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### Demonetization and Its Impact on Various Sectors

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#### **Introduction:**

On 8<sup>th</sup> November 2016, PM Narendra Modi announced the demonetization of rupees 500 and 1000. He said “Notes of rupees 500 and rupees 1000 will not be legal tender midnight. And from 9<sup>th</sup> November 2016, these notes will be just a piece of paper, totally worthless. Though in last 5-6 months we all heard and experienced it in daily life we don’t know what exactly demonetisation is or what is the meaning of it. Here in this post, we will clear all these basic facts.

As per Investopedia, “Demonetization is an act of stripping a currency unit of its status as legal tender”. Now, what’s legal tender means, again as per Investopedia, “Legal tender is any official medium of payment recognised by law that can be used to extinguish a public or private debt, or meet a financial obligation”. In simpler words, after demonetization of 500 and 1000 rupee notes one cannot use it under law (legally) for financial transactions. You cannot buy any goods or service with it.

#### **Objectives:**

- 1) To study the meaning of demonetisation
- 2) To study the Impact of demonetisation on the various sectors
- 3) To study of advantages and disadvantages of demonetization

#### **Meaning and Definition of Demonitisation:**

1. 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 currency.
2. to divest (a monetary standard or the like) of value.
3. to withdraw (money or the like) from use.
4. to deprive (an issue of postage stamps) of validity by legal methods and without marking the stamps themselves.
5. Demonetisation is an act of cancelling the legal tender status of a currency unit in circulation

#### **Effects of Demonetisation on various sectors of Indian Economy**

Demonetisation, that sent a shockwave across the Indian economy, completes one month since its announcement on the midnight of November 9. To uproot the problems of corruption, black money, and counterfeiting, Prime Minister Narendra Modi orchestrated this master plan which has reportedly swept off a mammoth portion of India’s monetary base. It is anticipated that this surgical strike on black money will also increase cashless transactions in the country and untie all knots in tax collection. But on the other hand, rural households and elder citizens have been worst hit due to the sudden monetary reform. The decision to scrap all Rs.1000 and Rs.500 notes have made it to headlines all over the world, attracting both positive and negative comments.

### **Demonetized currency and small savings schemes**

Government has notified banks to not accept the discontinued currency notes for deposit in small saving schemes. However, no reasons have been specified for such a move by the competent authority. Small savings schemes are one of the most sustainable financial options which provide greater returns with low risk factor. Some of the popular savings schemes are Kisan Vikas Patra, Sukanya Samridhi, Post Office Savings Schemes, etc. For those without access to banks, cash transactions are the only practical means to meet their everyday requirements and for small scale investments. The statement also mentions that Post Office accounts have been excluded from the rule imposed on small savings schemes.

### **Impact of Demonetisation on Indian economy**

In a country where 85% of transactions take place by cash, cancelling the legal tender character of two high denomination banknotes arises a lot of questions. The service sector in the country that depends mostly on cash transactions will be adversely hit because of Demonetisation. Not to mention, the consumption activity of India has come to a screeching halt. This drop in economic activity could last for a few months and as a result, GDP could fall significantly from the previous year's values.

Even as country faces the greatest financial crunch of all times, some analysts predict the economic conditions to stabilize in a few quarters. Deutsche bank and Goldman Sachs expect India to join the list of the fastest growing economies by next fiscal year. An improved monsoon season in 2017 can favor agricultural economy of the nation, which in turn will add to the financial recovery as a whole. Economists also predict that the decision to scrap high-value currency notes will lead to GDP growth by 2%.

### **Effect of Demonetisation on bullion market**

Demonetisation is expected to bring sharp changes in the prices of gold, and it is likely to start reflecting from the first quarter of 2017. At present, gold rates are not being announced by most of the jewelers due to dampening trade. Recently, government also announced the exemption limits on gold ornaments as the next giant move to curb black money. The notification comes within weeks after invalidation of Rs.500 and Rs.1000 notes. The following restrictions have been placed on the possession of gold:

### **Effects of Demonetisation on real estate**

The unorganized sector will be largely affected by the invalidation of the higher denomination currency notes. However, there won't be much of a change in the primary real estate market as property buyers make purchases either in the form of cheques or through loans. The impact of Demonetisation may be felt in secondary markets where most of the property dealings happen through cash. The currency reform is likely to yield positive results in the real estate sector with increased transparency in dealings. More opportunities can be expected from debt investment, private equity, and FDIs as well.

### **Demonetisation impact on equity and mutual funds**

The effect of Demonetisation on equity funds is expected to be positive with more money entering the organized system of financial transactions. If cash flow across the nation is fully tracked, equities will strengthen significantly, as more people will invest in equity linked savings schemes to save on taxes

### **India moves to cashless economy**

One of the key effects of Demonetization 2016 has been that more people have made digital payments part of their lives moving towards a cashless economy. The details of growth of

such digital transactions since January 2016 to August 2017 reflect that NEFT transactions that involved Rs. 7086 bn increased to Rs.12500 bn; Debit cards transactions increased from Rs.2328 bn to Rs. 2700 bn; credit cards from Rs. 214 bn to Rs.366bn and the IMPS transaction which was not used by the people, got a share of Rs.651 bn.

#### **Advantages of Demonetisation :**

1. Eradicate the use of fake currency.
2. Tackle with corruption due to currency upholds.
3. Withdrawal of old currency and bring unaccounted money back into the banking system by a considerable increase in bank deposits. With this the idle money becomes productive.
4. Encourage digital payment modes to reach the target of a cashless society.
5. Reduction of illegal activities.
6. Reduced tax avoidance by encouraging higher tax payments. With a perfect implementation, demonetisation policy can provide a great boost to any country's economy.

#### **Disadvantages of Demonetisation :**

1. Inconvenience to the public.
2. Huge economic cost to the nation.
3. Disruption of business activities.
4. Decrease in sales, particularly cash based sales.
5. Labour / Wage payment issues.
6. Additional printing and distribution cost of new currency.

#### **Conclusion :**

Even though demonetization move created adverse short-term policy impact the real impact of must be assessed in the medium/long term. The reduction in overall investments, both in the formal and informal sectors, would certainly reduce economic growth potential. However, the move need to be followed up with ensuing actions to remain effective. These actions relate primarily to structural changes to make the system more lawful, reducing too much bureaucracy, make the tax system simple and transparent. In addition, a greater effort is required to include the informal sector and ensure effectiveness and the illegal activities such as generation of black money and corruption should not be channeled back into the economy.

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