

# DEMONETIZATION- A MAJOR BANKING SECTOR REFORM POST INDEPENDENCE

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**Abstract-**This paper gives the note on major banking sector reform post independence its impact on the economy and views of an author which could make the readers a in depth understanding of the phenomena. Demonetization is the act of stripping a currency unit of its status of legal tender or scrapping high value denomination currency unit in the country. The government reasoned that this process would strength the hands of common citizens in the fight against corruption and black money and counterfeit notes which used to fund terror attacks, he viewed that how the magnitude of cash in to circulation is linked to inflation and how inflation situation has worsened due to the cash deployed through corrupt means which widened the gap between have's and have not's and brought huge inequalities in income distribution. He reiterated that despite India's very good growth trajectory on the world average it ranked 130<sup>th</sup> position by the World Bank in the list of 189 countries. With this all measures the rulers of the country expected transparency in tax compliance, realization of assets and people of the country at some extent. Unplanned and sudden move had brought a big impact on the common man and the livelihood of daily wage earners, artisans had been affected badly. We get to see serpentine lanes before the banks and ATM's to convert old currency notes for new currency and withdrawal of cash. Government had failed to maintain enough new currency stock at the chest of banks to remonetise which brought the economy to grinding halt for some time and the country's growth rate has been affected. The government could have done the process of demonetization in a phased manner without affecting the common man. Hence, the very purpose of demonetization is to weed out corruption from the system which it had failed to address.

**Key Words:** Goods and Service Tax, Reserve Bank of India, Micro, Small and Medium Enterprise

## 1. INTRODUCTION

Demonetization is the act of stripping a currency unit of its status of legal tender or scrapping high value denomination currency unit in the country. On Tuesday, November 8<sup>th</sup> 2016 the prime minister of India addressing the nation announced that the Rs. 500 and Rs. 1000 notes will no longer be legal tender from the midnight of November 8<sup>th</sup> 2016 and a new series of Rs. 2000 and Rs. 500 notes will be issued by Reserve Bank of India (RBI). The Rs. 500 and Rs. 1000 notes were about 86% of the total value of currencies in circulation estimates of RBI till October 2016.

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To ease the process of demonetization few efforts are being taken by government from past 3 years which include formation of Special Investigation Team (SIT) on black money, law passed in 2015 on disclosure of foreign bank accounts, levy of strict rules to curtail benami transactions in 2016 and voluntary disclosure schemes like Income declaration scheme IDS 2016 have been resulted in unearthing more than □ 1.25 trillion worth of black money from the system.

To supplement the surgical strike on black money the earlier steps being taken by the Government to move towards a cash less economy like Jandhan yogana, Payment banks, Digital India, Unified Payment Interface (UPI). The first part of the article is about the introduction of the titles, second part is about the brief history and the third part discusses the impact of demonetization and fourth part offers concluding comments.

## 2. HISTORY OF DEMONETIZATION

Demonetization is not new phenomena , in the past twice it has been affected but failed to bring desired results, firstly in before independence the then British Government in 1946 had demonetized the high value currencies in circulation like 10,000 , 5,000, 2,000 denomination currency notes. Secondly when Janata party assumed power in 1977 post emergency period again on January 1978 announced demonetization of high value currencies of 10,000 and 5,000 currency notes. Hence, it failed bring desired results due to huge corruption from the ground level.

Need for demonetization: Usually countries resort to invalid the high value denomination currencies to tackle the issue of counterfeit currency notes, to effectively nullify black money hoarded in cash and to curb funding of terrorism with fake notes.

As per RBI, the counterfeit currency detected in banking system has increased from ₹1.25 lakh notes to 6.33 lakh notes in 2006 and 2016 respectively. As per the IMF report, the estimated size of India's shadow economy grew from 23.6 of GDP in 2002 to 25.6 percent in 2007. It is estimated shadow economy would be approximately 30 percent of the GDP by 2016.

India ranked 3<sup>rd</sup> in illicit financial outflows after china and Russia in 2013 almost US \$ 83billion of illicit money was siphoned out of India- by Global financial Integrity.

