



DEMONETIZATION A BIG LEAP FOR INDIA

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ABSTRACT:

Demonetization is one of the boldest movements taken by Indian government. The ban of high value currency notes of Rs. 500 and 1000 has received mixed reactions. Some sections are opined that it can cause hardships for common people and some sections are reacted to this decision with overwhelming support. But the sudden purge of 86% bank notes in circulation is bound to create some hassles for the general public. This scheme has impacted the businesses, common people and financial institutions along with multi-diverse background in India. This paper attempts to provide an overview of demonetization in India and tries to elucidate the impact of demonetization which has created decrease in demand and consequently a decrease in growth of Indian economy.

Keywords: Demonetization, Impact, Indian government, Common people, Demand, Decrease in growth.

INTRODUCTION:

Demonetization is an economic term which is used to mean the scrapping of old currency notes and stripping them off their status of legal tender, usually when a new currency note or currency is being introduced in the economy of the world for different reasons. In a surprise move, the Indian Prime Minister, Narendra Modi in his address to the nation on November 8, 2016 declared the demonetization of the Indian Rs. 500 and Rs.1000 currency notes with the effect midnight of November 8. The Reserve Bank of India manages currency in India Act, 1934 and a new redesigned series of Rs. 500 banknote, in addition to a new denomination of Rs. 2000 banknote in circulation since November 10, 2016. The new redesigned series also in circulation introduced to the banknote denominations of Rs 2000, Rs 100 and Rs 50. The term demonetization is not new to the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the Rs10, 000 notes in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data. But less than 5 percent population in India had access to such notes thus demonetization didn't have a big impact on the country. However the latest surprise move of demonetization, the common public and bankers are facing hardship since more than 85 percent of currency in circulation has been rendered illegal in one stroke.

PURPOSE OF DEMONETIZATION

The main reason for the ban to for certain people with illegal cash holdings to deposit the money into bank accounts and pay taxes on them. According to Kaushik Basu, former chief economic adviser to the Indian government, noted at the New York Times, the most reliable estimate of India's "shadow economy", or the untaxed part of it, puts it at 1/5 of country's GDP. The government recently released data that showed in 2013, merely 1% of Indians paid taxes.

The demonetization scheme is also a way to cease criminal activity. It will be hard for people with large cash holdings from purely criminal enterprises to explain how they paid their taxes,

and so they won't be able to deposit their money and the government expects that it can use the ban as an opportunity to round up counterfeit currency minted by terrorist operations.

In addition to all this, the ban also pushes the country towards the transition to a cashless society, harmonizing decently with Modi's bid to digitize services in the economy.

DEMONETIZATION ADVANTAGES

Demonetization as a cleaning exercise which may result in several good things in the economy.

- 1000 and 500 banknotes being invalid legal tender, until the new 1000 and 500 bank notes are widely circulated, money supply will gradually increase
- 500 and 1000 banknotes are expected to be deposited in the banks can increase in banking deposit base. A rise in deposit base may also banks to lower the blended cost of funds as higher current accounts and savings accounts deposits help to replace the high cost of borrowing and lower overall cost of funds.
- Some part of unaccounted money tries to make it's own way into formal channel, aiding the government from higher tax collections. This should help the government's FY17 fiscal deficit target and also enhance the government's ability to tax commercial transactions, a structural improvement in tax-to-GDP ratio in the economy.
- Consumer goods, gold and luxury goods, real estate property sectors are expected to have moderation in demand in the near term from the consumer side and reduction in price levels, assuring the significant amount of cash transactions.
- Reduction in cash transactions pave a way to alternate forms of payment will see a surge in demand, such as online transactions using e-banking ad debit and credit card usage and apps. This will eventually lead to strengthening of systems and the infrastructure for cashless transactions.
- In rural India it is not possible that the ban will decrease GDP growth in the near term . There are also short-term implications for growth in cash-intensive sectors and discretionary household consumption. However, most economists expect the long-term benefits of demonetization on GDP growth.

CHALLENGES OF DEMONETIZATION

Demonetization is a generations' memorable experience and is going to be one of the boldest economic events of our time. But what are challenges being faced, are ahead with the currency ban, this paper makes an effort to find out the challenges

- Absence of intermediate denominations like Rs: 500 and Rs: 1000 reduce the utility of Rs: 2000. Effectively, this will make Rs: 2000 less useful as a transaction currency though it can be a store value denomination.
- Demonetization technically a liquidity shock; a sudden stop of currency availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc.



- This exercise is not a big disaster like global banking sector crisis of 2007, but it will acts as a liquidity shock that disturbs economic activities.
- Demonetization may produce short term, long term, consumption, investment, welfare, growth impacts on Indian economy.
- Taking out 85% liquidity from the economy and slowly replace it by 5%, then the circulation of income goes down. If this situation persists for long period investment will decline and the impact will be for more than a year.
- Replacing the Rs 500 and Rs 1000 notes worth Rs 14.5 lakh crore which had printed over 15 years and have to be replaced very quickly. This is not possible because for this paper and ink largely imported. And ink is in short supply. According to Business Standard, it will take 108 days to replace the old currency, provided there is no shortage of ink or paper. If printing 100 notes then we need to print 10 times more notes than for a Rs 1000 note and that will take lot more time.
- By introducing Rs 2000 notes, the government has made it easier who want to hoard black money in cash as they will. Need only roughly half the space they needed earlier for their Rs 1000 note thus, in this sense this move will give a boost to black economy.
- The argument that the move will spur a cashless economy is flawed. First point is how does replacing Rs. 1000 notes with Rs 2000 ones help make the economy cashless?, second point is merely depriving people of cash doesn't make an economy cashless, only 22% of internet connectivity, 19% of population without electricity connection and only 12 lakhs of 1.4 crores of merchants having point of sale devices, India simply doesn't have the infrastructure for a cashless economy.
- People are desperate for cash so much of work force that should be productively working is wasting long hour in unending queues at the bank ATMS

Unless these real challenges are addressed, withdrawing the bulk of cash only creates chaos as we now see.

