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**DEMONETIZATION: 'ILLUSION OR REALITY'**

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**ABSTRACT**

*Demonetization is a radical monetary step in which a currency's status as a legal tender is declared invalid. The series of currency is not acceptable as legal currency. This is usually done where there is a change of national currency replacing the old currency unit with new one. Same happened in India on the eve of 8<sup>th</sup> November 2016 when Indian government announced that the Rs. 500 and Rs. 1000 denominated currency notes will cease to be legal tender. The move was targeted towards tackling black money, Corruption, Terrorism etc. Declaration of 86% of currency notes as illegal tender was just a blink of time on the eve of 8<sup>th</sup> November 2016 created immediate interruption in daily lives of the people. The chaos was created in every strata of society either it was upper, middle or lower. Where some welcomed the move as it was seen for curbing black money, many others suffered by this move. Supreme sufferers of this move were the informal sectors of Indian economy where cashless transactions were minimal. Informal sectors include activities like agriculture, works in construction, local transport, community services & small workshops like shoe makers & garment makers, rural population, urban poor and middle class. After initial Euphoria, questions began to emerge. What are costs of this demonetisation, will it be effective if people can still create fresh black money there after? Will it increase the GDP? Will it increase inflation? What about tax revenues. In this paper I want to discuss the short term and long term pros and cons of recent demonetization.*

**KEYWORDS**

demonetisation, remonetisation, informal sectors.

**INTRODUCTION**

**D**emonetization is stripping a currency unit of its status as legal tender. Demonetization becomes a necessity when there is a change of national currency the old unit has to be retired and replaced with a new unit of currency. It includes either introducing new notes of the same denomination or completely replacing the old denomination. Which is often carried out as an ambush on the black money and market. Opposite of demonetization is remonetisation in which a form of payment is restored as a legal tender. Currency is a commonly accepted form of money which is issued by a government and circulated within an economy. As used for a medium of exchange of goods & services, currency forms the basics of any trade.

Demonetization of Nov. 2016 is a generation's memorable experience and is going to be one of the economic events of our life. Its impact was felt by every Indian citizen. Demonetization affected the economy through the liquidity side. Its affect is worth telling because nearly 86% of currency value in circulation was withdrawn without replacing bulk of it. As a result of 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. Absence of intermediate denominations like Rs.500 and Rs.1000 reduced the utility of Rs.2000. Effectively, this made Rs.2000 less useful as a transaction currency though it can be store value denomination.

**OBJECTIVES OF THE PAPER**

1. To study the history of Indian Demonetization.
2. To analyse the Instant implications of demonetization on Indian economy.
3. To work out the probable consequences of demonetization in future.

**RESEARCH METHODOLOGY**

This paper is based on secondary data. The data has been collected from the internet

**DEMONETIZATION: HISTORY & BACKGROUND IN INDIA**

- This is not the first time when currency is demonetised in India.
- First demonetization took place in the year 1946 and the second in 1978 when an ordinance was promulgated to phase out notes with denomination of Rs. 1000, Rs. 5000 and Rs. 10000.
- The highest denomination notes ever printed by Reserve bank of India was Rs. 10000 note in 1938 and again in 1954. But these notes were demonetized in Jan. 1946 and again in Jan. 1978, according to RBI.
- Rs. 1000 and Rs. 10000 bank notes were in circulation prior to January of 1946.
- Higher denomination bank notes of Rs. 1000, Rs. 10000 were reintroduced in the year 1954 and all of them were demonetized in January 1978.
- The Rs. 1000 note made to 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 bank notes in circulation due to inflation.

India carried out demonetization exercises twice before, in 1946 and 1978. In Jan. 1978 episode, currency worth INR 1.46 bn (1.7% of total notes in circulation was demonetized) of this INR 1.0 bn (or 68%) was tendered back. In 1978 the value of demonetization was very -very small (only 0.1% of GDP)

However, the 2016 demonetization efforts cover 86% of total currency in circulation (11% of GDP)

**DEMONETIZATION OF THE YEAR 2016**

On the 8<sup>th</sup> of November 2016 when the sun had descended below the horizon & the light of the day had completely faded, and people were returning back home from a long day at work, a misty light of a new economy was brewing over the country. All Rs. 500 and Rs. 1000 bank notes of the Mahatma Gandhi series ceased to be as legal tender in India from 9 November 2016.

The Government claimed that the demonetization is an effort to stop counterfeiting of the current bank notes allegedly used for funding terrorism, as well as a crackdown on black money in the country. The move was described as an effort to reduce corruption, counter feiting of currency.

However, in the days following demonetisation, banks & ATMs across the country faced severe cash shortages. Also, after Modi's announcement, the BSE, SENSEX and NIFTY 50 stock indices crashed for the next two days.

The term demonetisation has become much more than a household name, since the old Rs. 500 and Rs. 1000 were pulled out of circulation. While as per dictionary demonetization means "ending something (e.g. gold or silver) that is no longer the legal tender of a country" one needs to understand that there is much more than the literal meaning to the word demonetization.

One needs to understand that 80% of India's Labour force is employed in the informal sector, of the country, which comprise of 45% of the GDP of our country. Over 60% population of India lives in below the international poverty threshold line of 1.9\$ per day. Since our economy is an under banked economy, present demonetization moves, no doubt caused a severe social experiment across the segment of our vast population.

