



DEMONETISATION: A STRATEGIC MONETARY TOOL

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ABSTRACT

The last stroke of demonetization on November 8, 2018, declared by the Prime Minister of India, Mr. Narendra Modi was an unexpected decision that had taken the people aback. Its abruptness was most appropriate making the decision more productive and effective. Every human decision, irrespective of the field, is always imperfect. In democratic country, the opposition plays a role in thwarting the advantages of any government decision. Nevertheless, the creation of black money and expansion in corruption have been slowed down in aftermath of the demonetization.

Key words

Monetary tools, demonetization, tax evasion, Havala deals.

Introduction

The Central Bank of the country that holds the exclusive and absolute authority, on the recommendations of the government issues order and switches abnormally fast to introduce new currencies in exchange of the existing national currencies. Undoubtedly, this exceptional tool, which creates monetary turmoil in the national markets, is brought into operation to strike upon the number of economic ills and crimes that cause to damage the very structure of a country's economy. The unscrupulous and reckless elements whenever make the mockery of national currencies, in order to protect the economic interests of the government and the public at large, such steps are inevitable. Long ago, the first celebrated Governor of the Reserve Bank of India, Dr. C.D. Deshmukh (1) warned in these words, "I do abstain with a great restraint from demonetizing the national currency at this point of national political turmoil, as it will add fuel to the fire".

The Government of India resorted to strong dose of demonetization on November 8, 2018, for a number of reasons. It was a historic bold decision unpredictably announced by the Prime Minister himself. Its impact on several lateral aspects of the economy has not been critically examined in an objective manner. An exhaustive attempt is made in this paper to highlight its



contents and impact on a few significant fields of the economy of the country. Prior to such study, it is in the fitness of things to clearly understand the nature, conditions and results of demonetization In the country.

The last demonetization on November 8, 2018 was not the first incident in India. In 1946, The Reserve Bank of India under the governance of Dr. C. D. Desmukh had demonetized the currency notes of Rs. 100 and 1,000 in order to protect the currency war from neighboring countries. Late Morarji Desai, the then Prime Minister of India, got an Ordinance issued by the Government of India for demonetization of currencies of Rs. 1000/- 5,000/- and 10,000/ in order to huge cash holdings by individuals and the corporate sector. The common people were not affected by those incidents of demonetization.

Definition

According to A.C. Datar (2) demonetization is the act of stripping a currency unit of its status as legal tender. The current legal tender having become illegal is replaced by new currencies in exchange within the fixed period of time. No sooner the demonetization is declared by the government, the people have to exchange their currencies holding into new legal tender within the stipulated period. During the exchange, the bankers offering the services of exchanging new currencies may ask the sources of holdings in old currencies. They also examine the legitimacy of the old currencies submitted for exchange. Unless the bankers are assured of authenticity of the old currencies, they can deny conversion into new currencies. The holder of the old currencies is required to furnish the necessary documents in support of his claims.

The last stroke of demonetization was severe and harsh disturbing the common citizens in India as they were totally unaware of the its reasons, processes and effects. No doubt, the Prime Minister himself while declaring the decision of demonetization had narrated them in details. The confused minds of the people could not grasp its mechanism. In the light of such confusion worst confounded, the attempt is made here to explain its causes and consequences affecting the economy of the country.

Objectives

The objectives of this study include;

- to examine the causes and conditions cognized by the government in declaring the stroke of demonetization different currencies;
- to analyze the consequences on certain sectors of the economy as well as certain markets.



Hypothesis

Demonetization is exclusively a monetary decision or measure recommended by the Reserve Bank of India and announced by Government of India. The hypothesis, the basis of this study, implies that it was unexpectedly declared by the government to curb the black and unaccounted money kept hidden in huge currency notes of different denominations by unscrupulous dealers in money and properties whether individuals or corporate entities.

Analysis

Cash transactions by all the sections of the society multiplied umpteen times as the matter of habit. According to Dr. C. Rangarajan, (3) the former Governor of the Reserve Bank of India, “Whenever the velocity of currency expands, the clouds of inflation loom large over the economy”. But it is not advisable to restrain the velocity for tactical reasons. . Such habit resulted in even people with accounted money are started using cash transaction for high value transactions.

Causes for demonetization

[1] Generation of Unaccounted Money

There are a number of factors that cause to generate massive unaccounted money. While buying the property its buyer pays the amount in cash equivalent to the value stipulated in the sale deed. In order to minimize the property tax, the seller value stipulated therein is far less than its actual price. Since, undervaluation does not mean underpayment; it causes to generate unaccounted cash with the seller of property. Under invoicing, under commission, etc., create unaccounted cash called black money.

[2] Counterfeit currency

Unscrupulous and reckless dealers money secretly introduce fake or counterfeit currency in the economy in massive amount, Ordinary people unaware of the difference in legal tender and fake currency, openly and freely exchange without any iota of doubt. Huge amount of legal currencies are displaced by illegal currencies generating black money in the country.

