7.	Managing Director, Kerala State Cooperative Bank	Member
8.	Managing Director, State Cooperative Agriculture and Rural Development Bank	Member
9.	Presidents, District Cooperative Bank	Members
10.	Chairman/General Secretary, Kerala Urban Cooperative Bank Federation	Member
11.	President/Primary Cooperative Societies Association	Member
12.	Registrar, Cooperative Society	Convenor

District Level Committee

1.	President, District Cooperative Bank	Chairman
2.	Chairman, Circle Cooperative Union	Member
3.	3 Employees' Representatives (District Joint Registrars (General) shall select district level representatives)	Members
4.	President's, Primary Agriculture and Rural Development Bank	Members
5.	Manager, District Cooperative Bank	Member
6.	District President/Secretary, PACS Association	Member
7.	Joint Director (Audit)	Member
8.	Assistant Registrars (General)	Members
9.	Assistant Directors (Audit)	Members
10.	Joint Registrar (General)	Convenor

Taluk Level Committee

1.	Chairman/Officer, Circle Cooperative Union	Chairman
2.	Presidents of all PACS	Members
3.	Presidents, Taluk Urban Banks	Members
4.	Assistant Director (Audit)	Member
5.	Assistant Registrar (General)	Convenor
6.	President, Primary Agriculture and Rural Development Bank	Member
7.	Valuation Officer, Primary Agriculture and Rural Development Bank	Member
8.	Executive Officer, District Cooperative Bank	Member
9.	Branch Manager, District Cooperative Bank	Member
10.	3 Representatives from PACS (Assistant Registrar (General) shall select representatives)	Members
11.	Presidents, Other Category Cooperative Societies (Circle Cooperative Union shall nominate)	Member

Society Level Committee

1.	President, Primary Cooperative Society/Bank	Chairman
2.	Members, Society/Bank Governing Body	Members
3.	Unit Inspector, Cooperative Society	Members
4.	Representatives, Kudumbasree/SHG	Member
5.	Society Secretary	Convenor

Copy to

1. Registrar, Kerala High Court, including Covering Letter, Ernakulam
2. Secretary, Kerala Legislative Assembly, including Covering Letter
3. Director, Co-operative Audit, Office of the Audit Director, Vikas Bhavan, Thiruvananthapuram
4. Managing Director, Kerala State Cooperative Bank, Thiruvananthapuram
5. Managing Director, Kerala State Cooperative Agricultural Rural Development Bank, Thiruvananthapuram
6. All Joint Registrars (General)
7. All Joint Directors (Audit)
8. All Assistant Registrar (General) (through Joint Registrar (General)

9. All Assistant Directors (Audit) (Through Joint Director (Audit))
10. Primary Cooperative Societies/Banks/Urban Banks/Employees' Cooperative Societies (through Joint Registrar (General)
11. Primary Agricultural Rural Development Banks (through Joint Registrar (General)
12. Non-credit cooperative societies that accepts deposits from members (through Joint Registrar (General)
13. General Managers, all district cooperative banks
14. Editor, Cooperative Veedhi/Cooperative Journal
15. Website
16. All officers in the office
17. Stock File/ Spare