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A STUDY ON PROS, CONS AND CONSEQUENCES OF DEMONETIZATION OF CURRENCY IN INDIA

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ABSTRACT

The present paper focuses on studying the impact of demonetization on Indian Economy. This work concentrates on highlighting the advantages and disadvantages of the move by the government. This paper tries to explore the negative and positive aspects of recent demonetization of Indian Economy. The reader of this paper would be getting the knowledge about the pros, cons and consequences of demonetization of Indian economy.

KEYWORDS

demonetization, circulation, re-monetization, counterfeiting, legal tender.

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INTRODUCTION

Demonetization is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency¹.

The opposite of demonetization is remonetization, in which a form of payment is restored as legal tender. Here are multiple reasons why nations demonetize their local units of currency:

- to combat inflation
- to combat corruption and crime (counterfeiting, tax evasion)
- to discourage a cash-dependent economy
- to facilitate trade

Dramatic Examples of Demonetization

The Coinage Act of 1873 demonetized silver as the legal tender of the United States, in favor of fully adopting the gold standard. Several coins, including two-cent piece, three-cent piece, and half dime were discontinued. The withdrawal of silver from the economy resulted in a contraction of the money supply, which subsequently led to a five-year economic depression throughout the country. In response to the dire situation and pressure from farmers and silver miners and refiners, the Bland-Allison Act re-monetized silver as legal tender in 1878.

An example of demonetization for trade purposes occurred when the nations of the European Union officially began to use the euro as their everyday currencies in 2002. When the physical euro bills and coins were introduced, the old national currencies, such as the German mark, the French franc and the Italian lira were demonetized. However, these varied currencies remained convertible into Euros at fixed exchange rates for a while to assure a smooth transition.

In 2015, the Zimbabwean government demonetized its dollar as a way to combat the country's hyperinflation, which was recorded at 231,000,000%. The three-month process involved expunging the Zimbabwean dollar from the country's financial system and solidifying the U.S. dollar, the Botswana pula and the South African rand as the country's legal tender in a bid to stabilize the economy².

INDIA'S DEMONETIZATION

In 2016, the Indian government decided to demonetize the 500- and 1000- rupee notes, the two biggest denominations in its currency system; these notes accounted for 86% of the country's circulating cash. With little warning, India's Prime Minister Narendra Modi announced to the citizenry on Nov. 8 that those notes were worthless, effective immediately – and they had until the end of the year to deposit or exchange them for newly introduced 2000 rupee and 500 rupee bills.

Chaos ensued in the cash-dependent economy (some 78% of all Indian customer transactions are in cash), as long, snaking lines formed outside ATMs and banks, which had to shut down for a day. The new rupee notes have different specifications, including size and thickness, requiring re-calibration of ATMs: only 60% of the country's 200,000 ATMs were operational. Even those dispensing bills of lower denominations faced shortages. The government's restriction on daily withdrawal amounts added to the misery, though a waiver on transaction fees did help a bit.

LITERATURE JUSTIFICATION

- On 9 November 2016, a report by CARE Ratings said that with the decision of demonetization the overall demands of consumer goods, real estate businesses, luxuries goods, automobiles are expected to be affected and the prices of the relevant items would be affected due to the contraction in demands. According to the report, the small size traders and professional who generally deals in daily cash basis transactions such as households, service sector, farmers are expected to be affected. Those customers prefer online shopping and makes cash payment on delivery also expected to be decrease³.
- On 18 November 2016, an another report by CARE Ratings on Impact on demonetization on GDP growth said that earnings of hotels, transportation, small trades where payments and receipts are highly cash basis. The losses which are expected to be occur estimated to be cover in next quarter.
- On 11 November 2016, Investment advisory group of HDFC Bank Ltd said in a report on demonetization that the value of old notes of Rs. 500 and 1000 is approx. Rs. 14.2 trillion which covers the 85% of money circulation. After the decision of demonetization, the notes of Rs. 500 and 1000 are not considered as legal tender

and all the old denominations of Rs. 500 and 1000 are deposits in banks till 31st December⁴. According to the report, the decision of demonetization will strengthen the tax system, fiscal balance and banking sector. But it is not expected as a strong decision for consumer goods, luxurious goods and real estate as the demands of the customers are expected to be highly affected due to the demonetization.

