

## Demonetization Of Currency Notes: Significance And Challenges

Mr Sharif Mohd.

P.hd, Resaerch Scholar, Department of Commerce,  
Himachal Pradseh University, Shimla

*Abstract: 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. The demonetisation was done in an effort to stop the counterfeiting of the current banknotes alleged to be used for funding terrorism and for cracking down on black money in the country. Following the announcement by the Prime Minister the Governor of the Reserve Bank of India (RBI), Urjit Patel made a press release with details on the procedure for exchanging the 500 and 1000 rupee notes that are currently in circulation. On 8 November, other than the notification that these denomination will be discontinued. The present study has been deals with the announcement of demonetization of currency notes (500, 1000) its needs and challenges faced by the society. Secondary data has been used for study which is collected from different newspapers and websites. Hence, it can be concluded that apart from disrupting daily lives of the common citizen, there are even bigger implications for the economy as a whole. Politics and various elections are known to run on cash. Same is the case with sectors such as real estate. The rural areas in particular, which do not have formal sources of banking, also deal largely in cash. Unorganised labour, including in urban households, such as domestic workers and drivers, are paid in cash, and mostly in these denominations. It is too early to even imagine the impact on all sections of society and parts of the economy. The advantages of this move, though, will be felt only in the long-term. While formal modes of payments such as debit and credit cards, net-banking and digital wallets should get a boost, this will take a long time to be felt simply because the proliferation of these products is still low among the middle classes and the poor, for whom cash is still the predominant mode of transactions. The government's move is bold in its intent and massive in its measure. Arguably, this is Modi's biggest move since he was elected prime minister. While the intent is clear, the implementation and impact is yet to be seen.*

**Keywords:** *Demonetisation, currency notes, RBI, Exchange of Currency.*

Demonetization is the act of shedding 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. The coins issued under the authority of Section 6 of The Coinage Act, 2011, shall be legal tender in payment or on account i.e. provided that a coin has not been defaced and has not lost weight so as to be less than such weight as may be prescribed in its case:

- ✓ Coin of any denomination not lower than one rupee shall be legal tender for any sum.
- ✓ Half rupee coin shall be legal tender for any sum not exceeding ten rupees.

Every banknote issued by Reserve Bank of India (₹ 2, ₹ 5, ₹ 10, ₹ 20, ₹ 50, ₹ 100, ₹ 500 and ₹ 1000) shall be legal tender at any place in India. The demonetisation of 500 and 1000 rupee banknotes is a step taken by the Government of India in November 2016 to fight corruption and black money issues in the country. In 2000, Anil Bokil, Chairperson of ArthKranti Sansthan, had proposed the government ban Rs 500 and Rs 1,000 notes to curb black money and corruption. Bokil wrote newspapers articles about his proposals and made many presentations to Government officials. Soon to be Prime Minister Dr. Manmohan Singh heard his speech in 2003. In 2013, when Bokil met then Bharatiya Janata Party Prime Ministerial candidate Narendra Modi, he realised Modi meant business. After that meeting, Bokil met Modi four times to

explain how black money can be curbed. On Tuesday, November 7, Modi announced that the Reserve Bank of India would demonetise Rs 500 and Rs 1,000 notes. Starting from midnight of 8 November 2016, all 500 and 1000 rupee notes ceased to be accepted as a form of legal tender in India. The announcement was made by the Prime Minister of India Narendra Modi in a live televised address to the nation at exact 8:15 pm IST the same day. In the announcement, Modi declared circulation of all 500 and 1000 rupee banknotes (approximately \$7.50 and \$15 USD respectively) of the Mahatma Gandhi series as invalid and announced the issuance of 500 and 2000 rupee banknotes (approximately \$7.50 and \$30 USD respectively) in the new Mahatma Gandhi series in exchange for the old banknotes.

The demonetisation was done in an effort to stop the counterfeiting of the current banknotes alleged to be used for funding terrorism and for cracking down on black money in the country.

