

Demonetization in India – A Bold move towards clean transactions and clean money

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Abstract: India has seen a number of revolutionary changes in its history and present, and will continue to come across many more in future too. The important point to be noted here is that, it has brought a huge change in the monitoring and governing system of the country. Instead of appreciating the efforts taken by our regulatory system, majority of the citizens are surprised and shocked by such decisions at the same time. One such revolutionary effort is the demonetization of Indian currency to combat various forms of corruption in our society. It is executed to replace the old currency with a new one, and is necessary whenever there is a need to bring about a change in the national currency of any country. The prime motto of implementing this system is to get rid with the practice of using money for unfair means in the society. So far, many nations have witnessed demonetization of their currency, with India being able to experience it for the third time. However Public faced minor problems for a few days owing to the scarcity of lower denomination notes in the system. This paper reveals the impact and benefits of demonetization in India.

Key Words: Demonetization, Master stroke, Indian Economy, Inflation, Black money, Currency destruction, Chaos.

Introduction

The ‘demon’ in demonetization is in the beginning. On November 8, Indian Prime Minister Narendra Modi announced in a broadcast to the nation that Rs500 and Rs1, 000 currency notes would no longer be recognized legally as currency. “Great,” said Corporate India, economic commentators, foreign investors, international think tanks and global rating agencies. “Masterstroke,” echoed the Confederation of Indian Industry (CII).

The aim behind the government’s action was to combat tax cheating, counterfeiting and corruption. Eliminating large denominations makes it harder to hide large amounts of cash. Modi noted that the move complements the country’s swachh bharat abhiyan (Clean India campaign). “For years, this country has felt that corruption, black money and terrorism are festering sores, holding us back in the race towards development,” he said. “To break the grip of corruption and black money, we have decided that the currency notes presently in use will no longer be legal tender from midnight tonight.” Added Finance Minister Arun Jaitley: “The goal of this is to clean transactions, [to] clean money.”

“This announcement appears to be the most significant change made by the Modi government to date,” says Girish Vanvari, partner and head (tax), KPMG in India. “Its impact could be even bigger than GST (the Goods and Services Tax which is still running the gauntlet of politicians).” Adds a report by Crisil, a global S&P company: “Tuesday’s move could change the face of the Indian economy, improve the government’s fiscal position and tax compliance. The size of the cash economy will shrink, as will black money generation avenues, because of the better cash-flow trail.”

That was Tuesday. By Wednesday, the picture on the streets had begun changing somewhat: The demon started surfacing. India is a cash economy; almost everyone keeps a few Rs500 notes as a nest egg. Lines forming in front of ATMs and banks which could exchange old notes for new. A mere exchange — a new Rs500 for an old Rs500 — was not enough; there was also a limit imposed on how much one could exchange or withdraw from their accounts. In some cases, there were altercations as people waited for hours. Gas pumps and hospitals (which were allowed to accept old notes) saw a boom in business.

About 85% of all currency in circulation has just been turned into coupons that can only be exchanged in specific places. These notes can be converted into currency again only with identity proofs (which hundreds of millions don’t have) and the additional hardship of standing in many queues for many hours.

Over half of India's population doesn't have any sort of bank account at the moment and about 300 million don't have basic ID such as Aadhaar either and hence, cannot access the banking system at all. About 130 million Indians have mobile wallets (about 25 million have credit cards) and there are maybe 550-600 million debit cards in circulation. So access to cash is very, very important for average Indians. India is a cash economy. Well over 90% of all transactions are done in cash.

Demonetization

Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit.

"This [demonetization] is a step which will make a positive difference, if the transition challenges get handled well by the administration," says Jitendra V. Singh, Wharton emeritus professor of management. "We will need to be careful of potential attempts to derail this positive agenda." The International Monetary Fund (IMF) echoes those sentiments. "We support the measures to fight corruption and illicit financial flows in India," said a spokesperson. "Of course, given the large role of cash in everyday transactions in India's economy, the currency transition will have to be managed prudently to minimize possible disruption."