[3] Terror Finances

In India ever since independence, the number of terror groups with different denominations have been active to disorder for destabilizing the legally formed governments. The huge foreign



currencies through illegal channels get entry into the economy of the country without the knowledge of the RBI. They cause displacement of legal tender from the circulation despite the strict control by central bank i.e. RBI. Havalatransactions being beyond the control of the bank, have been most dangerous channels injecting high doses of illegal currencies in the country.

[4] Corruption

This is an inevitable malaise or evil that is rampant in every field of human activity. The people in service having legal or administrative powers have cheeks to ask for money for rendering services to the common public. The amount required depends upon the propensity of the need of a person to secure the services. The money so received cannot be deposited in any bank nor could any property be developed which is subject to clearance from the income-tax authorities. The black money so generated is stored in legal tenders but cannot be declared.

[5] Taxevasion.

Evasion of income tax, capital gain tax, and many other taxes is another factor that importantly contributes in generation of black money. Under pricing of commercial goods, luxurious goods and heavy machines and flats and houses are observed to be the major sources of generating black money in the country. Transactions never offer any clues in estimation of evasion of taxes. According to the rough estimates of the Public Accounts Committee of the Parliament in its Report for the year 2018-19, the following are the share of different source in generation of black money in country”

Sources	Percentage of contribution
• Generation of unaccounted money	24%
• Counterfeit Currency	21%
• Terror Finance	17%
• Corruption	18%
• Tax evasion	20%

Significant Indicators

- Currently high-value currency notes accounts for the value of 86% of the notes in circulation in India.
- According to some estimates the size of the black economy in India range from 20% to 60% of GDP and more and the currency in circulation is just 12% of GDP.



- Even if more than 50% of money in circulation is black money, but most of it will find its way back to the banking system one way or another, and be recycled as new notes.

Positive effect of Demonetization

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.

Another benefit is that due to people disclosing their income by depositing money in their bank accounts government gets a good amount of tax revenue which can be used by the government towards the betterment of society by providing good infrastructure, hospitals, educational institutions, roads and many facilities for poor and needy sections of society.

Negative effect of demonetization:

[1] Scarcity of ready cash

The small denominations are accounted to only 14 to 15% of the total currency in the market, more and more small denominations would have been supplied. The currency may not be supplied in a large number.

[2] Economic slowdown:

The major industries like real estate, infra, gold etc. have been affected and sales would come down and that impacts the growth of the economy. Many transactions halt, until the markets get back to normalcy. Markets may see a temporary fall, and temporary recession. At least a year would be the span to retain the normalcy. There could be a long-term gain.

[3] Problem of small currencies



This step proved that, given a chance, every individual is prone to corruption. Indian banking system is supposed to be one of the most stable, rigid and strongest across the globe. Our banking system is so strong that it could even face and withstand the global recession in 2008, but all that reputation is at stake now. This bold step leads to many banking frauds and illegal transactions across the country. Bankers, Currency chests and may be a few at RBI, played a major role in the frauds post-demonetization. Police, CBI and I-T raids are just seeing shocking and disturbing figures of new currency been supplied illegally. Also, poor people are prone to corruption. There are huge deposits in Jan dhan accounts, bank accounts of poor people, which shows even poor people are corrupted and are ready to save the corrupted. So, given a chance, at least 95% of people are prone to corruption. We expect a very serious action with respect to banking frauds, as we common people are facing the trouble and can't afford to see things happen this way. But, it is the responsibility of the government to take out all the lawbreakers in order to gain the credibility, as it shouldn't be very difficult to track the new currency as it is just a month old.

Due to the demonetization millions of citizens and foreign Indian residents are facing on account of making high currency notes as illegal tender. Families of Indian origin/NRIs could possibly have anywhere from 1000 to 50,000 rupees value with them with these high denomination currencies that they may have as leftover from previous visits or they purposely keep to not have to rush to foreign exchange every time they visit India. Based on the current RBI guidelines, at this point, their only direct options are either waste this money or come to India to deposit into accounts. The latter is not practical as the travel costs + unplanned vacation time would end up being way more expensive than the amount they possess. All of this is legal (White) money and there's no reason for anyone to accept that this money should be wasted. With a rough calculation, possibly about many thousand cores of amount is at stake due to this issue. As you would know, currency exchange businesses and all local and Indian banks have also stopped exchanging Indian currency outside India, immediately after the PM's announcement on Nov 8th, so converting to local currency option is also ruled out.

Summary

Central government's to demonetize the high value currency was certainly a major step towards the eradication of black money in India. The demonetization drive as obviously created a number of problems for the common citizens but they patiently suffered it in a larger interest of the country such decisions are inevitable. Also it may not curb black money fully, but definitely it has major impact in curbing black money to large extent.

ChetanBhagat (3) .says, “ We Indians have no choice to believe the intent of the politicians, instead of looking at implementation part. I may add to this, we as a democratic country going



through a very volatile phase. Some people are becoming fan of politicians, which is very dangerous. In this process we loss the very important principle of asking questions in a democratic environment”.

Few experts were of the opinion that the last demonetization could reduce the black money only to an extent of 5 per cent, while the government claimed the eradication of black money to an extent of more than 53.7 per cent by the end of March 2019.

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