Following the announcement by the Prime Minister the governor of the Reserve Bank of India (RBI), Urjit Patel made a press release with details on the procedure for exchanging the 500 and 1000 rupee notes that are currently in circulation. On 8 November, other than the notification that these denomination will be discontinued, there were a few other relevant announcements such as:

- ✓ Citizens will have until December 30, 2016 to tender the discontinued banknotes at any office of the RBI or any bank branch and credit the value into their respective bank accounts.
- ✓ For immediate cash needs, the discontinued banknotes of value up to ₹4000 per person can be exchanged for the new banknotes over the counter of bank branches from 10 November 2016 by furnishing a valid ID proof.
- ✓ All ATMs will remain closed from midnight on 8 November 2016. The ATMs will resume functioning from 11 November 2016 upon their recalibration to dispense bank notes of only 50 and 100 rupee denominations.
- ✓ Banks have been advised to provide all cash withdrawal transactions at their ATMs free of cost to their customers till 30 December 2016. Cash withdrawals from ATMs will be restricted to ₹2000 per day per card up to 18 November 2016 and the limits will be raised to ₹4000 per day per card from 19 November 2016.
- ✓ All banks will remain closed to the public on 9 November 2016.

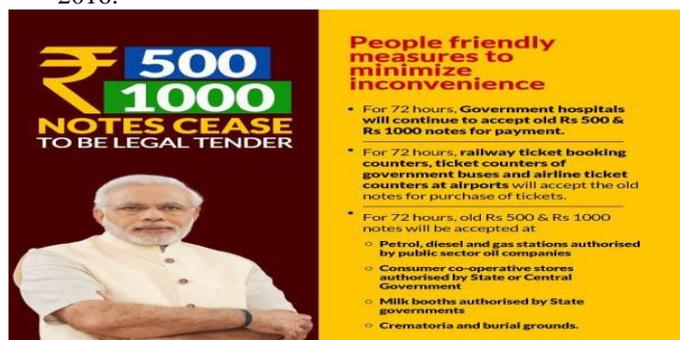


Figure 1

#### WHAT INDIA WITNESSED ON 8TH NOVEMBER 2016 WAS THE NOT THE FIRST TIME WE PLUGGED AND PLAY THE DEMONETIZATION GAME

1946: Rs1,000, Rs5,000, and Rs10,000 notes were taken out of circulation in January 1946. The Rs10,000 notes were the largest currency denomination ever printed by the Reserve Bank of India, introduced for the first time in 1938. All three notes were reintroduced in 1954

1977: The Wanchoo committee (set up in 1970s), a direct tax inquiry committee, suggested demonetization as a measure to unearth and counter the spread of black money. However, the public nature of the recommendation sparked black money hoarders to act fast and rid themselves of high denominations before the government was able to clamp down on them!

The High Denomination Bank Notes (Demonetisation) Act deemed the Rs 1,000, Rs 5,000 and Rs 10,000 notes illegal for the second time. At the time, then-RBI governor I.G. Patel disagreed with the measure.

#### 2016: RECOMMENDATIONS OF SIT ON BLACK MONEY AS CONTAINED IN THE FIFTH SIT REPORT

**CASH TRANSACTIONS:** The SIT has felt that large amount of unaccounted wealth is stored and used in form of cash. Having considered the provisions which exist in this regard in various countries and also having considered various reports and observations of courts regarding cash transactions the SIT felt that there is a need to put an upper limit to cash transactions. Thus, the SIT has recommended that there should be a total ban on cash transactions above Rs. 3, 00,000 and an Act be framed to declare such transactions as illegal and punishable under law.

**CASH HOLDING:** The SIT has further felt that, given the fact of unaccounted wealth being held in cash which are further confirmed by huge cash recoveries in numerous enforcement actions by law enforcement agencies from time to time, the above limit of cash transaction can only succeed if there is a limitation on cash holding, as suggested in its previous reports. SIT has suggested an upper limit of Rs. 15 lakhs on cash holding. Further, stating that in case any person or industry requires holding more cash, it may obtain necessary permission from the Commissioner of Income tax of the area.

