

A Multidisciplinary Indexed International Research Journal

ISSN: 23203714

Volume: IX



ADHYAYAN
INTERNATIONAL
RESEARCH
ORGANISATION

“DEMONETIZATION ISSUES AND CHALLENGES”

*Submitted by : *Saritha Madipelli *Y. Chinnappaiah*

Research Scholar, Kakatiya University Warangal

Mobile no: 7799005525 E mail id: sarithamadpelli@gmail.com

Saritha Madipelli, H.No: 16-4-739,Shivanagar, Warangal, Telangana State

Mobile no: 7799005525E mail id: sarithamadpelli@gmail.com

Abstract

“Corruption and hypocrisy ought not to be inevitable products of democracy, as they undoubtedly are today” -Was said Mahatma Gandhi. To tackle the corruption and black money the prime minister of India has announced one of the boldest moves in the history of India’s socio- economic scene that’s is to demonetize the old Rs.500 and Rs.1000 notes. It is imperative to know the reasons, pros and cons of such a move. In this context the present article elucidates the impact of such a move on Indian economy.

Key words: Demonetization, corruption, black money, currency

Introduction

Currency demonetization is almost as old as the currency. The biggest demonetization phenomenon of modern currency was introduction of Euro, when all EU nations demonetized their currency and started using Euro. In modern world many countries including developed and developing countries have done it like US, Australia, USSR, India, Pakistan, multiple African nations like Nigeria and Ghana have done it.

To understand demonetization, we have to understand currency. Currency is a legal tender guaranteed by sovereign. IT demonstrates authority of a sovereign. In olden days it was representative of the king and his authority as sovereign. Higher the number of state accepting the currency of a king, higher was his stature among kings. This hasn’t changed since then. Today currency, apart from being the means of transaction represents the identity and independence of a country. Universal acceptance of dollar/pound and euro as international currency shows the clout

that these countries have on businesses worldwide. So, every time, a king acquired a new state, or a new king inherited the throne, he resorted to demonetize the coins of previous kings.

In modern world, after the paper currency was introduced, the demonetization has been a routine phenomenon primarily to take currency, which is no longer in use, out of circulation like lower or exceptionally higher denomination currency. 2nd most common reason for demonetization is counterfeit currency. New currency which better demonstrates the spirit of sovereign nation usually keeps replacing the old currency.

The latest initiative of the BJP government is the direct result of the injury caused to the Indian democracy and its individuals by the amount of corruption and black money taking place in India. On the heels of The Undisclosed Foreign Income and Assets (Imposition of Tax) act of 2015; and the Income Disclosure Scheme of 2016, the Narendra Modi government has announced demonetization of Rs 500 and Rs 1000

currency, which has been referred to as a masterstroke by many experts.

Meaning:

It refers to the decision of RBI/Government to recall the status of a currency note to be used as a legal tender. Usually all the currencies issued by RBI can be used as a legal tender as the value they carry is promised by RBI and once the value has been demonetized/recalled/revoked, the currency note cannot be used. Globally the central banks follow a practice wherein older currency notes are recalled and new currency notes with enhanced security features are issued so as to overcome the menace of counterfeit currency.

Objectives of the Study:

- To study the issues (Pros & Cons, Effect on Indian economy) involved in demonetization.
- To present the challenges faced by demonetization.

Research methodology:

The study is based on secondary data. The data is collected from analyzing articles on various newspapers, journals and internet sources.

Reasons for demonetization:

In India all sections of the society are accustomed to use cash transactions, and this habit is unscrupulously misused by some bad elements of the society. Such habit resulted in even people with accounted money are started using cash transaction for high value transactions.

- i. It is resulted into parallel economy with unaccounted money, even much stronger than regular economy. The parallel economy black money, corruption, counterfeit currency and terror financing. These issues hampered growth and development of the economy.
- ii. In this background demonetization of Rs 500 and Rs 1,000 currency notes as a master stroke, as the move will address issues like black money and

corruption and also help the economy become more digital.