DEMONETIZATION IMPACT ON INDIAN ECONOMY

- **Consumer goods are down**

Consumer goods are sharply down. The reason for this suddenly there is a liquidity imbalance in the economy. The gateway is freely open to deposit money in banks but exit gate to take money is constricted. Practical problems like banks running out of cash, servers crashing and ATMS shutting down has only worsened the problem. All this created a cash squeeze in the economy and consumer goods are the worst hit. Considering the uncertainty, most consumers are not willing to splurge too much on their debit or credit cards.

- **Consumption will be hit**

When liquidity shortage strikes, it is consumption that is going to be adversely affected first.

Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓

- **Impact on bank deposits and interest rate**

Deposit in short term may increase but in long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. They saved money to convert the old notes into new notes. Not with the aim of gaining interest. Hence the new savings in banks is only transitory or short-term deposit. It may be encased by the savers at the appropriate time. Most of the savings are obtained by the public sector banks like SBI. They may reduce interest rate in the short term. But can't follow long term.

- **Impact on finance sector**

Banks are making hay with a sharp rise in deposits, the NBFCs, MFIs and other finance companies are feeling the discomfort. MFIs give small ticket loans and hence collect repayments in cash. That window is closed. Even NBFCs collect their EMIs and repayments in cash. That is not possible any longer. The liquidity squeeze has in fact pushed many smaller finance companies to the brink of default. Larger MFIs like Ujjain have already warned of a payment default due to the squeeze.

- **Curious case of realty**

India is still a cash-centric business. Officially, realty prices have not exactly crashed. The currency ban has made it virtually difficult for the realty sector to function smoothly. At present, the impact is being absorbed by the stock price of realty stocks which have corrected sharply. But this impact will show on realty prices later.

- **Loss of Growth momentum**

India risks its position of being the largest growing economy. Fall in the consumption, income; investment etc may reduce India's GDP growth as the liquidity impact itself may last for months.

- **Banks may not exactly gain**

Primarily, demonetization appears to favor the banks. That is right in that it will lead to a rise in deposit. However, the real worry may be on the assets side of the balance sheet. With the liquidity squeeze, banks may face a default risk not only on their corporate portfolio but also on their retail portfolio. Still the euphoria seems to be on the liabilities side of the bank's balance sheet. But bad loans may multiply if the liquidity squeeze continues for long period. That will be the acid test for the Indian economy in preventing an overall slowdown in the economy.

DEMONETIZATION IMPACT ON INDIVIDUALS

- **Income and welfare losses to the poor**

Demonetization 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 measurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.



- **Strict regulations on withdrawals**

The currency ban has been a huge problem for millions of Indians since the old 500 and 1000 notes are the bread and butter of most financial transactions in India. Everyone has been rushing to exchange them,. But the shortage of new banknotes is very smaller than the supply of old notes.

People are facing problems because the limit of withdrawal has not been kept at a higher level . They are unable to draw sufficient amount to satisfy their basic needs. the strict regulations on the quantity of new banknotes that people can withdraw at any given time. And even these regulations, reports of banks running out of cash abound.

- **Time consuming**

With the scarcity of new notes leads the people to rush to the ATMs,banks and spending their time for exchange and deposits.

- **Reluctant to learn**

There are few who are very adamant in the way they use to do things .they can't digest the fact that thing have changed. They would not be in position to sign up for net banking due to their illiteracy of digitizes banking.

- **Need for real money**

There are many places where you cannot find an alternate to real money like parking places, small provisions, petty shop etc.

VIEWS ABOUT DEMONITIZATION

The idea of demonetization is good but it has to be taken into consideration the most of the black money is kept in the form of land, buildings, gold or kept abroad. What is in cash constitutes only 4 % of the total amount of black money on which taxes are being paid.

Demonetization is an established practice in monetary policy to tackle black money. The Prime Minister Narendra Modi has explained why this is a financial surgical strike. It was meant to be suddenly implemented. In the past, demonetization has taken place twice but it fails because the idea is to tackle the black money existing in circulation. It is not tackle corruption per se or the Government is not saying that 100 % corruption will be tackled. If announcement and time would have been given, this step might not have been successful in controlling black money and counterfeit currency in circulation coming from other countries.

The stock of black economy constitutes a major part of the GDP is significant. Even if 50 % of this amount is withdrawn, the kind of relief that RBI will get on its liabilities and the sort of deposits commercial banks will get will lead to a rise in the deposit and later on there will be decrease in lending rates plus fiscal deficit. The black money in circulation is like a steroid in the economy which keeps the demand going gives a feeling that everything is going well. The problem is that investment is not taking place in the economy and the rate of growth of capital formation is down. The only way to bring this up is to divert more funds into investments which will happen when the cost of capital comes down.



CONCLUSION

In a surprise move minister Narendra Modi in his address to the nation on November 8, 2016 declared that the ban of older 500 and 1000 bank notes by replacing with 2000 note . India lost 86% of its monetary base. In this single move, the Government has attempted to tackle the three issues affecting the economy. Parallel economy, counterfeit currency in circulation and terror financing. So far this can be said this is a historical step and should be supported by all. One should look at the bigger picture which will definitely fetch results in the long term.

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