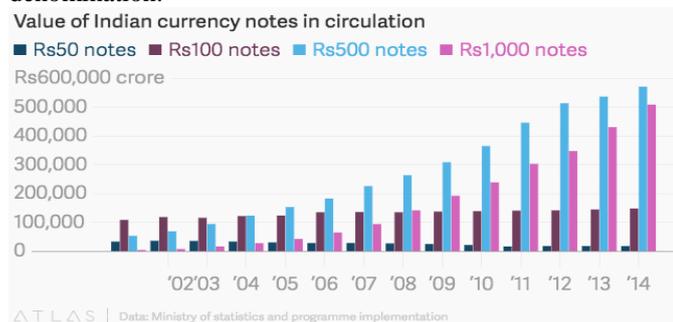
With full backing, for the third time, India participated in the process of demonetization. RBI governor, Urjit Patel applauded Modi's "very bold step" which addresses concerns about the "growing menace of fake Indian currency notes."



Figure 2

## HOW BIG IS THE IMPACT OF THIS ANNOUNCEMENT?

A better sense of this can be gauged from this graph below. As you can see, the monetary value of Rs500 and Rs1,000 notes in circulation far outstrips any other denomination.



ATLAS | Data: Ministry of statistics and programme implementation

Source: Data Ministry of statistics and Programme Implementation RBI.

Figure 3

Putting it simply, at the stroke of midnight, a little over 80% of the cash in India (by value) will be worthless pieces of paper.

With these notes now going out of circulation overnight, the government has created a solid opportunity to clean up the system. Currently India's black money economy is about 20% of its GDP, according to estimates from Ambit Research. Apart from cash, Indians also hoard wealth worth over billions of dollars in the form of gold.

## WHAT WAS THE NEED FOR SUCH A MOVE?

- ✓ The incidence of fake Indian currency notes in higher denomination has increased.
- ✓ Unaccounted money, often used in any form of corruption or illicit deals, usually takes the form of high-value notes, which in this case are the Rs 500 and Rs 1,000 bills.
- ✓ The Financial Action Task Force, a global body that looks at the criminal use of the international financial system, notes that high-value bills are used in money laundering schemes, racketeering, and drug and people trafficking. Comparison of high value bills across the world.
- ✓ In the United States, the highest denomination bank note is \$100. When it comes to the United Kingdom, the highest denomination bank note issued by the Bank of England is £50.
- ✓ As you can see, the highest denomination note is essentially 50-100 times the smallest denomination note of one dollar or one pound.
- ✓ In India, up until now the highest denomination note was Rs 1,000 and this was 1,000 times the smallest denomination note of Re 1 (Note: Re 1 notes are issued by the ministry of finance). When a currency has notes of higher denomination, it is easier to launder money i.e. store black money, as it takes less space and weighs less as well.

## THE POSITIVES THAT COME OUT OF THIS ANNOUNCEMENT

- ✓ Remember your economics basics? What happens when people go back and deposit their money. Deposits increase for the banks and that means eventually interest rates might come down.
- ✓ Curb on black money – corruption, terrorism etc. (as discussed above) [Backgrounder on Black money].
- ✓ Boost to cashless economy with people adopting habits of wallets etc. [Read about Payment Banks here].
- ✓ Boost to Jan Dhan Account's relevance for poor people – Would be interesting to factor the surge in new account creation and activity in dormant accounts [Read more on JAM Trinity].
- ✓ Politics and various elections are known to run on cash. Same is the case with sectors such as real estate. Expect a gradual reform in this area

## THE POTENTIAL NEGATIVES OUT OF THIS ANNOUNCEMENT

- ✓ Everything else being equal, withdrawal of currency in circulation, in the (very) short-run, might actually drive up interest rates.
- ✓ (Very) Short-term liquidity squeeze could be severe and hence economic activity could suffer.
- ✓ Sovereign credit rating – possibly no impact. But if there are short-term impact on economic activity which dampens government revenues and widens deficit, you can expect a short term decline in ratings.
- ✓ Cost of printing the new currency (if high) would create another political furore.
- ✓ Immediate chaos and public mayhem (which will bring out potential issues of execution).