- iii. The move will either unearth the black money slashed in the form of cash or forces to destroy those unaccounted currencies. Demonetization will curb the menace of black money and will help check stashing of funds to a large extent.
- iv. Similarly it has major impact on corruption that exists in India and also on financing of terror activities in India. Hence it was considered as courageous step in the fight against unaccounted money.

This is the only second time post independence (even before Independence Demonetization was done in 1946) that the measure such as Demonetization has been announced. The last time this was done was in 1978 under Morarji Desai government when Rs 500, Rs 1000 and Rs 10000 notes were demonetized. A CBDT report which evaluated this measure concluded that, it was an ineffective move as only 15% of the high denominations were exchanged.

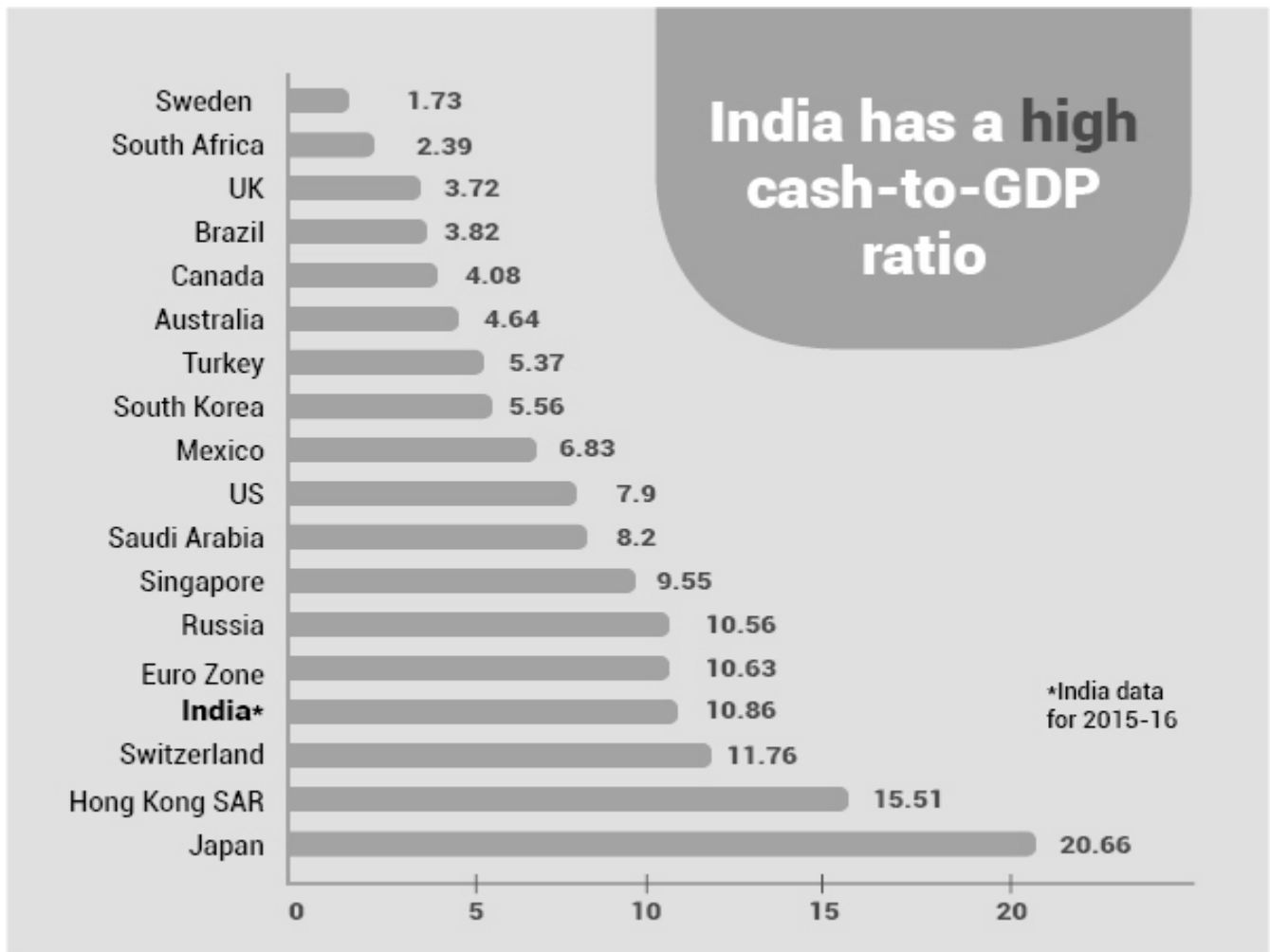
The rest never surfaced for the fear of stringent penalty by government. As per the High Denomination Bank Notes (Demonetization) Act, 1978, it barred the transfer and receipt of high denomination bank notes and made any contravention including false declaration by depositors and others punishable — with a fine or a three year prison term