NEED AND IMPORTANCE OF THE STUDY

After the current policy of demonetization implemented by the Indian government all the economy of India has been imbalance. It is important to study pros, cons and consequences of the demonetization on the businesses in India. So, this Research study endeavors to understand the impacts of demonetization on Indian economy.

OBJECTIVES

1. To analyze the advantages and disadvantages of demonetization on Indian economy.
2. To explore the positive and negative aspects of demonetization.

RESEARCH METHODOLOGY

TYPE OF DATA: The analysis of paper is completely based on the secondary data.

SOURCE OF DATA - The present study is based on secondary data and the sources of data include the facts by RBI and different websites.

LIMITATIONS - All the limitations of secondary data will be applicable for this study.

PROS OF DEMONETISATION

- It will help the government to fight Black money, corruption, terrorism and counterfeit currency with one single decision.
- Arms smuggling, espionage and terrorist related activities will be choked due to lack of funding.
- Counterfeit currencies are being used for financing terrorism, which is being run by the enemy in India. Now Govt has taken a bold move, which enables them to fight counterfeit currency/terrorist funding activities.
- With the new limits on ATM withdrawals being restricted to Rs 2,000 per day, withdrawals from bank accounts limited to Rs 10,000 a day and Rs 20,000 a week, it will drive the card payments across the country (In simpler words card transactions will slowly replace the cash transactions in daily activities).
- It will be easy for the Government to track the money being exchanged as exchange can only be done by producing a valid government identity cards like PAN, Aadhaar and Election Card from 10 to 24 November with a daily limit of Rs 4000. There is no limit on the amount as long as it is legal.
- FIU of India get info about transactions from banks. During this period, banks will take extra precaution. Banks will share info with Income Tax dept. as deemed fit. (So now it is difficult to get rid of the black money which is mostly in 500 and 1000 notes)
- The traditional benami transactions have already received a big blow as the new legislation has a provision for seven-year imprisonment and fine, replacing the three-year jail term, or fine, or both.
- This decision will help institutionalize the real estate sector bringing more transparency in the Indian real estate industry. This step would give the Indian real estate sector more credibility making it more attractive to the foreign as well as domestic investors.
- Housing prices could witness downward pressure, helping revive demand in the sluggish housing segment (this will give much needed bloodline to the sector)
- It will help the common man by putting an end to the artificial increase in Real Estate, Higher Education and Healthcare transactions bringing them within the reach of the common man⁵.

CONS OF DEMONETISATION

- Inconvenience to common people who will start running to the nearby bank to exchange the 500 and 1000 currency notes.
- Rs Cost of replacing the 500 and 1000 notes. If all this additional money (a spectacular Rs. 6.666 trillion) had to be printed using Rs. 100 notes, it would cost RBI about Rs. 11,900 crore, which is more than a four-fold increase. This is without taking into consideration the increased costs of operating ATMs (since they would need to be refilled more often), and of handling money in general. Scrapping Rs. 500, Rs. 1000 notes a costly idea
- Very difficult for more than half the population who are not well versed with the card transactions.
- This move deeply impacts the working sections of society: drivers, maids, cooks, electricians, plumbers. Anybody who provides services in the informal sector and depends on monthly or bi-monthly cash payments.
- How do you expect a chai wallah to leave his business and stand in a queue to deposit these notes in bank?
- What will happen to the common man who finds out that the note he is having is a fake one? How is the Government going to handle such situations?
- The small businesses will be affected at least in the shorter run.
- Jan Dhan scheme, UPI/digital payment stack and payment banks are still in the nascent stage. It will be a long time before rural India moves to completely cashless transactions. In the short-term, people in rural India who have a significant amount of Rs 500 and Rs 1000 notes, but no official form of identification will have a tough time in exchanging their notes.
- The big fish will be left out whose black money is in the form of foreign currency, gold and stashed away in tax havens⁶.

But the Pros which are in the long term interest of the country comfortably outweigh the cons.

