

DEMONITIZATION AND ITS EFFECTS

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ABSTRACT

Demonetization is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency.

The opposite of demonetization is remonetization, in which a form of payment is restored as legal tender.

The Government of India has implemented a major economic decision of demonetizing high value currency notes of Rs. 500 and Rs. 1000. The rationale given behind this is that it would curb black money and its flow as most of it would get invalidated. This proposition, however, is not backed by any evidence or proof and therefore portends distinct long-term, medium-term and short-term complications. This makes it imperative to assess the challenges such a shock is expected to have on functioning of the Indian economy, which may vary according to the extent of re-monetisation that would follow-up. This paper tries to explain the repercussions of such a move on the obtainability of credit, spendings and extent of economic activities, particularly in India. The research conducted has a descriptive and analytical nature to it. The paper also seeks to elucidate the implications of demonetization in developing economies like India.

Keywords: Demonetization, Black Money, Counterfeit Currency, Corruption, Budget 2017, Remonetization.

➤ OBJECTIVES

The main objective of this paper is to study the impact of demonetization, its attack on black money, concept of less-cash economy, create bigger tax base.

➤ **METHODOLOGY**

The paper is based on the secondary data. The secondary data was collected from various published sources like journals, reports, magazines, newspapers and the like etc.

➤ **INTRODUCTION**

The Prime Minister Narendra Modi announced the demonetization of India's two largest currencies Rs.500 and Rs.1000 and it has been changed with new Rs.500 and Rs.2000 notes. This covers all the details about this great milestone event in the Indian economy which is currently the 7th Largest with a market capitalization of \$ 2.25 trillion to curb the menace of black money. Process of removing a currency from general usage, or circulation is known as demonetization. For example, gold was demonetized in this way when it ceased to be used as an everyday currency. The Indian rupee (INR) is the official currency of India. The recent sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. Rs 1,000 and higher denomination notes were first demonetized in January 1946 and again in 1978. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data. To check undisclosed black money, corruption and fake currency the Government of India on the 8 November 2016 announced demonetization of high denomination currency notes Rs 500 and Rs1000. A new redesigned series of Rs 500 and Rs 2000 banknote is in circulation since 10 November 2016.

➤ **HISTORY AND BACKGROUND**

The sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. Rs 1,000 and higher denomination notes were first demonetized in January 1946 and again in 1978. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data. Rs 1,000 and Rs 10,000 bank notes were in circulation prior to January 1946. Higher denomination banknotes of Rs 1,000, Rs 5,000 and Rs 10,000 were reintroduced in 1954 and all of them were demonetized in January 1978.

The Rs 1,000 note made a comeback in November 2000. Rs 500 note came into circulation in October 1987. The move was then justified as attempt to contain the volume of banknotes in circulation due to inflation. However, this is the first time that Rs 2,000 currency note is being introduced. While announcing currently circulated Rs 500 and Rs 1,000 notes as invalid from midnight 8 Nov, Prime Minister Narendra Modi said new Rs 500 note and a Rs. 2,000 denomination banknote will be introduced from November 10.

Bank notes in Ashoka Pillar watermark series in Rs 10 denomination were issued between 1967 and 1992, Rs 20 in 1972 and 1975, Rs 50 in 1975 and 1981 and Rs 100 between 1967-1979. The banknotes issued during this period contained the symbols representing science and technology, progress and orientation to Indian art forms. In the year 1980, the legend Satyameva Jayate — ‘truth alone shall prevail’ — was incorporated under the national emblem for the first time.

In October 1987, Rs 500 banknote was introduced with the portrait of Mahatma Gandhi and Ashoka Pillar watermark. Mahatma Gandhi (MG) series banknotes – 1996 were issued in the denominations of Rs 5, (introduced in November 2001), Rs 10 (June 1996), Rs 20 (August 2001), Rs 50 (March 1997), Rs 100 (June 1996), Rs 500 (October 1997) and Rs 1,000 (November 2000).

The Mahatma Gandhi Series – 2005 bank notes were issued in the denomination of Rs 10, Rs 20, Rs 50, Rs 100, Rs 500 and Rs 1,000 and contained some additional/new security features as compared to the 1996 MG series. The Rs 50 and Rs 100 banknotes were issued in August 2005, followed by Rs 500 and Rs 1,000 denominations in October 2005 and Rs 10 and Rs 20 in April 2006 and August 2006, respectively. Impact of Demonetization

1) **Black Money and Corruption**

By demonetization, Black money will be taken out of Indian system. As predicted by ICICI Securities Primary Dealership the government's plan to remove INR 500 and INR 1,000 notes from circulation will disclose up to INR 4.6 lakh crore in black money. Corruption will also be automatically reduced by removing black money from economy.