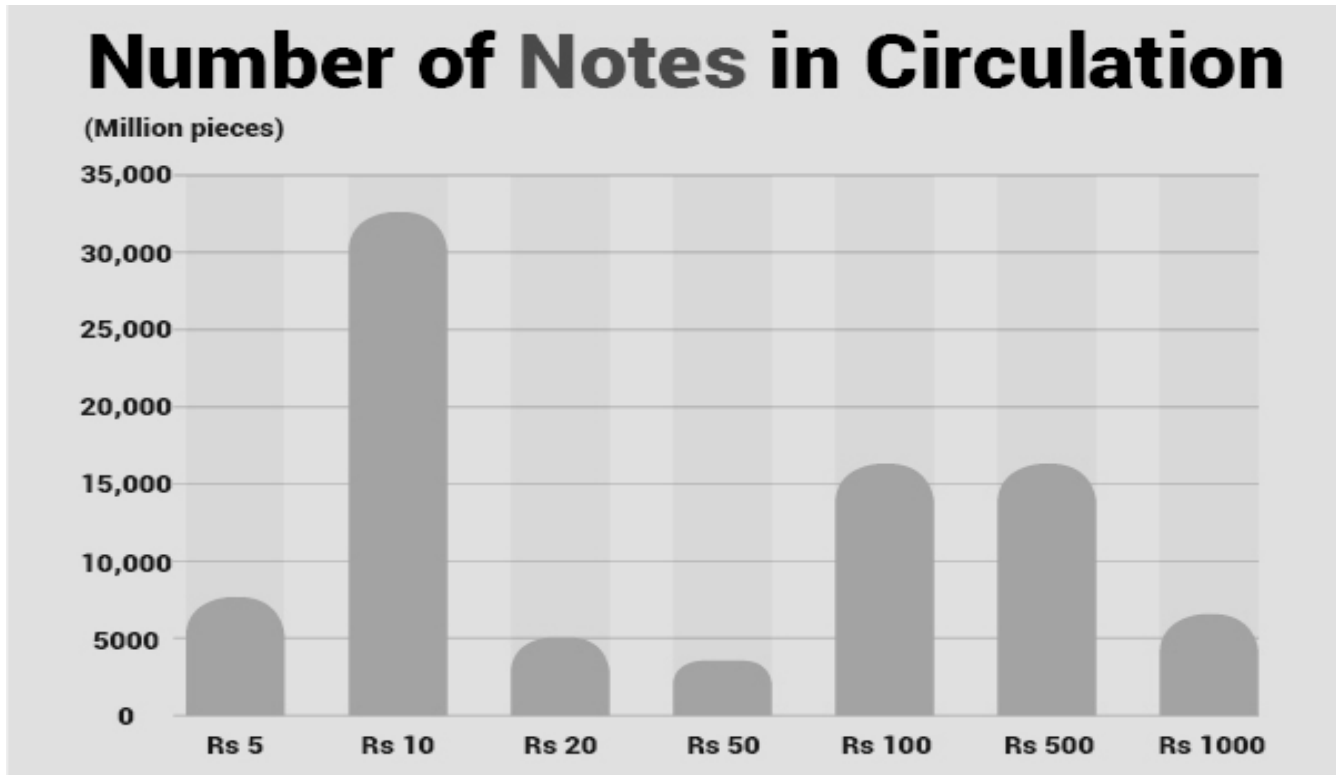
The report concluded that demonetization may not be a solution as black money was largely held in the form of benami properties, bullion and jewellery. Such a measure would only increase the cost as more currency notes which have to be printed. It could also have an adverse impact on the banking logistics.