NEGATIVE EFFECTS

1. As government has announced it in a hastiness, it may effect its execution.
2. Allow withdrawal from ATM is up to Rs. 4000 and from bank its Rs 10000 only. Long queues will not allow a person to get money on time. It will be a little difficult for a family person to survive with this amount.
3. The Average Population per Bank Branch (APBB) as on 31.3.2013 stands at 12,100 Government has given us 50 days to deposit all our cash money into our bank accounts. Let's say 40 days are working out of 50. It means, on banks have to deal with average of 300 people daily. Yes, I agree that this number includes every living human being (children, senior citizens, women), so you can say that this number will reduce on practical scale. But wait, what about people who will come along? What about people who will come repeatedly, or I can say, daily? What about people who have to come again due to closing time or any other reason? This number will surely exceed. Believe me, public dealing is a very tough job and when you have 300 hassled brains in front of you, it becomes horrible.
4. Running out of Money: Though, everyone needs new currency notes, it is very hard to provide cash on time, even by RBI. Because, there is a limit on printing currency notes. Government just can't order RBI to print new notes as per requirement. There is a regulatory system which guides RBI and Indian government how much new currency notes should be printed other country has to face some serious issues like, inflation. So, government will not be able to provide enough money to banks to pass on to consumers. It will create uncertainty.
5. Empty ATM's: Same as bank branches, queues on ATM's will also have to face same fate. Standing in long queues and returning with nothing will not please anyone.

6. Patients: Government hospitals have been allowed to accept old Rs 500 and Rs 1000 notes. According to National Family Health Survey-3, the private medical sector remains the primary source of health care for 70% of households in urban areas and 63% of households in rural areas. So it's easy to understand that what will be the effects on these 63% and 70% patients.
7. White Into Black: As Indian, we do believe in cash. Even if our money is purely white, we go to bank, withdraw some money and go for shopping. Cheques and ATM swipes are not available everywhere. Like, if someone in family is hospitalized or, have marriage in house, we do withdraw our cash and feel comfortable. So, whatever the reason is, if someone has withdrawn a decent amount from his account then it will create a huge problem for him to prove himself innocent. So, in this case, instead of converting black money into white, a person has accidentally converted his white money into black.
8. Patience of People: Considering all of the above points (and many more in the line), it will need a superman effort from a common man to keep his patience in balance. Any outburst in the tolerance of people will make the situation more terrible. Though, for now, people are more in favor of respected PM because right now they are not suffers. But when they will face hurdles in their routine jobs due to shortage of money then it will be their patience which will make this historic move a success story.
9. Downfall in Economy: Though, it will be a very temporary effect, but for the next few months, there will be a visible effect on economy due to the decreased purchased capacity of consumers. Worst effects will be on startups and medium sized companies and firms.

POSITIVE EFFECTS

1. Foreign Trust: Transparency is always welcomed, specially in business. It is the most important gradient for foreign investors. Everyone like to have their money in safe hands. Black money is a major factor in India, which inhibits the rapid growth in private sector. When a company decides to invest in a product they can calculate almost every kind of expenditure they will have to face except bribe. Ratan Tata has shown his irritation about corruption and bribe many times. So decreased black money will surely help Indian government to gain trust from foreign investors.
2. Lubrication in Circulation: Money is the lubricant that makes the market economy possible. A large portion of this lubricant was immobilized in the form of black money. Rs 500 and Rs 1000 shares a major part. Due to this immobilization, government is bound to circulate more currency notes in the market to keep it running.
 - a. In simple terms, say, government gives you 100 potatoes to distribute in the market. Instead of distributing all, you circulate only 80 pieces. Rest you preserve for your own benefits. Now for the fulfillment of the requirement, government will provide you 20 more potatoes, out of them you circulate only 16 and this keeps going on. Government have to invest more to fulfill the need and you will eat more as compare to others. Here, 'you' refers to market. This cause inflation.
 - b. Now imagine, somehow government raids on you and liberates all the stored stock of potatoes. Surely stock will be huge which will help government to fulfill the need without any expense. It can distribute the extra potatoes to those who require the most. Now, replace potatoes by money and imagine the outcomes.
3. Hard Money to Digital Money: Though, it is the first of its kind, but we may have to face these surgical strikes on black money in the future too. This will give some time to people to understand the need of digital money in the current era. We have seen some inspiring pictures where vegetable seller is accepting money via PayTm. India is changing.
4. New Hope: Black money was a key agenda for BJP during election campaigns. But people were disappointed when there was no major step taken by the current government. Now when PM Modi has declared the demonetization of Rs 500 and Rs 1000 notes, a positive vibe has been spread throughout the country.
5. Zero Counterfeit Notes:
 - a. In India, the circulation of fake Indian currency notes (**FICN**) has been on the rise, according to the Reserve Bank of India's (**RBI**) annual reports. The year 2014-2015 saw a steep rise, with 594,446 FICN detected, up from 488,273 in the year 2013-14. When it comes to the type of notes counterfeited in 2014-15, RBI data showed that counterfeited Rs 500 notes were most common, with 273,923 recorded. Rs 100 and Rs 1000 notes were the second and third most counterfeited bills, respectively.
 - b. Most of the FICN are printed in Pakistan. Major transit points include India's neighboring countries Nepal and Bangladesh. Other transit routes includes Dubai, Thailand, Malaysia, Sri Lanka and China.

