

## Demonetisation

Alok Agrawal

*Research Scholar, School of Management, Jagran Lake City University, Bhopal*

When a currency note of a particular denomination ceases to be a legal tender it is termed as demonetisation. Our government is replacing the old Rs. 500 notes with newer ones and doing away with the Rs. 1000 notes, it would be more appropriate to call the move as “scrapping” or “phasing out” of certain current currency notes.<sup>1</sup>

**Impact Analysis of demonetisation in India:** The term demonetisation is not new to the Indian economy. The highest demonetisation note ever printed by Reserve Bank of India was the Rs. 10000 note in 1938 and again in 1954. But these notes were demonetised in January 1946 and again in January 1978, according to RBI data. The Reserve Bank of India manages currency in India and derives its role in currency management on the basis of the Reserve Bank of India Act 1934 and a new redesigned series of Rs. 500 banknote, in addition to a new demonetisation of Rs. 2000 bank note is in circulation since November 10, 2016. The redesigned series is also expected to be introduced to the bank note denomination of Rs. 1000, Rs. 100 and Rs. 50 in the coming months.<sup>2</sup>

**Impact on the Indian Economy:** The Indian Economy which was billed as the “fastest growing major economy” in the world and the “only bright spot” among emerging market seems to have slowed down even before the latest “shock therapy” of demonetisation indeed. The Central Statistical Office considered to be the releases projected and actual growth figures hints at a slowdown in the Indian economy even during the quarter before demonetisation happened.<sup>3</sup> With the latest round of demonetisation, the common public and bankers are undoubtedly facing hardship since more than 85 percent of currency in circulation has been rendered illegal in one single stroke. Demonetisation is surely hampering the current economy and will continue to do so in the near term and will also impact India’s growth for the coming two quarter but will have positive long lasting effects. The Indian banking system is now “flush with cash” and this has enabled the government to “nudge” the RBI to cut rates as well as to allow banks to pass on the benefit of ample liquidity to consumer by lowering lending rates. There are certain pros and cons of demonetisation.

**Pros:** One of the biggest benefits of this move is that it is going to drastically affect the corrupt practices. People who are holding black money in cash will not be able to exchange much as they would be in a fear of getting penalised and prosecuted by the authorities. Enemies of the country which are involved in counterfeit currency and terrorism will not be able to continue it further for quite some time at least. It will also reduce tax avoidance, money will be deposited or exchanged authorities will keep a track of it and they will be extra cautious in this period. Dealing in this period in sector like jewellery and real estate will be on radar and those entering into loan transactions may also undergo tax scrutiny. Search and Seizure activities of the IT department will also rise to curb such malpractices. Limit have already been prescribed for reporting to the IT Department those bank accounts in which excess cash deposits are being made in this 50 day window (Rs. 2.5 lakh in case of individual and Rs. 12.5 lakh in case of firms).

**Cons:** The liquidity squeeze caused by demonetisation will be negative across sectors with high level of cash transactions. Real estate, jewellery, retailing, restaurants, logistics, consumable durables and luxury brands, cement and some segment in retail/SME lending space will be facing short time instability. Those companies with high level of debt will face more pressure and can face loan defaults. There will be an added replacement of cost of currency, we cannot ignore the increased cost of operating ATMs need to be refilled more often and also it be a huge burden on banks. It is very difficult to create a cashless society as more than 50 percent of

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<sup>1</sup> “Demonetisation and its side effects”, retrieved on 06/04/2017, <http://economictimes.com/market/stock/news/demonetisation-and-its-side-effects/articlesshow/55678393.cms>, pp 1-3

<sup>2</sup> “Impact analysis of demonetisation in India”, retrieved on 07/04/2017, <http://www.moneycontrol.com/news/business/economy-920030.html>, pp 1-5

<sup>3</sup> “Demonetisation and its impact on the Indian economy”, retrieved on 06/04/2017, <http://www.managementstudyguide.com/demonetisation-impact-on-indian-economy.html>, pp 1-5

Indian population is not well versed with card transactions. Indian is certainly going to experience “Acche Din” in Modi’s regime. The decision of this surgical strike on black money was not taken in a day or two. Rome was not built in a day.<sup>4</sup>

**Currency in circulation:** RBI data show currency in circulation in India at Rs. 12.45 trillion as on 10<sup>th</sup> March, which is 30% less than the 4<sup>th</sup> Nov’16 figure of Rs. 17.97 trillion it had dropped to a low of Rs. 8.98 trillion. The demonetisation move led to severe cash crunch across the country, leading to a spike in the adoption of e-wallets and other modes of electronic transaction.<sup>5</sup>