(In the present age the European Central Bank has announced that it would demonetize €500 note)

India has one of the highest levels of currencies in circulation which is more than 12% of its GDP value; and the 1000 and 500 rupee notes account for 24.4% (around 2300 crore pieces) of currencies in circulation but for over 85% in terms of value of the currency in circulation Having said so it has to be kept in mind that India is not an outlier in this segment as there are various other countries such as USAs \$100 note and Japan's ¥10000 account for over 80% of currencies under circulation.

Denomination	Number of Units in Circulation (in millions)	%age of units out of the total circulation	%age value out of the total value of notes
Rs 100 note	15778	17.5	09.6
Rs 500 note	15707	17.4	47.8
Rs 1000 note	06326	07.0	38.6





Cash is the king – In India majority of the transactions are done in the form of cash. As per RBI, 87% of the transactions in India are cash transactions. As per RBI report, debit cards at ATMs account for 88% and 94% (by volume and value respectively) of the debit card transactions and 12% and 6% account for POS transactions.

The infrastructure growth is slow – The POS machines and ATMs are 1.2 million (and there are around 14 million merchants in India, in essence more than 90% of the merchants are not using the POS machines) and 0.19 million respectively. (From 2013 to 2015, ATMs increased by 43% and POS machines by 28%)

Reasons

- i. ATMs and POS machines are concentrated in urban area
- ii. Penetration in non-urban areas is very poor add to this, the connectivity issues
- iii. Even if the POS machines are installed, low value transactions are discouraged by the merchants
- iv. Silver lining
- v. The number of card issued are on the rise
- vi. The acceptance infrastructure has to be placed

- vii. Increasing trade on e-commerce (provided it promotes online payments/transactions)
- viii. Increasing number of digital wallets- Paytm, Pockets etc
- ix. The government has implemented Jan Dhan Yojana and under this a large population has been able to open their accounts which will be helpful (in the sense the debit cards issued have increased)
- x. Menace of counterfeit currency (FICN- Fake Indian Currency Notes)
- xi. As per the statements given in RS by Arjun Ram Meghawal (Minister of

State for Finance), the total FICN is to the tune of Rs 400 Cr

- xii. As per the Lok Sabha Website between 2011 and 2015, the RBI has seized around 26 lakh counterfeit notes of denomination Rs 500 and Rs 1000 amounting to Rs 167 Cr
- xiii. Amongst the two, FICN of Rs 500 currency notes were higher (both in numbers and in value)

As per a study done by ISI (Indian Statistical Institute), at any given point of time, the FICN is to the tune of Rs400 Cr and annually the FICN pumped into the economy is Rs 70 Cr

FICN Notes seized between 2011 and 2015

S.No	500		1000	
	Notes	Value in Crore (RS)	Notes	Value in Crore (RS)
2011	3.8 lakh	15.41	99,050	9.9
2012	5.3 lakh	26.51	1.65 lakh	16.54
2013	4.29 lakh	21.49	1.94 lakh	19.48
2014	2.9 lakh	14.52	1.46 lakh	14.69
2015	2.61 lakh	13.05	1.58 lakh	15.84
TOTAL	18.9 lakh	90.98	7.64 lakh	76.47

Measures taken:

FCORD (FICN Co-Ordination) group has been set up by MHA (Ministry of Home Affairs) to share the information with other security agencies regarding controlling FICN.