2) **Funding**

Funding for smuggling and terrorism will take a blow since all the money will get back to bank and from there it is easy to identify the fake currency. Demonetization thus affects the funding of terror networks in Jammu and Kashmir, North-eastern states and the other areas.

3) **Real estate**

Another impact of the demonetization would be reduction in cash transactions in real estate. This is likely to reduce to real estate prices and make it affordable. In the short term, prices of real estate would come down for the same reason above. There will be fewer suitcases moving.

4) **Elections**

Demonetization has shocked political parties. Many states like Punjab and Uttar Pradesh, cash donations are a huge part of "election management". Political parties will find themselves helpless as cash hoards are often undeclared money. So upcoming elections 2017 will be transparent to the some extent.

5) Gold/Silver and Jewellery

After demonetization the demand for gold and other precious metals rise greatly. Because people are trying to invest their black money in gold to make it white in short period. But demand for gems and jewellery to decline in the next two to three quarters.

6) Digital payments

People adopting online payments system such as Paytm etc. after ban for high denomination currency in India. Digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), etc. will definitely see substantial increases in demand. This behavioural change could be a game changer for India in the near future.

7) Fake Currency

The impact on the fake currency would be more significant. Many dealers with the existing counterfeit notes would be trapped as they would have to take the notes to the bank and have better chances of getting their racket exposed. Thus, they have only option to destroy their notes and incur losses.

8) GDP

The sudden decline in money supply and increase in bank deposits is going to adversely impact consumption demand in the economy in the short term. This, coupled with the adverse impact on real estate and informal sectors may lead to lowering of GDP growth.

9) Markets

There will be positive move in markets in long run that could bring confidence of overseas investors in Indian stock markets. Market goes a bit down in the short and medium term. India is still a very attractive destination on a longterm basis. It is not the best market in the next three months.

10) Decrease in Interest Rates

We will see a lowering interest rates for education loans, home loans and medical loans very soon. It will make higher education and medical facilities more accessible. This change is hard to undo because if any subsequent government increases loan it will suffer huge backlash.

11) Lower Inflation

As the black money goes out of the system the money supply will shrink to some degree. This will reduce inflation rate in the absence of any open market interventions by the Reserve Bank of India

➤ Effects of Demonitization

Demonetisation hit India's economic activity in the period following the November 8, 2016, event but the impact had dissipated by the summer of 2017.

- 1) The immediate impact of these measures has been a decrease in cash liquidity, which may cause a short term reduction in the purchase and trade in securities by the public.
- 2) Demonetisation is not as end in itself. Rather, it's a conduit for India to become a less cash economy at first and a cashless economy later.
- 3) As 86% of currency is now striped off, this will lead to a cashless economy. Going cashless has its own range of advantages.
- 4) Any slowdown in the Indian economy or reduction in investment in securities in India as a result of this may adversely affect our business, results of operations, financial condition and prospects
- 5) This will reduce the total currency circulation in the economy - leading to deflation. Deflation increases the value of money that we have because the total money supply goes down but the commodities and things available in the market have not gone down.
- 6) It will help the government to fight Black money, corruption, terrorism and counterfeit currency with one single decision.
- 7) Counterfeit currencies are being used for financing terrorism which is being run by the enemy in India. Now Govt has taken a bold move which enables them to fight counterfeit currency/terrorist funding activities.
- 8) With the new limits on ATM withdrawals being restricted to Rs 2,000 per day, withdrawals from bank accounts limited to Rs 10,000 a day and Rs 20,000 a week, it will drive the card payments across the country.

- 9) It will be easy for the Government to track the money being exchanged as exchange can only be done by producing a valid government identity cards like PAN, Aadhaar and Election Card from 10 to 24 November with a daily limit of Rs 4000. There is no limit on the amount as long as it is legal.

Demonetization in Union Budget 2017

Negative effects of demonetization not expected to be felt in 2017-18. Surplus liquidity due to demonetization will lower borrowing cost and increase access to credit. This will lead to growth.

➤ Conclusion

The study, which focused on the short-term consequences, noted that longer-term consequences may include higher tax revenue and a shift to digital modes of payment.

“There may be longer-term advantages from demonetisation that arise from improvements in tax collections and in a shift to savings in financial instruments and non-cash payment mechanisms,”

It can be said that this is a historical step by the Modi Govt. and should be supported by all. This decision of govt. will definitely fetch results in the long term. From an equity market perspective, this move would be positive for sectors like Banking and Infrastructure in the medium to long term. This could be negative for sectors like Consumer Durables, Luxury items, Gems and Jewellery, Real Estate and allied sectors, in the near to medium term. This move can lead to improved tax compliance, better fiscal balance, lower inflation, lower corruption, complete elimination of fake currency and another stepping stone for sustained economic growth in the longer term.

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