Demonetization effect on Co-operative Banks in Kerala

Mr. Moncy Kuriakose
Assistant Professor, MBA, Girideepam Business School

Mr. Sarun Jacob
Assistant Professor, BBA Department, GIAL

Abstract

Demonetization of Indian Rs 500 and Rs 1000 was implemented on 8th November 2016 in India with the aim to stop counterfeit current banknotes allegedly used for funding terrorism, as well as a crack down on black money in the country. The sudden withdrawal of currency not only had an impact in every sector of industry but also on every person's life. The effect of demonetization on different sectors was different. Further, the impact of such a move depended on the government remonetisation policy. Under the supervision of RBI banks got effected by the demonetization to some extent only but the working of co-operative banks in Kerala was severely effected. This paper elucidates the effect of such a move on co-operative banks in Kerala.

Keywords: Demonetization, Co-operative Bank

Introduction

Demonetization

Demonetization of currency means discontinuity of the particular currency from circulation and replacing it with a new currency. In the current context it is the banning of the 500 and 1000 denomination currency notes as a legal tender.

Objectives behind Demonetization

The government's stated objective behind the demonetization policy are as follows;

1) It was an attempt to make India a corruption free nation.

2) Another objective was to wipe out the fake currency from the Indian market. Counterfeit bank notes were largely in circulation and that the use of fake currency notes was causing adverse effect to the economy.

3) It was done to curb black money. High denomination bank notes were used for storage of unaccounted wealth as evident from the large cash recoveries made by law enforcement agencies.

4) To control escalating price rise by reducing the flow of money in the market.

5) To stop flow of funds to illegal activity. Fake currency were causing damage to the economy and security of the country by financing subversive activities such as drug trafficking and terrorism.

6) To make people accountable for every rupee they possess and pay income tax return.

7) Finally, it is an attempt to make a cashless society as digital transaction was promoted.

There is a background to the current decision of demonetization of 500 and 1000 rupee notes. The government has taken few steps in this direction much before its November 8, 2016 announcement.

As a first step the government had urged people to create bank accounts under Jan Dhan Yojana. They were asked to deposit all the money in their accounts and do their future transaction through bank only.

The second step that the government initiated was a tax declaration of the income and had given October 30, 2016 deadline for this purpose. Through this method, the government was able to mop up a huge amount of undeclared income.

However, there were many who still hold the black money and in order to tackle them, the government opted for the demonetization of 500 and 1000 currency notes.The demonetization policy is being seen as a financial reform in the country but this decision is fraught with its own merits and demerits.

Positive impact of Demonitization

- It will help the government to fight Black money, corruption, terrorism and counterfeit currency with one single decision.
- Arms smuggling, espionage and terrorist related activities will be choked due to lack of funding.
- Counterfeit currencies are being used for funding terrorism which is being operated by the terrorist supporting agencies in India. Now Govt has taken a bold move which enables them to fight counterfeit currency/terrorist funding activities.
- People will do more digital transactions than cash transactions.
- FIU of India get information about high amount transactions from banks.
- This step would give the Indian real estate sector more credibility making it more attractive to the foreign as well as domestic investors.
- Housing prices could witness downward pressure, helping revive demand in the sluggish housing segment

Negative impact of Demonitization

- It caused inconvenience to common people to exchange their 500 and 1000 currency notes by standing in long queue in the bank. Also faced inconvenience in withdrawing their money for their personal emergency purpose like marriage etc.
- Additional cost burden for RBI for printing new currency notes, transportation, increased costs of operating ATMs (since they would need to be refilled more often) and of handling money in general.
- More than half of the population who were not well versed with the digital/card transactions faced difficulty .
- This move deeply impacts the working sections of society: drivers, maids, cooks, electricians, plumbers. Anybody who provides services in the informal sector and depends on monthly or bi-monthly cash payments.
- The small businesses were affected at least for shorter run due to transaction restriction.