According to Mauro F. Guillen, a Wharton management professor and director of the School's Lauder Institute, "In the short term, [the move] could stifle some businesses that are legal and clean, if they use cash payments. But everyone will adjust. And while it can hurt some small businesses and individuals, it is better to do it than not."

Guillen adds that large-value currency is an "important source of problems" such as corruption, black money, terrorism and counterfeit money. "The eurozone will be eliminating the largest euro note. The U.S. is also trying to reduce the [number of] 100 dollar bills in circulation."

The role of cash and high-value bank notes in the Indian economy cannot be understated. According to Reserve Bank of India (RBI) figures, as of March 2016 currency in circulation amounted to Rs16,415 billion. Of this, Rs500 notes accounted for 47.8% in value and Rs1,000 notes another 38.6%. Together, they were more than 86% of the value of the notes in circulation. That's a whopping amount to be frozen in one fell swoop.

Understandably, banks and ATMs can do only so much. There's a lot of tinkering to be done with limits and schedules of the exchange outlets and bodies authorized to take payments in old bills — state-owned electricity suppliers, for instance. To the credit of the government, this is being done on a continuous basis. But there are questions — especially from political parties — over their effectiveness.

Review

Sukanta Sarkar (2010) conducted a study on the parallel economy in India: Causes, impacts & government initiatives in which the researcher focused on the existence of causes and impacts of black money in India. According to the study, the main reason behind the generation of black money is the Indian Political System i.e. Indian govt. just focused on making committees rather than to implement it. The study concludes that laws should be implemented properly to control black money in our economy.

Tax Research Team (2016) in their working paper stated in favour of demonetization. Its main objective is to analyze the impact of demonetization on Indian economy. This paper shows the impact of such a move on the availability of credit, spending, level of activity and government finances.

However, because all people are unique and react to situations in a different way, it is interesting to have a closer look at what the influence of personality is on the relationship between social presence and product rating and product choice. **Uziel's (2006)** meta-analysis showed the responses toward social presence within social facilitation are moderated by personality regarding self respect. People scoring low on self respect are more impressionable for the effects of social facilitation. Derived from this his work, it can be said that personality traits can have an influence on the effects social presence, which will have on consumer behavior.

Steinbruck et al (2002) found that virtual reembedding increases online trust. Virtual reembedding means: incorporating social cues in an online design (such as photos, video text or speech). Likewise, **Dash and Saji (2007)** have found that increased level of social presence embedded in a website will result in greater trust in online shopping websites. Of the many ways to add social presence to a website, chat has been used by several other researchers.

Black Money

Black money stored in the form of Rs 500 and Rs 1000 notes helps in bringing out of our system. As predicted by ICICI Securities Primary Dealership the government's plan to scrap 500 and 1,000 notes will uncover up to 4.6 lakh crore in black money.

The biggest advantage of demonetization is that it helps the government to track people who are having large sums of unaccounted cash or cash on which no income tax has been paid because many people who earn black money keep that money as cash in their houses or in some secret place which is very difficult to find and when demonetization happens all that cash is of no value and such people have two options one is to deposit the money in bank accounts and pay taxes on such amount and second option is to let the value of that cash reduced to zero.

Since black money is used for illegal activities like terrorism funding, gambling, money laundering and also inflating the price of major assets classes like real estate, gold and due to demonetization all such activities will get reduced for some time and also it will take years for people to generate that amount of black money again and hence in a way it helps in putting an end this circle of people doing illegal activities to earn black money and using that black money to do more illegal activities.

Reduction in illegal activity

Banning high-value currency will halt illegal activity as the cash provided for such activities has no value now. Black money is usually used to fund the illegal activity, terrorism, and money laundering.

Fake currency circulation will come to a halt in a single shot. Corrupt officers, money launderers are under threat as Income tax department is taking all the measures to track such people.

Fake Indian Currency Notes (FICN) network will be dismantled by the demonetization measures. Taking out 500 and 1000 rupee notes out of circulation will have a lasting impact on the syndicates producing FICN's, thus affecting the funding of terror networks in Jammu and Kashmir, North-eastern states and Naxalite hit states.

Tax payment

Most of the businessmen who have been hiding some income are ready to pay advance tax as current year's income. Tax payers who have been hiding some income can come forward to declare income and pay tax on the same.

