

STUDY OF IMPLICATIONS OF DEMONITIZATION OF CURRENCY IN INDIA

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There will be excess fake currency in the economy is main reason of demonetization. India has demonetized before as well. It was done for the first time on 12 Jan 1946, second time on 16 Jan 1978 and third time on 8th November 2016. The paper focuses on analyzing basic reasons for implementation of demonetization in India and its overall impact of demonetization

INTRODUCTION

'Cashless economy'-a dream that almost every young Indian dreams of may be a reality in coming few years. The present Prime Minister's demonetization intervention affected 85% of the money in circulation in India. It was an unprecedented move, whether in India or almost anywhere else, and it is by far Prime Minister's boldest policy intervention to date. Demonetization is an established practice in monetary policy to tackle black money. Demonetization is a process by which a series of currency will not be legal tender. The series of currency will not acceptable as valid currency. There can be many causes of Demonetization in any economy some of them are Introduction of New Currency, Black Marketing, Currency Storage. There will be excess fake currency in the economy is main reason of demonetization. The French were the first to use the word Demonetize, between 1850-1855. India has demonetized before as well. It was done for the first time on 12 Jan 1946, second time on 16 Jan 1978 and third time on 8th November 2016. The first was when Rs1,000, Rs5,000, and Rs10,000 notes were taken out of circulation in January 1946, a year and a half before the country won independence from the British. The Rs10,000 notes were the largest currency denomination ever printed by the Reserve Bank of India, introduced for the first time in 1938. All three notes were reintroduced in 1954. At the stroke of the hour on midnight of 9th November 2016, India lost 86% of its monetary base. In this single move, the Government has attempted to tackle all the three issues affecting the economy i.e. a parallel economy, counterfeit currency in circulation and terror financing.

LITERATURE REVIEW

According to **Madan Sabnavis & Anushka Sawarkar (2016)**, with cash transaction lowering in the short run, until the new notes are spread widely into circulation, certain sections of the society could face short term disruptions in facilitation of their transactions.

As per an article, since the Republic of India took birth and even before, paper currency in the subcontinent had been periodically transformed to reflect the needs of the time. (**Adrija Roychowdhury, 2016**)

Abhiroop Sarkar (2016) puts up his view that since people don't stash black money in cash, rather, they stash it in undisclosed accounts in Swiss Banks. so the demonetization won't affect the biggest fish.

This move by the government is likely to have long term benefits for the economy. The extinguishing of the major proportion of unaccounted currency would reduce from the liabilities of the government and would add to its finances. This can have very strong implication as the government would get money to spend without borrowing from the market. This would mean that while interest rates can be low, the government spending on large infrastructure (we assume that the government would use large proportion for infra spending) projects would kick-start capex cycle and push economic growth higher in the medium term. **(HDFC Bank Investment Advisory Group, 2016)**

According to **Girish Vanvari**, demonetization appears to be the most significant change made by the Modi government to date.

Digital wallet providers like MobiKwik and Freecharge have seen enormous jumps in activations; market leader Paytm, already well positioned thanks to its user engagement strategies and Alibaba backing, has gained 20 million customers. Yet digital wallets, and their effect on local vendors, are just the beginning. In the background, digital wallets are helping to construct an infrastructure that will better support credit and e-commerce, two areas in which India has been lagging behind Western economies and rival China. **(Ainsley O'Connell)**

OBJECTIVES OF THE STUDY

The paper focuses on the following objectives:

1. Basic reasons for implementation of demonetization in India
2. Overall impact of demonetization on different sectors of the economy.

METHODOLOGY OF THE STUDY

Till now not much work has been taken up in relation to this topic. So, basically the paper is based on the data and information collected through secondary sources like, newspapers, magazines, official speeches, articles, TV news channels, etc.

ANALYSIS AND INTERPRETATION

➤ Reasons for demonetization in India

In a single master stroke, the government has attempted to tackle all three malaise's plaguing the economy—a parallel economy, counterfeit currency and terror financing. Since it is a Government decision, we have to go by the Prime Minister's announcement that it's for curbing black money, fake money and terror money. There are several theories doing round in social media and public and private discussions. There is another opinion circulating in social media that it was done to check mate Pakistan's effort to print 15 trillion fake Indian money and push into Indian economy. There are also people who feel that the sole aim was to wipe out bank's deficits created by NPAs of big business houses. The specific reasons were found to be:

- 1) To tackle black money in the economy.
- 2) To lower the cash circulation in the country this is directly related to corruption in our country.
- 3) To eliminate fake currency and dodgy funds which have been used by terror groups to fund terrorism in India.

➤ **Impact Of Demonetization On Various Sectors**

The aim behind the government's action was to combat tax cheating, counterfeiting and corruption. Eliminating large denominations makes it harder to hide large amounts of cash. The issue of black money in the past has been in debate vehemently during a number of elections, mostly pointing towards the cash stacks hidden in Switzerland & other foreign countries. However in the recent past the focus on the same closer home has helped the government raise nearly \$10 billion through a tax amnesty for Indians to declare hidden income and assets. The key motive of demonetisation was to improve the economy, especially in long-term. As a result of the demonetisation, the public has been forced to deposit massive amounts of money, helping to fill Bank coffers with an unprecedented amount of money in record time. Conversely, the value of Indian Rupee is at one of its lowest and may even drop further to Rs 70 per US Dollar. Economy will become more organized, transparent and cash-less, all long-term benefits. In comparison, developed countries use around 4% cash on a day-to-day basis, while India functions on a 12% cash based system. Short-term however, the transition from cash economy to cash-less will be an immense undertaking. Demonetization is a generations' memorable experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. Demonetization affects the economy through the liquidity side. Its effect will be a telling one because nearly 86% of currency value in circulation was withdrawn without replacing bulk of it. As a result of the withdrawal of Rs 500 and Rs 1000 notes, there occurred huge gap in the currency composition as after Rs 100; Rs 2000 is the only denomination. Demonetization as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn't have the digital transaction culture. Overall economic activities will be dampened in the short term. But the un-measurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