Co-operative Bank

Co-operative banks have their own salient and distinctive features. They are set up with built-in-safeguards but are handicapped by serious infirmities. At the very outset, it is 'worthy of stating that they are different from other banks and co-operative societies. Co-operative Banks are those banks which are registered under the co-operative Societies Act 1904 and are controlled by the provisions of the Banking Regulation Act.

Brief History

The concept of co-operative banking in India was first introduced in the year 1904, when the first Co-operative Credit Societies Act was passed. The Act gave a legal status to the credit societies. The first urban co-operative credit society was registered at Conjeevaram in Madras province. This was followed by the registration of one society each in Dharwar District and Bangalore city. The development of urban co-operative credit societies did not receive much attention till 1915.
when the Maclagan Committee referred to the potentialities for the organisation of such societies as a means for training the upper and middle urban classes in ordinary banking principles. The failure of several local joint stock banks in the country at that time gave sufficient impetus to the growth of urban co-operative credit societies. It was then realised that urban credit societies are the institutional agencies best suited for collecting local savings and for offering relief to those who were in the clutches of money lenders, by providing them with financial accommodation.

However, the rapid growth in the operations of Co-operative Banks made it necessary to bring them under the purview of the Reserve Bank of India. In addition, the statutory control by the Reserve Bank of India was a pre-requisite for extending the benefits of Deposit Insurance

Scheme to the Co-operative Banks. In view of these considerations, the Banking Laws (applicable to co-operative societies) Act, 1965, was enacted to extend the operations of certain provisions of the Reserve Bank of India Act. 1934, and the Banking Companies Act, 1949, to Co-operative Banks. As a result, the Banking Company's Act 1949 was renamed as the Banking Regulation Act 1949. It came into force on 1st March 1966.

Thus the enactment of the Act has vested the Reserve Bank of India with various statutory powers of control and supervision over the Co-operative Banks. But, the Registrar of Co-operative Societies of the state concerned continues to be the authority to decide matters regarding incorporation and management of these banks. Further the provisions of the Act are in addition to the existing rules and regulations of these banks. Thus Co-operative Banks are required to comply with the provisions of the Banking Regulation Act as well as other laws applicable to them. But in respect of matters specifically provided for in the Banking Regulation Act, the provisions of the said Act will prevail over the provisions of the Co-operative Societies Act. However it is worthwhile to note that a lion's share of the registered co-operative societies do not come under the purview of Reserve Bank of India and the Banking Regulation Act.

3 Tier Structure

The Co-operative Banking System in India consists of 3 tiers in a state set up - State Apex Bank or State Co-operative Bank, Central Banks or District Co-operative Banks and Primary Co-operative Banks at the basic level. The co-operative network in Kerala includes 14,896 co-operative societies functioning under the State Registrar of Co-operative Societies (RCS) out of which 11,565 are active, 2,665 are dormant and 666 face a threat of liquidation, because of - as detailed by the Kerala Economic Survey - poor governance and management, lack of professionalism, operational inefficiency and obsolete infrastructure.

Demonetisation and co-operative banks

Demonetisation had effected the functioning of co-operative banks in Kerala, not only in the account related transactions but also in the payment and repayment of loans.

In Kerala it is normal practice that people deposit their entire earning form their service tenure in co-operative bank account as fixed deposit for earning high interest earnings because co-operative banks always offer high fixed deposit rate. The other reason for depositing money in co-operative banks is that it is in their native place; it does not require a lot of documentation and does not need the tedious process of the fulfillment of KYC norms. So if a man goes to deposit money, normally the manager knows everyone, even if he does not he can just ask some local people as everyone knows everyone and the accounts are opened by depositing the money.
Co-operative banks came into being during Jawahar Lal Nehru’s time and are an accepted financial model. An attempt to end the co-operative banking system was made during the globalisation period, but the co-operative banks went to the Supreme Court and got relief. It is by that time only the co-operative bank obligated to inform as a norm for cash deposit of more than 25 lakhs to the income tax (IT) department. And all banks are complying with this order. So obviously income tax or evasion of tax was not an issue, they are functioning within the guidelines.