Individuals are required to submit PAN for any deposit above Rs 50,000 in cash, which will help tax department to track individuals with high denominations. Also, deposit up to Rs 2.5 lakh will not come under Income tax scrutiny.

Jan Dhan Yojana

Now individuals are depositing enough cash in their Jan Dhan accounts which they were reluctant to do so a few days back. The amount deposited can be used for the betterment of the country.

Real estate may see significant course correction

The demonetization decision is expected to have far reaching effects on real estate. Resale transactions in the real estate sector often have a significant cash component as it reduces incidence of capital gains tax. Black money was responsible for sharp appreciation of properties in metros; real estate prices may now see a sharp drop.

Political parties in crisis ahead of polls

With nearly five state elections in 2017, demonetization has stunned political parties. Especially, in large states like Punjab and Uttar Pradesh, cash donations are a huge part of "election management". In one stroke, big parties will find themselves hamstrung as cash hoards are often undeclared money. Parties will have to completely rejig campaign strategies in light of expected cash crunch.

Moving towards digital payments

Demonetization will likely result in people adopting virtual wallets such as Paytm, Ola Money etc.: This behavioural change could be a game changer for India.

Cost of currency destruction

After the news, we have seen that many individuals have burnt their cash and discarded the same, which is a loss to the economy. The government has to bear the cost of printing of new currency and its circulation. It makes sense when benefits of demonetization are higher.

Temporary chaos and confusion

The biggest disadvantage of demonetization is that once people in the country gets to know about it than initially for few days there is chaos and frenzy among public as everybody wants to get rid of demonetized

notes which in turn sometimes can lead to law and order problem and chaotic situation especially in banks and ATMs which are the only medium to change the old currency units to new currency units.

Public faced minor problem for a few days owing to the scarcity of lower denomination notes in the system.

Impact of Demonetization

The RBI (Reserve Bank of India) considers the CPI (consumer price index) as its primary gauge of measuring inflation. Prior to the RBI adopting the CPI in India (PIN), another measure of inflation—the WPI (wholesale price index)—was the key gauge of inflation and it's still considered for reference. To learn more about these measures of inflation, read India's different inflation measures—WPI versus CPI.

The RBI has CPI growth targets to adhere to while deciding its monetary policy stance. By January 2016, it was supposed to keep inflation below a target of 6%, which it was able to do. Its next target is to keep inflation at or below the 5% mark by March 2017.

The demonetization that has been in effect since November 9 is expected to have a negative impact on inflation. Consumer spending activity fell to a near halt. Consumers are refraining from making any purchases except essential items from the consumer staples, healthcare, and energy segments. Activity in the real estate sector, which includes a lot of cash and undocumented transactions, slowed down significantly, Metropolitan and Tier 1 cities reported up to a 30% fall in house prices.

Food item inflation, measured by changes in the Consumer Food Price Index, accounts for 47.3% of the overall CPI. Due to 86.4% of the value of the currency notes in circulation going out of the financial system and re-monetization being slow, the supply and demand of food items fell. It will exert more downward pressure on inflation.

Investors in India-focused funds (EPI) should continue to monitor CPI inflation. It will determine future rate cuts by the RBI. A change in the repo rate will impact interest rate-sensitive sectors and industries like financials (HDB) (IBN) and automobiles (TTM), among other sectors like the tech (WIT) (INFY) sector.

The government of India recently took a bold step to demonetize Rs 500 and Rs 1000 currency, which means that the legal tender of currency units is declared invalid from the specified date.

Most of the people hailed the Modi's strong decision, while poor were shocked by the move. The overnight decision changed the life of many as black money holders were worried about the pile of cash they were sitting on. Many poor daily wage workers were left with no job and income as owners were unable to pay their daily wage.

It is no doubt a bold step taken by the government which will definitely help India to become corruption-free.

Here are some advantages and disadvantages of de-monetization:

Conclusion

As one can see from the above that demonetization has both advantages and disadvantages and it is up to the government to see and analyze all the pros and cons and then decide whether it is beneficial to go ahead with demonetization or not.