In the common parlance demonetization expected to benefit the country in the long run like GDP growth and realization of Assets, increase in the revenues of government by better tax compliance, fall of prices of commodities in the short run due to reduction in the purchasing power of people in the short run. Since demonetization was announced on November 8, how much old 500 and 1000 rupee notes will not come back into the banking system has been a subject of intense speculation. The economic research department of SBI expects Rs. 2.5 lakh crore not to come into the banking system. According to SBI's estimates, Rs. 13 lakh crore worth of banned notes might be deposited in the banking system out of the total value of high denomination currency in circulation (before November 8) worth Rs. 15.5 lakh crore. This means that around Rs. 2.5 lakh crore might not be coming back into the system, the bank said in a report. Of the total Rs. 2.5 lakh crore not coming into the banking system, the amount not coming back altogether due to unlawful activities, for example, could be around Rs. 1.5 lakh crore this amount assumed to be not going to be disclosed by the individuals.

SoumyaKanti Ghosh, the author of the report and group Chief Economic Adviser at SBI, told NDTV Profit that the extinguished currency liability is among the things "that the RBI and the government need to work out." Out of the Rs. 2.5 lakh crore, Rs. 1 lakh crore could be disclosed under the recent self-declaration of undisclosed income scheme, the report said. Under the scheme, taxpayers may declare undisclosed income by paying around 50 per cent tax. "This means there will be an immediate short term benefit to the government will be Rs. 500 billion (Rs. 50,000 crore)," the report said.

It is believed that taxes collected will be beneficial to the government rather than currency getting extinguished as such taxes could be immediately factored in next year budget for welfare needs". This means on the RBI's balance sheet, the liability in the form of notes issued gets extinguished to the extent the banned notes are not deposited. Mr Ghosh said that at this juncture it is too early to talk about how fast the Indian economy would rebound from the anticipated slowdown caused by demonetization.

An example of demonetization for trade purposes occurred when the nations of the European Unionofficially 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 economy.

### 3. IMPACT OF DEMONETIZATION

The immediate effect on the general cash market transactions until the current value denominations have been replaced with new notes. On the other hand high denomination notes are the preferred payment mechanism of carrying illicit activities (hawala transactions, betting, gambling etc). The announcement to remove the current high denomination notes out of the system was sudden without any prior intimation provided with little and no opportunity for entities to convert their black money in to white. This sudden overnight shocking move has halted all type of illegal activities.

In the short run, the large part of the informal sector that engages only in cash transactions will face disruption. Various sectors to be impacted are retail, transportation, metal scrap and dealing in agriculture land. In the long run, this initiative along with Goods and Service Tax (GST) will push the informal sector to become more organized and transparent. GST and its supporting bills have passed recently in the both houses of parliament on 29<sup>th</sup> March 2016 and got a assent from the President of India will get in to force from 1<sup>st</sup> July, 2017.

There is a logic as the money supply in the economy reduces (reduction in purchasing power of the people) would reduce the interest rates, prices will fall and inflation will ease in the short run, with the increase in the declaration of income and income sources, the revenue collection of the government will increase for the current fiscal year and help in further reducing the fiscal deficit. Economic growth of a country is expected to fall for the next few quarters

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due to fall in the manufacturing activities and allied operations. The MSME (Micro, Small and Medium Enterprises) comprise almost 51 million units in the country and 93% of them are unregistered. Small traders and business in the rural areas and semi-urban parts of the country had affected badly because their existence is on only cash transactions. Small and medium size business across the country are likely to be struggling to cope with lower consumer demand, fewer supplies and pending salaries in the short run. For a short term perspective, demand slowdown is expected to be seen in certain sectors such as real estate, high ticket consumer durables, luxury brands etc.

### CONCLUSION

With this all measures the rulers of the country expected transparency in tax compliance, realization of assets and people of the country at some extent. Unplanned and sudden move had brought a big impact on the common man and the livelihood of daily wage earners, artisans had been affected badly. We get to see serpentine lanes before the banks and ATM's to convert old currency notes for new currency and withdrawal of cash. Government had failed to maintain enough new currency stock at the chest of banks to remonetise which brought the economy to grinding halt for some time and the country's growth rate has been affected. The government could have done the process of demonetization in a phased manner without affecting the common man. Hence, the very purpose of demonetization is to weed out corruption from the system which it had failed to address.

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