The MHA (Ministry of Home Affairs) has set up CCT Cell (Combating Financing of Terrorism Cell) to co-ordinate with FATF (Financial Action Task Force- it's a intergovernmental body has remarked that high value bills are used in money laundering schemes, racketeering, and drug and people trafficking).

TFFC (Terror Funding and Fake Currency Cell) has been set up under NIA (National Investigation Agency) to investigate the terror financing using FICN.

MoU (Memorandum of Understanding) has been signed between India and Bangladesh to prevent circulation and smuggling of FICN (majority of the inflows of FICN is done through Pakistan, Nepal and Bangladesh).

Less cash Vs Cashless

Debate has been raging in India over the need for the country to become a cashless economy but the fact of the matter is that sudden shift from cash based to cashless will have huge repercussions and not to forget that cash facilitates trade, hence there is a need for India to first move into less-cash economy (one of the aims in introducing Rs 2000 note) and then move towards becoming a cashless economy

The intelligent always find a way around when the currency are demonetized

It becomes much more difficult if they have stored the black money in other forms-gold, asset etc

So the way out is that rather than running behind these measures, we must implement the systems, procedures which will bring all those who are supposed to pay the tax, under the tax bracket and we can collect the appropriate taxes from them (as in India, the highest rate of taxation is around 33%, whereas in America, after including the federal and state taxes the tax rates are around 50% and in case of UK it is hovering around 45%)

The opportunists

The online service providers have up their ante when there is a shortage of currency notes, pushing their products/services by providing discounts, coupons, credit etc. For example Paytm, which is the largest mobile wallet company, has said that it (since the ban kicked in)

Pros of Demonetization:

- Attack On Black Money Holders - People who possess huge amounts of black money in hard cash are at a complete loss now .Their black money in hard cash is now a pile of trash. Now If a Black money holder Want to Deposit Money in Bank Account Than he/she Has to Show ID .There will be 200% penalty on income tax amount.
- Death Knell To Fake Currency Rackets -Most of the fake currencies used to be in the denominations of Rs. 500 and Rs. 1000 .By banning Rs. 500 and Rs. 1000 notes, Modi has busted all these unethical rackets completely .Now There Will be no use These Money
- End Of Terrorist Funding - Huge sums of money especially in hard cash in the

Has seen a 700% increase in overall traffic on the platform 1000% growth in the value of money added to the Paytm accounts Average transaction value has increased by 200% Mobile app downloads have increased by 300% Has processed around 5 million transactions each on 12th and 13th (Saturday and Sunday respectively) of this month.

denominations of Rs. 500 and Rs. 1000 was used to fund Islamic terrorists , Naxalites and other non-state actors. Now, these Organizations will suffer from shortage of funds .

-Most of These terrorist ,Maoist Organization Used These Funds For Buying Arms and Weapons

-Buying arms is an extremely difficult task now after this ban .

- Transparency - Online transaction = More transparency = [Financial Intelligence Unit](#) Will tack All Online transactions
- Now there Will be More Transparency In Real Estate Sector

- End of Huge Donations - Huge amounts of donation that is taken in the private education and healthcare sectors would be stopped

-Schools, engineering and medical colleges and hospitals (private ones) used to take huge amounts of money as donations especially in the form of hard cash in the denominations of Rs. 500 and Rs. 1000 .

-These money-minded people running these institutions won't be able to make any easy money now .

- Towards A Cashless Economy - While it is practically impossible to have a [100% cashless economy](#) , the proportion of hard cash in the economy will decrease and our economy will get

Cons of Demonetization:

- Rush At Banks -Banks will be extremely over-crowded by people .People will forget everything else and throng to the places where the banned notes are being officially exchanged leading to a tremendous chaos.
- Shortage of money to common people

more digitized.This will result in greater transparency. Now government has put some limitation for Cash Withdraw from bank Accounts. People will go for online payments, They Will Use PayTM or other online payment Companies for Buying goods or Making payments.