Demonetization has been a radical unprecedented step with short term costs and long term benefits. The liquidity squeeze was less severe than suggested by the headlines and has been since end tenement December 2016. A no. of follow up actions would minimize the costs and maximize the benefits of demonetization.

## INSTANT IMPLICATIONS OF DEMONETIZATION

### Pros

#### 1. ATTACK ON BLACK MONEY HOLDERS

People who possess huge amount of black money in hard cash were at a complete loss at the time of demonetization. Their black money in hard cash became a pile of trash. If a black money holder wanted to deposit money in bank account, then he/she had to show ID proof. There was 200% penalty on income tax amount.

#### 2. DEATH KNEEL TO FAKE CURRENCY RACKET

Most of the fake currency used to be in the form Rs. 500 and Rs. 1000 notes, Modiji busted all these unethical rackets completely.

#### 3. END OF TERRORIST FUNDING

Huge sums of money especially in hard cash in the demonetization of Rs. 500 and Rs. 1000 was used to fund Islamic Terrorists, nexalites, etc. After demonetization, these organisations suffered from shortage of funds.

#### 4. TRANSPARENCY

Online Transactions= more transparency. Financial intelligence unit can track all online transactions. Now there will be more transparency in real estate sector also.

#### 5. END OF HUGE DONATION

Huge amount of donations that is taken in private education and health care sectors stopped after demonetization. Schools, Engineering & Medical Colleges and Hospitals (Private ones) used to take huge amount of money as donations especially in the form of hard cash in the denomination of Rs. 500 and Rs. 1000. These money minded people running these institutions could not make easy money then at the time of demonetization. Same applies to real estate sector also.

#### 6. TOWARDS A CASHLESS ECONOMY

While it is practically impossible to have a 100% cashless economy. But the proportion of hard cash decreased during the period of demonetization. So, our economy got more digitized. This resulted is greater transparency. Now the government has put some limitations for cash withdrawal from bank accounts. So, the people had to go for online payments. And use more of debit and credit cards.

#### 7. HAWALA TRANSACTIONS END

Most of the hawala transactions used to be carried out in the form of Rs. 500 and Rs. 1000. Using this ban, Modiji delivered a fatal blow to the unethical hawala traders as they couldn't trade any more using denominations of Rs. 500 and Rs. 1000.

### Cons

#### 1. RUSH AT BANKS

Banks were extremely overcrowded by people. People forgot everything else and throng to the places where the banned notes were being officially exchanged which led to tremendous chaos.

#### 2. SHORTAGE OF MONEY TO COMMON PEOPLE

Common people had to suffer from shortage of money.

#### 3. STOCK MARKET

Due to currency being sucked out of market coupled with trump's victory, the mood at the stock market was completely bearish. Sensex lost 1600 points at open. This led to negative effect on trade in general.

#### 4. PROBLEMS FOR HOUSE WIVES

Many Indian house wives store money secretly. So that they could be of help during times of financial crisis in their households. The accumulated money of our respected Indian house wives was of no use then until those are exchange in banks & post offices.

#### 5. SHORT TERM INFLATION

Due to shortage money in the market, a short term cost push inflation occurred. Price of gold became sky high. Prices of vegetables and fruits also soared burdening the common man.

#### 6. MARRIAGE SEASON

Families, which had marriages during that period also had to suffer a lot due to shortage of funds.

#### 7. ATTACK ON CONSUMPTIONS

When liquidity shortage stroke, it was consumption that was going to be adversely affected first.

### DUE TO SHORTAGE OF CONSUMPTION



### LONG TERM IMPACTS

#### 1. IMPACT ON COUNTERFEIT CURRENCY

The real impact will be on counterfeit take currency as its circulation will be checked after this exercise.

#### 2. IMPACT ON BLACK MONEY

Only a small portion of black money is actually stored in the form of cash. Most of the, black income is kept in the form of physical assets like gold, land & building, etc. So, impact of demonetization would be less than expected. But more than anything else, demonetization has big propaganda impact. People are now much convinced about the need to fight against black income. Such a nation wise awareness and urge will encourage government to come but with even strong measures.

#### 3. LOSS OF GROWTH MOMENTUM

India risks its position of being the fastest growing largest economy. Reduced consumption, income, investment, etc. may reduce India's GDP growth as the liquidity impact itself may last three to four months.

#### 4. IMPACT ON BANK DEPOSIT AND INTEREST RATES

Deposits in the short term may rise but in the long term, its affect will come down. The savings in 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 longer time. They saved this money into banks just to convert their old notes into new notes. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the saver when full-fledged new currency supply take place. This may reduce interest rates in the short\medium term. But they cannot follow it in the long term.

#### 5. REAL ESTATE CLEANING

It is said that real estate is an industry built on mostly black money. The extent of black money floating around in this sector in huge. According to an estimate at least 40% of real estate transactions in Delhi, NCR are in the black money. Modi's demonetization move will curtail the flow of black money into the real estate sector. This will help in making the much needed correction in this sector. The impact: An unexpected dip in land and property prices.

**CONCLUSION**

The demonetization effort being led by PM Modi in India was appreciable to an extent but followed both positive and negative impacts. The most prominent reason brought forward for this far reaching move were to curb black money, to eliminate counterfeit notes and to promote the use of electronic payments. Though this move caused a lot of difficulties for common people but also welcomed by them also.

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