## 3 IMPORTANT STEPS TAKEN BEFORE THIS ANNOUNCEMENT WAS MADE

- ✓ Jan Dhan scheme, under which 22-crore new bank accounts were opened in one-and-a-half years (May 2016), was the first truly game-changing move. Most of these accounts brought those people into the network who were outside the ambit. According to the Economic Survey for 2015-16 released in February this year, leakages in LPG subsidy transfers fell 24 percent and the exclusion of beneficiaries had been greatly reduced, thanks to the infrastructure created by Jan Dhan accounts, Aadhaar and mobile networks, or the JAM trinity.
- ✓ The next step was to bring back black money stashed away in tax havens or foreign banks abroad and here.
- ✓ Then came the Income Declaration Scheme. By 30 September, all illegal asset holders had the chance to declare their holdings and pay 45 % tax and a penalty in exchange for anonymity and immunity from criminal proceedings.

The tax department has reported Rs 65,250 crore worth of black money from 64,275 declarations. This means about Rs 30,000 crore will flow into the government's tax kitty.

## CHALLENGES AHEAD

- ✓ The government should come up with additional economic stimulus to offset the dampening effect:
  - Accelerated reduction in corporate income tax along with withdrawal of exemptions;
  - Ending uncertainty on GAAR and retrospective taxation or any other blockbuster measure that they might be working on, that would offset the initial adverse economic impact.
- ✓ Assess Black Money better: There's no good estimate for how much of India's black money is in forms other than currency/physical notes such as gold, jewellery, land or any other form of wealth. Therefore, while banning Rs 500 and Rs 1,000 notes will tackle the black money that is in the form of hard cold cash, it won't affect other forms of black money.
- ✓ Prepare for the challenges of cashless economy: The UPI (unified payment interface) system is likely to be fully operationalised only by January 2017. India was recently hit by one of its biggest financial security breaches compromising hundreds of thousands of debit cards.



Figure 4

## REACTIONS

Finance Minister Arun Jaitley said that demonetisation would clean the complete economic system, increase the size of economy and revenue base. Along with the upcoming Goods and Services Tax (GST), this demonetisation is "an attempt to change the spending habit and lifestyle." Jaitley also dispelled rumours of the Rs. 2,000 note having a "micro nano GPS chip" to enable its tracking through satellite.

The decision was both praised and criticised by economists, other experts, politicians and common people. Right after the news spread out, a large number of people reacted on social media sites like Twitter. Several bankers like Arundhati Bhattacharya (Chairperson of State Bank of India), Chanda Kochhar (MD & CEO of ICICI Bank) and Deepak Parekh (Chairman of HDFC) appreciated the move that would help curb black money. Businessmen Anand Mahindra (Mahindra Group), Sajjan Jindal (JSW Group) and Kunal Bahl (Snapdeal and FreeCharge) welcomed the decision that would also accelerate e-commerce.

However, CM of West Bengal Mamata Banerjee called the new declaration as "drama" and tweeted "Heartless and ill-conceived blow on the common people and the middle class in the fake name of anti-corruption". Indian National Congress spokesperson Randeep Surjewala welcomed the move but showed apprehension on consequences that would follow. A

Public Interest Litigation was filed in Madras High Court by M Seeni Ahamed, General Secretary of Indian National League, to scrap the decision. The High Court dismissed the PIL stating that it could not interfere in monetary policies of the government, however found the action suitable for country's security and development. Similar PILs have been filed in the Supreme Court of India.

