

Demonetisation In India

Dr.Mukesh Mathur

Professor

Deptt. of Banking & Business Economics, Mohan Lal Sukadia University, Udaipur(Raj.)

Abstract

Demonetisation is a decision in which a currency unit's status as a legal tender is declared invalid.

Prime Minister Mr. Narendra Modi, by an announcement in the evening of November 8, 2016, has taken away the legal tender of Rs.500 and Rs.1000 bank notes. The goal of the demonetization in India is to make the economy stronger and eliminate the parallel cash economy which is unaccounted and untaxed. Although this can impact the GDP negatively in the short term, it should have positive long term consequences. One of the main aims of demonetization process is to make use of digital payments through debit/credit cards and using other apps

Keywords: Demonetisation, India, Prime Minister, Currency..

Introduction

Prime Minister Mr. Narendra Modi, by an announcement in the evening of November 8, 2016, has taken away the legal tender of Rs. 500 and Rs.1000 notes with immediate effect from midnight at 00:01 am. It means that these high denomination bank notes can no longer be used as currency from midnight, of November 8, 2016. The people were given chance either to exchange the old currency with new one through banks or post offices or deposit the same in their accounts upto December 30,2016 with a rider that any deposit of more than Rs.2.50 lakh would be scrutinised by the income tax authorities. All notes in lower denomination of Rs.100,50,20,10,5, 2 and 1 and all coins continued to be valid, and new notes of Rs.500 and Rs.2000 were introduced. The step was aimed at curbing the "disease" of corruption and black money which had taken deep roots.

There were two similar instances of demonetisation of high currency notes in India. The move was first implemented in January 1946 when the RBI discontinued Rs.1000 and Rs.10,000 notes. Eight years later in 1954, Rs.1,000 and Rs.10,000 was brought back and Rs.5,000 note was introduced. Later in 1978, the Morarji Desai government demonetised the high denomination notes of Rs.1,000, Rs.5,000 and Rs.10,000. The government's move to demonetise, even then, was to tackle the issue of black money economy, which was quite substantial at that point of time.

In a recent move Prime Minister Narendra Modi hit hard on corrupt bureaucrats, politicians, and business class, terrorist's groups, smugglers, drug traffickers, hawala traders, and many others engaged in unlawful activities by announcing on November 8, 2016 that Rs 500 and Rs 1000 notes would no longer be legal tender money.

Meaning of Demonetisation

When a currency note of a particular denomination ceases to be a legal tender it is termed as demonetisation. In other words demonetisation is the act of stripping a currency unit of its status as legal tender. Currency includes coins and paper notes of different denominations issued by the central bank of a country duly backed by the sovereign authority. Every bank note in a country is a promissory note by the government and acts as a legal tender duly signed by the head of the central bank. The following is printed on an Indian currency of 500 Rupees note. "I promise to pay the bearer the sum of five hundred rupees." To demonetise means to take away the promise of it being the legal tender of the said bank notes, and thus depriving it of its monetary value by the sovereign authority.

Effects of Demonetisation

Since our economy is heavily dependent on cash, as only less than half the population uses banking system for monetary transactions, demonetisation has hit trade and consumption hard. With people scrambling for cash to pay for goods and services, the move is likely to take a big toll on the country's growth and output during the current fiscal. Consumption makes up for around 56 percent of India's GDP, hence, a drop in spending will pull down growth. The current step could also lead to behavioural changes in households' savings and their consumption pattern.

The effect of denomination will be felt across India in all the sectors of the economy and society at their respective levels and pace. It is too premature to spell out the exact effect at each level but rest assured, it will create a ripple in the economy whose effects will create a ripple in the economy whose effects will last more than what the government has assured. There are positives and negatives of the move, but

only time will tell how the economy rebalances itself after 86 percent of its cash is stripped off by the government.

Economists have welcomed the government's focused attack on black money as a long-term initiative. However, in the short term, the ripples of demonetisation will be felt for some time. Experts visualized the following impact of demonetisation on the economy in the near future:

- Cash crunch in the economy has led to fall in demand of the consumer products, which will lead to fall in demand of the consumer products, which will lead to fall in production of such products which will further lead to loss of employment in the short term at least for those in the lower pyramid of the society. Most active segments of the population who constitute the base of the pyramid use cash to meet their transactions. The daily wage earners, labourers, small traders who use cash frequently run the risk of losing their income in the absence of liquid cash.
- Cash stringency will compel firms to reduce labour cost, thereby reducing income to the poor working class. This will ultimately slow down growth and revenue for the government. People have already switched to savings mode as there is a limit on cash withdrawal in banks which is causing huge economic and social hardship to many people. While citizens will be inconvenienced in the short term, this is a big medium-term positive in the government's effort to crack down on black money and corruption.
- In the short- run GDP growth rate may decline by 0.1-0.2 percentage points, but in the long run the net impact of demonetisation will be positive.
- Commercial banks across India were recently suffering from severe bad loans and NPAs. As the old currency notes are deposited with banks, bank deposit growth will witness a pickup and currency in circulation will moderate a positive for banking sector liquidity.
- As rural households open new bank accounts to deposit old notes, this may also end up giving a boost to the government's financial inclusion thrust.
- The effect of demonetisation has severely impacted the micro, tiny and small enterprises that run their daily business mostly in cash. Lack of enough bank branches in the rural India has compounded their business losses due to sudden squeezing of cash from the market. Small traders are struggling to keep their business running amid cash crunch and sudden lack of demand.
- Cash is the primary mode of transaction in agriculture which contributes 15% to India's total output. Formal financing is significantly from cooperative banks, which are barred from exchange or deposit of

demonetised currency. Agriculture is also impacted though sale, transport, marketing and distribution of ready produce to wholesale markets which are dominantly cash dependent.

- Since black money played a role in real estate transactions, this crackdown is very likely to hurt the real estate market. The current demonetisation will make it extremely difficult for any buyer to pay in cash. Hence dealing in this sector will create an immediate negative impact on demand which will lead to fall in prices. This move will definitely relieve the genuine home buyers. Real estate investment had become one of the best ways to park illegal and unsolicited wealth by the corrupt. This move will surely hurt them and the real estate developers in a big way.
- The demonetisation drive has taken a huge toll on the tourism sector, especially hotels and restaurants which depend heavily on cash to cater to tourists coming from different parts of the country. Indians traveling abroad and foreigners traveling to India are severely hit by the cash crunch. Even people traveling domestically are stranded due to scarcity of cash.

Conclusion

The demonetization drive by the Prime Minister Mr. Narendra Modi is a bold decision to root out corruption, to tackle terror funding and fake currencies from the system. The goal of the demonetization move in India is to make the economy stronger and eliminate the parallel cash economy which is unaccounted and untaxed. While this can impact the GDP negatively in the short term, it should have positive long term consequences. It is also a good step towards a digital way of life as it infuses a cultural change among the citizens of India to go cashless.

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