**Effect on bank loan interest rates:** With demonetisation more people are depositing money into banks; this means the banks have more liquid funds and more money to lend. Many banks have also slashed their deposit rates including SBI, ICICI & HDFC Bank. Canara Bank, ICICI Bank and HDFC Bank have cut their fixed deposit rates by up to 1%, State Bank of India cut their fixed deposit rates by 0.15% on select maturities. In the banking world, when deposit rates are cut, it generally means the lending rates will also be slashed down. Since banks are paying lower deposit rates to customers this allows them room to charge lesser on loans. Once interest rates come down, this would translate into a lower EMI.<sup>6</sup>

**Bank deposited with RBI reach a record high:** As bank park a record amount with the Reserve Bank of India in the aftermath of the demonetisation of high value currency notes, the central bank may have to look at new collateral to offer against these deposits. Banks have parked Rs. 4.3 trillion in reverse repo operations under the liquidity adjustment facility wherein RBI accepts money from banks by offering government securities as collateral. This is the highest liquidity absorption by RBI ever, according to Indian Rating and Research Pvt. Ltd., easily beating the earlier record of Rs. 1.7 trillion in May’2009.<sup>7</sup>

**Digital Payments:** In recent months, all of us have heard extensively about **war on cash**, the move to make India and other country **cashless economies** and the general trend among policymaker worldwide to move the economies of the world to a digital and information enabled paradigm. Digital payment are payments that are conducted over the internet and mobile channels and hence a payment that is sent online or through mobile computing and internet enabled devices can be called such. This mean that for digital payments to take place the sender of the payment must have a bank account, an online banking method a device from which he or she can make the payment and a medium of transmission meaning that either she or he should have signed up to a provider or an intermediary such as a bank or a service provider. We will come to the last part in a bit. While in developed countries, almost everyone has a bank account or has access to credit and debit card in addition to most merchant having POS (point of sale) machines in their establishment means that the job of digital payments is infinitely easier than in developing countries where such infrastructure either does not exist or in basic form thus for countries such as India to move to the digital payment paradigm means that there is a massive need and demand to bring in all the players in the payment value chain into the digital backbone. Most merchant lack POS devices, and this where services providers such as PayTm and the newly launched BHIM App from the government can do the trick in addition as most of the country has already been covered under the Aadhar cards it is easier to create a digital backbone using such biometric models. Digital payment are an evolutionary step towards the **business at the speed of thought** model that pioneers such as Bill Gates have always predicted would be the next step in our move from physical to digital, despite the challenges and doubts one must indeed take steps to move toward it.<sup>8</sup>

**Impact on the common man:** India’s GDP is \$2000 billion(Rs. 125 lakh crore) and estimated parallel economy is 23 percent, which makes it about Rs. 28 lakh crore. A large percentage of this amount is divided that Rs. 3 lakh crore or \$ 45 billion will flow into India’s white economy, which is equivalent to GDP of more than 100 countries. The following impact moves on the common man:-

- a. Financial/business impact: People with large amount of black money are using unscrupulous means to convert it into legitimate currency. A taxpayer has to stand in queues to withdraw his hard earned money. Banks will be having a tough time they will be flooded with cash.
- b. Political impact: BJP will be gain tremendously. Modi portrait could replace Gandhi’s portrait in coming time on the walls of government offices. No cash doles out in elections.

<sup>4</sup> “Impact analysis of demonetisation in India”, retrieved on 07/04/2017, <http://www.moneycontrol.com/news/business/economy/920030.html>, pp 1-5

<sup>5</sup> “currency in circulation of demonetisation level”, retrieved on 07/04/2017, <http://www.livemint.com/industry/w9zeqf0jdncu3ahmdthwci.html>, pp 1-5

<sup>6</sup> “effect of demonetisation on banks loan interest rates”, retrieved on 07/04/2017, <http://www.quora.com>, pp. 1-5

<sup>7</sup> “Demonetisation impact, bank deposits with RBI reach a record high”, retrieved on 07/04/2017, <http://www.livemint.com.html>, pp. 1-3

<sup>8</sup> “digital payment benefits and problem”, retrieved on 07/04/2017, <http://www.managementstudyguide.com>, pp. 2-3