CONSEQUENCES

1. Rein on Terrorism:
 - a. The ISI has been making a profit of 30-40% on the face value of each counterfeit Indian note produced in Pakistan, according to the report. The cost of printing a Rs 1,000 counterfeit note, for instance, is Rs 39 (the RBI spends Rs 29 to print a Rs 1,000 note), but it is sold at Rs 350-400, according to the report.
 - b. It is a measure source of funding for these terrorist groups.
 - c. Now all these funding will be equal to ZERO.
2. Increased Income Tax Revenue: It would be an exaggeration to say that all black money holders will deposit all of their stored cash into bank accounts. But they will also not let their hard-earned cash to become worthless paper. And whatever they will do it will convert their black money into white, at least for once. Someone is surely going to pay income tax on that amount. It will drastically increase the revenue generated from tax.
3. Deflation: Deflation refers to situation, where there is decline in general price levels. It increases the real value of money and allows one to buy more goods with the same amount of money over time. All of the above mentioned points will lead to the decrease in inflation which will automatically increase deflation rate. Goods will be cheaper and facilities will be in the range of poor people.

CONCLUSION

It is too premature to conclude if the Demonetization scheme of the Government is a success or failure. This post brings to you the arguments on both sides, without attempting to arrive at a judgment.

DEMONETIZATION IS A FAILURE

1. Issued is a liability for the RBI. Hence, it was predicted that the notes that did not return would have the impact akin to confiscation of money and this money could be used to recapitalize the banking system.
2. It was also expected that RBI's dividend to the Government would increase due to a reduction of its liabilities as explained in the previous point. Instead, RBI's dividend to the Government fell by half (Rs. 30659 crore) in the year ended June 2017. This reduced transfer was due to increased expenditure due to demonetization.
3. The increased expenditure was on account of the cost of printing currency post demonetization and managing the logistics, which amounted to a whopping Rs. 30000 crore.
4. RBI had to incur huge costs in paying interests. Post demonetization, banks were flushed with excess liquidity. They made large deposits with RBI.
5. There has been no significant dent on corruption and terrorism.
6. The Indian economy grew at 5.7% in the June quarter 2017 from 6.1% in the last quarter. However, it is not sure that the decline in GDP growth rate is due to demonetization.

7. Lastly, though the digital transactions reached a peak in November 2016 due to cash crunch imposed by demonetization, it has been declining since. It increased to record Rs. 957.50 million in November 2016 and gradually declined to Rs. 862.38 million in July 2017. The Government has failed to sustain the momentum.

DEMONETIZATION IS A SUCCESS

1. Demonetization is only one of the many initiatives taken by the Government to root out black money. Others are Benami Property Act, GST etc. It cannot be analyzed in isolation.
2. Even if close to 100 % of the notes have returned to the banking system, it does not mean that the black money has been converted into white. The Operation Clean Money project was launched in January 2017 to scrutinize the deposited cash of the people.
3. The Government could identify lakhs of shell companies due to increase in their deposits post-demonetization and launched a systematic crackdown against the black money generated by them. All money has been brought into the formal financial system. The Government has details of all those who deposited cash and so it is more difficult to evade taxes. It has led to increased compliance as well as tax revenues.

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