- More Use of Debit and Credit Card
- Hawala Transactions End - Most Hawala transactions used to be carried out in the denominations of Rs. 500 and Rs. 1000 .

-With this ban , Modiji has delivered a fatal blow to the unethical Hawala traders as they can't trade anymore using denominations of Rs. 500 and Rs. 1000 .

- Stock Market - Due to currency being sucked out of the market coupled with Trump's victory, the mood at the stock market was completely bearish.
- Problem For House Wives - Many Indian housewives 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 housewives is of

no use now until they exchange in the banks and post-offices .

- Short Term Inflation - Due to shortage of money in the market, a short-term cost push inflation will occur .
- The price of gold has already become sky high.
- Prices of vegetables and fruits have also soared burdening the common man.
- Marriage Season - difficult for those families those have weddings.

Impact of Demonetization on Indian Economy - Both Long term and Short term impact of Demonetization, Positive and Negative impact of Demonetization on Indian Economy.

- Effects on Parallel Economy - The removal of these 500 and 1000 notes and replacement of the same with new 500 and 2000 Rupee Notes is expected to – remove black money from the economy as they will be blocked since the owners will not be in a position to deposit the same in the banks
- Temporarily stall the circulation of large volume of counterfeit currency

- It would curb the funding for anti-social elements like smuggling, terrorism, espionage, etc.
- Effects on Money Supply - With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to reduce in the short run.
- To the extent that black money (which is not counterfeit) does not re-enter the system, reserve money and hence money supply will decrease permanently.
- However gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pick up.
- Effects On Demand - The overall demand is expected to be affected to an extent. The demand in following areas is to be impacted particularly:
 - Consumer goods
 - Real Estate and Property
 - Gold and luxury goods

-Automobiles (only to a certain limit). All these mentioned sectors are expected to face certain moderation in demand from the consumer side, owing to the significant amount of cash transactions involved in these sectors.

➤ Effects On Prices

➤ Effects on various Economic Entities

➤ With cash transaction lowering in the short run, until the new notes are spread widely into circulation, certain sections of the society could face short term disruptions in facilitation of their transactions. These sections are:

-Agriculture and related sector

-Small traders

-SME

-Services Sector

-Households

-Political Parties

-Professionals like doctor, carpenter, utility service providers, etc.

-Retail outlets

➤ Effects On GDP - The GDP formation could be impacted by this measure, with reduction in the consumption demand.

-The impact on GDP growth is clearly going to be negative in the short run and depends to a large extent on how long the cash crunch is going to take," Thomas Rookmaaker, Director, Fitch Asia Pacific Sovereigns Group,

-Most of International Credit rating Agencies Cut India Growth rate.

-GDP growth rate is likely to slow down anywhere by 0.5 percent to 2 percent from the last year GDP growth of 7.6 percent for at least for next 6 months.

-After a slowdown of 6-8 months the GDP is expected to grow rapidly.

➤ Effects On Banking Sector - As directed by the Government, the 500 and 1000 Rupee notes which now cease to be legal tender are to be deposited or exchanged in banks (subject to certain limits).

-This will automatically lead to more amounts being deposited in Savings

and Current Account of commercial banks. This in turn will enhance the liquidity position of the banks, which can be utilized further for lending purposes. However, to the extent that households have held on to these funds for emergency purposes, there would be withdrawals at the second stage.

- Effects On Online Transactions And Alternate Payment Methods - With cash transactions facing a reduction, alternative forms of payment will see a surge in demand.

-Digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), etc. will definitely see substantial increase in demand. This should eventually lead to strengthening of such systems and the infrastructure required. In spite of the initial hiccups and disruptions in the system, eventually this change will be well assimilated and will prove positive for the economy in the long run.