- c. Social impact: Low income people have been impacted as their payments are delayed. Marriages to become cheap, death of dowry. Death of drug mafia and terror networks.
- d. Impact on Indian economy: GDP will be impacted as consumption will fall indirect tax collection may be lower. Disorganised work to move to organised sector.
- e. Long term impact: Income tax rates may come down. Loans will become cheaper. Housing will become affordable. Real estate and Gold market to fall. Fiscal deficit will come down. FDI to sky rocket. The society will become more equitable with lesser class distinction. Politics may change forever.<sup>9</sup>

**Black Money and Demonetisation:** The Government of India announced that Rs. 500 & Rs. 1000 denominated currency notes will cease to be legal tender. The move was targeted toward tackling black money, corruption and terrorism. To start off, black money is a wider societal ill and demonetisation is but one step in the war against black money. Black money and black economy are also two different constructs. The term shadow economy and underground economy are also used as synonyms for black economy. The issue of black money has been well explored. The National Institute of Public Finance and Policy has been active in research about black money in their survey. Black money is nothing but money generated in legitimate transaction which is hidden from government so as to avoid paying the transaction cost (usually tax) in the legitimate economy, this is usually done by using physical cash. Black money is also used in legitimate investment, foreign channels play critical role, quite substantial investment in P notes is actually round tripped black money. The key aspect of these instrument is create anonymity by begin away from arms of the laws of the country from where income can be fed into the legitimate hands. In such cases, the source of income is illegal, thus many businesses in tax havens such as Mauritius, Cayman Islands etc. exist to convert illegal money into legal money and many of these investments come under the purview of money laundering. The distillation of various approaches for tackling of black money such as , establish identity of person, enable low the cost direct bank transfer, reform tax system (GST), auto processing returns for tax refund, create attribute chain for funds entering and exiting the country, control of holding of cash and physical money. As per RBI estimates, 15 billion notes of 500 and 6 billion notes of 1000 denomination exist. In addition, RBI estimates that fake 0.2 million notes of Rs. 500 and 0.15 million notes of Rs. 1000 were discovered. Those who can disclose deposits equal to the amount they hold in cash will have no problem. Part of the actual money in circulation is never recovered, depending on various conditions at least 20% of this paper money will never reach banks. This stock of money is lost; many believe this to be deflationary. This money did contribute to the economy but to smaller extent. Black money is not a pool but a chain, break the chain or make the chain costly and you inconvenience the poor who did not have access to bank systems, but with Jan Dhan accounts, poor have ready access to banking channels. So if you are law abiding citizen then you can sail through mostly unscathed no matter how poor you are. Real estate, Gold etc., driven consumption is out of purview of the legitimate formal economy. The effect of demonetisation on such consumption will be positive. The issue in present case is the quantum of readjustment, if RBI balance sheet shrinks by 30% on fine day, there will be panic, but this effect can also be muted by writing down in phased manner while keeping the liability alive on paper, if this was possible you could have seen demonetisation every 5 years. The actual terror attack is only the “last mile” effect, the ultimate attackers are usually pawns without any knowledge of systems, it will serve to shock this chain. Demonetisation eliminate black money is just one move of one piece in the chess board of black money to check mate the black money king, you have to win the board there are various steps required.<sup>10</sup>

White money is being constantly converted into Black money and vice versa. Much of conspicuous consumption is paid for in unaccounted money which, in the hand of the recipients become perfectly legal income. “Benami” deals on the stock exchanges and commodity markets make it difficult to trace the transactions to the ultimate buyer or seller. Even if the existing stock of illegal currency is wiped out by demonetisation, it will be soon replaced as long as such points of contact exist between legitimate and illegitimate deals. Ultimately the problem of undisclosed income and wealth has to be tackled at the source. The major requirement is for the Government to reduce the opportunity for such transaction by generally reducing the gap between the market valuation of goods and the officially fixed prices. A check of inflation would be more effective than anything else in eliminating opportunities for speculative profit and black market deals.<sup>11</sup>

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<sup>9</sup>“the impact of demonetisation on the common man”, retrieved on 04/06/2017, <https://yourstory.com/2016/11/demonetisation> on impact common men, pp 1-5

<sup>10</sup> “Black money and demonetisation”, retrieved on 06/04/17, <http://www.rahuldepdhar.com> , pp 1-22

<sup>11</sup> “Demonetisation and Black money”, Economic and political weekly, vol.2 No. 19, <http://www.jstor.org/stable/4357924>, pp 868-869