Impact on Real Estate: The government's surprise move to clamp down on black money hoarders through the ban on Rs 500 and Rs 1,000 currency notes is expected to have a cooling effect on certain pockets of the residential market in the country. The luxury and high-end segments of residential real estate will also see a major impact from this exercise, since it is another area which has seen a lot of payments done in cash. The legal banking/financing channels have accounted for only a small part of all transactions in this space. The demonetization move is likely to result in luxury property prices dipping by as much as 25-30% as sellers struggle to offload properties to generate liquidity. This means that luxury home buyers will suddenly have a much wider bandwidth of options to choose from. The real

estate sector will definitely be affected by the demonetization exercise, as it has traditionally seen a very high involvement of black money and cash transactions.

Impact on Stock Market: It does look as if demonetization hasn't really affected the overall market much and investors believe the impact is temporary, with lower interest rates and more government spending offsetting any adverse effects. In the long term, the mutual fund industry will benefit from scrapping of 500 and 1,000 rupee notes.

Impact on Agriculture: Cash is the primary mode of transaction in agriculture sector which contributes 15% to India's total output. Formal financing in many parts, especially Punjab, Uttar Pradesh, Odisha, Maharashtra, Gujarat and Kerala is significantly from cooperative banks, which are barred from exchange-deposit of demonetized currency. Notably, this was a time of kharif harvest and start of rabi sowing, partly explaining why this period is dubbed the 'busy season' from a standpoint of credit demand, the other being bunching of festivals and weddings. Agriculture is impacted through the input-output channels as well as price and output feedback effects. Sale, transport, marketing and distribution of ready produce to wholesale centers or mandis, is dominantly cash-dependent. Disruptions, breaks in the supply chains, increased wastage of perishables, lower revenues that show up as trade dues instead of cash in hand and when credited into bank accounts with limited access affect the sector.

Impact on black money and corruption: The biggest mission of demonetization is described as fighting black money. India's economy historically holds a big parallel economy where unreported income is the norm. Immediate effect of demonetization comes through the netting of black money deposited in the banking system in the form of banned Rs 500 and Rs 1000 notes from November 10 onwards. Around Rs 12 lakh crore of the Rs 15.44 lakh crore demonetized currency is with banks now and the extent of black money identified out of this will be the direct effect. Here, it is believed that an estimated Rs 1.5 to 2 lakh crore may be identified as black income. Out of this, around Rs 1.2 lakh crores may be collected as taxes at 50% to 85% tax rate. If Rs 2 lakh crore is revealed as black money out of demonetization, it will amount to around 1.75% of India's GDP. According to National Institute of Public Finance and Policy (NIPFP), black income amounts to nearly 40% of the country's GDP. The long-term effect will be much impactful and depends considerably upon how government deploys more measures to depress the shadow or black economy. 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.

Impact on Rural India: The rural economy is an important segment of the ecosystem and accounts for around 70 percent of employment and 50 percent of GDP with agriculture being the main driver followed by services and manufacturing. It is largely unorganized and hence those working in rural India or consuming in this economy are a different category of economic agents driven by different factors. The economy is quite complex in so far as the fact that cash dominates in terms of transactions and while there has been some intrusion of the use of credit (kisan) and debit cards and ATMs, dependence on technology driven payments system is limited. This has hence also become a haven for routing black money both in terms of seeking tax exemptions by channelling funds, to convert to legitimate funds. But a lot of black money gets into land and 'apparent rural activity'. The recent demonetization has caused

significant distortions as farmers are unable to sell their goods. The penetration of banks in rural areas is remarkable. Almost 65 percent of branches are in rural and semi-urban areas with around 38 percent in just the rural segment. The problem is not infrastructure but the blockages caused by the inability of banks to deliver cash in adequate quantities and denominations on time.

Impact on Business: Small Businesses both in urban & rural areas will feel the heat as these are mostly run via cash transactions. Also with the rise in NPA banks will be averse to fund these businesses even for a short period of time. Businesses with cash transaction will now have to rely on funding from other sources and might end up paying a lot more.

Impact on Automobile Sector: Demand dipped for a couple of months for two-wheelers, but passenger vehicles and tractors were less impacted. In the two-wheeler industry, around 35-45% purchases are made via financing, while the rest are through banked cash, or are simply "unaccounted". But in the passenger vehicles segment, close to 75%-80% of sales are either through financing, or even down payments are made mostly by cheques -so this segment could face less heat. As for tractors, close to 65% of the purchases are financed, therefore the impact of cash squeeze could be minimal.

Impact on 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.

CONCLUSION

The demonetisation announced by Prime Minister Narendra Modi rendering currency notes of Rs 500 and Rs 1000 as invalid legal tender came as a shock to the country. The desired effect of the demonetisation is to reduce corruption, black money, counterfeiting and terrorist funding, but like any medicine, demonetisation also comes with side-effects. The social impact of demonetisation is the top concern for politicians queuing up to protest about the difficulties the common man is facing. Indeed, the social impact is the most major visible impact of demonetisation. People who do not use 'plastic money' such as credit cards, debit cards or online banking will not have usable money for basic necessities. Small time merchants and business persons without plastic money cannot buy further stocks. Small time shops and independent services like transport that do not accept other methods of payments will lose business. Daily-wage earners would not get money. As situation improves, it will still take time for sufficient amount of usable currency enters the market and/or the market adapts to a more cash-less style of functioning.

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