## CONCLUSION

With a view to curbing financing of terrorism through the proceeds of Fake Indian Currency Notes (FICN) and use of such funds for subversive activities such as espionage, smuggling of arms, drugs and other contrabands into India, and for eliminating Black Money which casts a long shadow of parallel economy on our real economy, it has been decided to cancel the legal tender character of the High Denomination bank notes of Rs.500 and Rs.1000 denominations issued by RBI till now. The timing of the announcement has been somewhat of a surprise. While the government has given a number of exemptions to stave off outright panic – Rs 500 and Rs 1,000 notes can still be used for the next 72 hours to pay at government hospitals or for train tickets for instance – it still puts quite a number of people in a pickle if supply of smaller notes are constrained in the days and weeks ahead. The timing is also curious for other reasons: the UPI (unified payment interface) system is likely to be fully operationalised only by January 2017. Would it have not been better to wait until then, if this move was to also spur India's shift towards a cashless economy which is real solution. On the other hand, if this had been announced in advance it could have been self-defeating in nature; allowing holders of black money to convert their cash for gold or other forms of wealth instead. Apart from disrupting daily lives of the common citizen, there are even bigger implications for the economy as a whole. Politics and various elections are known to run on cash. Same is the case with sectors such as real estate. The rural areas in particular, which do not have formal sources of banking, also deal largely in cash. Unorganised labour, including in urban households, such as domestic workers and drivers, are paid in cash, and mostly in these denominations. It is too early to even imagine the impact on all sections of society and parts of the economy. The advantages of this move, though, will be felt only in the long-term. While formal modes of payments such as debit and credit cards, net-banking and digital wallets should get a boost, this will take a long time to be felt simply because the proliferation of these products is still low among the middle classes and the poor, for whom cash is still the predominant mode of transactions. The government's move is bold in its intent and massive in its measure. Arguably, this is Modi's biggest move since he was elected prime minister. While the intent is clear, the implementation and impact is yet to be seen.

## REFERENCES

- [1] "Arun Jaitley dismisses rumours of nano GPS chip on Rs 2000 note". Zee News. 9 November 2016.

- [2] "Demonetisation of Rs.500 and Rs. 1000: Who says what". The Hindu. 8 November 2016. Retrieved 9 November 2016.
- [3] "Govt demonitises Rs 500, 1000 notes: Here is how India Inc reacted". Indian Express. 8 November 2016. Retrieved 9 November 2016.
- [4] "Govt's demonetisation move fit for country's security, development: HC". Economic Times. 10 November 2016. Retrieved 10 November 2016.
- [5] "Here is what PM Modi said about the new Rs 500, Rs 2000 notes and black money". India Today. 8 November 2016. Retrieved 9 November 2016.
- [6] "PILs in Supreme Court against making Rs 500, Rs 1000 notes illegal". India Today. 10 November 2016. Retrieved 10 November 2016.
- [7] "Rs 500 & 1000 currency notes banned: Congress raises questions against Narendra Modi govt's shocking move". India.com. 8 November 2016. Retrieved 9 November 2016.
- [8] "Rs 500, 1000 notes pulled out: How Twitter reacted". Times Of India Blogs. 8 November 2016. Retrieved 8 November 2016.
- [9] "Toll tax suspended on national highways till Nov 11, banks open this weekend". Hindustan Times. Retrieved 10 November 2016
- [10] "Why Were the Notes Scrapped? RBI Chief, Economic Affairs Secy Explain". News 18. 8 November 2016. Retrieved 9 November 2016.
- [11] "Withdrawal of Legal Tender Status for ₹ 500 and ₹ 1000 Notes: RBI Notice (Revised)". Reserve Bank of India. 8 November 2016. Retrieved 8 November 2016.
- [12] Bhatt, Abhinav (8 November 2016). "Watch PM Modi's Entire Speech On Discontinuing 500, 1000 Rupee Notes". NDTV India. Retrieved 8 November 2016.
- [13] Damodaran, Harish (9 November 2016). "Are banks equipped to replace 2,300 crore pieces of Rs 500 and Rs 1,000 notes?". Indian Express. Retrieved 9 November 2016.
- [14] Gopika Gopakumar, Vishwanath Nair (8 November 2016). "Rs500, Rs1000 notes may be back, if history is a guide". Live Mint. Retrieved 9 November 2016.

IJIRAS