- Black money hoarders will definitely lose out, eventually boosting the formal economy in the long run.

- Short term fall in real estate prices might benefit middle class citizens.
- This move by the Government along with the implementation of the GST will eventually make the system more accountable and efficient.

Challenges ahead:

This ban on high denomination currency has the potential to dramatically push up the volumes of electronic transactions. Consequently there are new cyber security implications.

In the emerging cashless transaction environment the government and the businesses will have to be on their feet to guard against cyber attacks as they are carried out not merely by criminals, but also by nation states.

Cyber warfare perpetrated by enemy states has the potential to hit a country's economy. Terrorist networks will find ways to penetrate the most protected vaults in the world in the absence of unregulated cash transactions.

The coverage of the banking sector- Only 27% of the villages have a bank within 5 Kms (as per Economic Survey 2015-16).

In spite of recording breaking implementation of JDY, the banking penetration is low-on an average 46% in all the states (as per Economic Survey 2015-16).

Another challenge in implementing and eradicating black money would be presence of informal economy. It accounts for 45% of GDP and 80% of employment hence this move may have a greater impact on informal economy.

Logistics and cost challenges of replacing all the Rs 500 and Rs 1000 notes – as per the RBI documents this measure would cost at least Rs 12000 crore as it has to replace over 2300 crore pieces of these currencies.

The decision to issue Rs 2000 denomination currency and withdrawal of Rs 500 and Rs 1000 currency will lead to huge challenge as most of the day to day transactions in India are centered around Rs 500 note (more than 47% of the value of notes in circulation is in Rs 500 note form)

The availability of Rs 500 and Rs 1000 notes will be the biggest challenge as both of them covered over 85% in terms of value of total currencies issued.

The process has led to huge rush and long queues of the people in front of ATMs and as

per the statement of finance minister the ATM recalibration would take around 2 to 3 weeks.

As per data furnished by the Finance Ministry, Rs 17,50,000 crore worth of currency notes were in circulation in October-end, out of which over 85% per cent or Rs 14,50,000 crore is in the now defunct Rs 500 and Rs 1,000 notes. So far for the first four days the government has been able to pump in Rs 50000 cr (on an average 12500 Cr). Going by these numbers it would take around 4 months to replace these notes as against the 50 days promised by the PM.

What needs to be done;

There is an immediate need for banks to get proactive about information security and beef up their IT infrastructure against potential cyber attacks. What holds good for banks also holds good for other businesses as cyber criminals are quite capable of targeting Point of Sale terminals, mobiles and a variety of other devices.

With more electronic transactions and monitored cash disbursements the government will have better control on who has access to money. But we will need a robust and a proactive cyber security strategy to ensure these objectives will work.

There is no doubt that the coming months will be painful for the common man, small businesses, housewives etc as there will be some shortage of legal tender/currency that will have an impact on them. Another rising issue will be that the demand for POS machines, Debit Cards which has to be resolved lest the measures will become an obstacle rather than the solution.

If these measures are implemented efficiently then we can expect higher collection of taxes, higher investments in the market, price corrections, improvement of India in some of the international rankings, prevent corruption practices etc and these are some of the reasons why people although are going through difficulties are lauding this measure of the government.

Conclusion:

Economists are busy in listing out many more merits and demerit of this policy. The government is saying that there are only

advantages of demonetization policy and this will be seen in the long term. Former Prime Minister Manmohan Singh who is a noted economist, former RBI governor and former Finance Minister of the country, dubs the demonetization move as an organized loot and legalized plunder. However, if we compare the merits verses demerits, it will be safe to conclude that the former outweighs the latter. Even though there is suffering and agony among the masses right at the moment but the forecast is that its benefits will be seen in the long run. Hence the government has to take necessary steps and actions to meet the currency demand and soon the trial and tribulations of the people will be over with the smooth flow of the new currency.

References:

- The Japan time Business line
- **Webliography**
www.financialexpress.com
- www.researchgate.net