There was a huge increase in the deposits in co-operative banks in the past decade hence the Income-Tax department put the co-operative banks under their scanner. However, their attempt to gather details of the deposits was resisted by the banks. A section of the banks even approached the Supreme Court against I-T scrutiny. The department investigation revealed that co-operative banks were the favourite channel for the real estate mafia, hawala dealers, corrupt officials and even politicians. They find it easy to deposit up to Rs 10 lakh in primary co-operative societies as they don't have to report it to the RBI and Income -Tax department. If the amount is higher, the banks help them in depositing money under fictitious names. Demonetisation of currency and restriction of transaction in co-operative banks was aimed at exposing these loopholes of co-operative banks.

In the case of co-operative banks the normal practice is that they don't file the STR (Suspicious Transaction Report), even if the cash deposit is above 10 lakhs. Whereas the other scheduled banks are under the obligation to report the same to the tax departments. As a practice they are creating fictitious account and deposit the surplus amount in different names. The co-operative banks are operating in conventional way, where they are not much exposed with the counterfeit detection machines. This will indirectly help the counterfeit notes to get circulate in the system. In the case of co-operative societies the norms like CRR and SLR are not practiced as a result they will tend to lend the maximum and there by the interest of the depositors may be at risk. In addition the borrowers may be charged higher interest in the loans disbursed by co-operative banks. All these easy going concepts in the operation of the co-operative banks got affected and the entire operation has changed with the implementation of demonetization.

What has happened after demonetisation is that lakhs of rupees are frozen in co-operative bank accounts, money that people have saved for a particular purpose say they have to get their daughter married or build a house – now that purpose has got jeopardised. They cannot withdraw that money out due to the restrictions imposed on the co-operative banks. Co-operative banks were not keeping the money with themselves. They were giving easy loans and now they also want the money, so they have to go to the district banks, but they are being considered as individuals and not institutions and are bound by the weekly withdrawal limit of Rs 24,000 only. This entire demonetisation policy and imposing of restrictions effected the functioning of co-operative banks. There is over 1,25,000 crore of rupees frozen in co-operative banks. People have so much faith in the system that they are even now depositing the money with their co-operative banks. As and when the information about demonetization came a lot of people who are having unaccounted money deposited the same in co-operative banks and the idle funds ultimately affected the profitability.

In the case of loans also the co-operative banks was not able to pay the money on the disbursed amount, as they don't have sufficient fund to give the cash to the customers. And again in the case of interest payment on loans also there was huge default. As the primary class who got affected by demonetization was low income groups, who largely rely on the cooperative banks for their financial requirements,started to find it difficult to get cash for the repayment.

Conclusion

In spite of the initial hiccups and disruptions, eventually demonitization will be well assimilated and will prove positive for the economy in the long run. Black money hoarders will definitely lose out, eventually boosting the formal economy in the long run. But its effect on the functioning of co-operative banks in kerala was bad. The collateral damage is most pronounced in Kerala because of the sheer expanse and outreach of the co-operatives in the state and the often disproportionate influence it has come to wield in everyday life, specifically for those excluded from mainstream banking facilities. Co-operative are the front runners of the idea of financial inclusion, even before RBI and the government start to think about the concept of financial inclsion. If the same system is misused for money laundering and tax-evasion, it has to be stopped. Hence in order to catch the black money hoarders without effecting the functioning of co-operative bank, the government should have framed the separate norms for implementing demonetization in co-operative banks. Rather than putting a temporary stop in the operation of the co-operative societies, leverages like including co-operative societies in the currency exchange process having some periodic reporting mechanism to nodal officer, special relaxation on the withdrawal limit by considering it as an organization and relaxation in the cash acceptance limit could have been provided, so that the problems faced by the rural Indian population could be eased to the maximum possible level.

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