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## A STUDY ON DEMONETIZATION AND ITS IMPACT ON ECONOMY

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### ABSTRACT

*In an important move, the government of India declared that the 500 and 1000 Rupees notes will no longer be legal tender from mid night of 8<sup>th</sup> November 2016. This step was shocking to the economy of country. The argument posited in favour of demonetization is that the cash that would be extinguished would be 'black money' and hence should be rightfully extinguished to set right the perverse incentives structure in the economy. Thus the facts are hidden. The move was targeted towards tackling black money, corruption and terrorism. This paper includes the objective and the impact of demonetization on various sectors of country.*

**KEYWORDS:** *Demonetization, Black money, corruption, GDP*

### INTRODUCTION

Demonetization is a systematic and independent process carried out to replace currencies generally of higher denominations with new currency units. In a cash economy, it is witnessed that a legitimate business can easily adopt ways to suppress income and in turn reduce or evade taxes. It is the act of stripping currency units of its status on legal tender. It occurs whenever there is a change in 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 replaced the old currency with a new currencies. India demonetisation is unprecedented in international economic history in that it combined secrecy and suddenness amidst normal economic and political conditions. All other sudden demonetisations have occurred in the context of hyperinflation, wars, political upheavals or other extreme circumstances.

The move of demonetization shall usher in the new era of digital economy and electronic payments and receipts. On the immediate periphery

of economic developments there are positive impacts on liquidity, inflation, deficit level in the short of run. The real test of this scheme shall arise when the quantum of revenues collected during the period of implementation of demonetization shall reflect any significant change in economic structure. Demonetization is an effective monetary tool to control the circulation of currency in the private sector economy and is on threshold of navigating the business fraternity and the common people towards developing a clean and transparent currency.

### HISTORY AND BACKGROUND OF DEMONETIZATION

The government of India has taken decisions at three times on the issue of demonetization. It was 1946, 1978 and 2016. In 1946 India was under British rule, the British govt. demonetized the 500, 1000, 10000 currency notes. Rumours were spread at that time across the country that the govt. is going to demonetize 100 notes as well, but that was not happened. In 1954 when India was independent country it started 1000, 5000, 10000 currency notes.

In 1978 the prime minister of India Morarji Deasai took the initiative of stopping the currency notes which were issued in 1954. The main objective behind that step was to control or eradicate the black money. The people were given a deadline of one week to deposit/change their currency.

In 2016 the present prime minister of India Mr. Narendra Modi in his surprise address to the nation on 8<sup>th</sup> November 2016 at around 8.p.m. astonished everyone with the government decision to demonetize Rs. 500 and Rs. 1000 currency notes. It was announced that the currency notes in the demonetization of Rs 500 and Rs. 1000 can be ceased to be legal tender from mid night of 8-9 November 2016.

Objectives of Demonetization:-

The prime objective of demonetization is to end the parallel black money economy running in the country from decades such demonetization will:

- Make unaccounted cash worthless
- Tackle counterfeit currency coming in country from neighbouring countries
- End of terrorist funding
- Bring hoarded cash back into system and utilize it gainfully through banking channels.

## LITERATURE REVIEW

*Tim Worstall(2016)* explained it is a fact that whether the death is as a result of natural cause, simply old age or effect of P.M. Modi's demonetization plan. So to say that 100 people have died as a result of the demonetization plans might be true – but what matters here is whether it is an important number or not.

Wade Shepard (2017) Modi's demonetization step was a "shock doctrine" tactic to dismantle the cash –centric black market, to cleanse the country of counterfeit notes, to further digitalize the economy, and to get more of the population on the formal, taxable economic grid.

Ramesh Thakur (2016) A major cause for the persistence of poverty and growth of corruption in India is regulators and tax inspectors who harass entrepreneurs at every rung of economic activity because of the maze of regulation and the thickets of red tape. The decision of demonetization has reinforced the Modi's image as a strong and received leader prepares to take bold and tough decision, in the country's interest.

National Institute of Public Finance and Policy New Delhi (2016) the decision taken by the govt. of India about the demonetization shocked the people at large. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency in circulation is extinguished. While it has been argued that the cash that would be "black money" and hence, should be rightfully

extinguished to set right the perverse incentive structure in the economy, this argument is based on impressions rather than on facts.

## OBJECTIVE OF THE STUDY

1. To be acquainted with the concept of demonetization
2. To know the impact of demonetization in India

## METHODOLOGY

Secondary data collection is used in this study. Our secondary data collection is mostly internet based study combined with few articles, online research reports.

## IMPACT OF DEMONETIZATION

There is likely to be an immediate impact of demonetization on sectors with high cash economy. But in the larger run, it would be a big positive for the nation's economy.

### Immediate impact:-

It is the negative as banks will face severe problems in cash replacement and smooth operations. There would be slowdown in consumer spending due to limited cash availability and severe liquidity issue in sectors like real estates and jewellery. The GDP may decline in next two quarters due to reduction in overall spending.

### Impact on government:-

Government will be immediate and biggest beneficiary in medium terms. Those who keep their money with them, their notes will expire worthless reducing RBI liability. Those who declare their money, approx. 60-70 % will go to the govt. Those who try to launder their money will face several risks including penalties and persecutions. There are around 14 lakh crore of old notes, assuming 50% of them (Rs. 7 lakh crore) are unaccounted money then, 60-80% of it or around Rs. 5 lakh crore will come to Govt In form of taxes and penalties. It is enough to take care of India's entire fiscal deficit for one year or more.

### Overall Economic impact:-

GDP growth is expected to be negative for next six months, but next two years would see exponential revival in growth as inflation is expected to fall sharply in real estate price. Govt. Deficit may turn surplus in next two years. Currency is expected to strengthen on inflation drops and growth pick up. Banking sector will get a boost as around 7-8 lakh crores legal money enters system.

### Impact on various asset classes:-

- Bond prices are expected to rise as interest rates comedown
- Real estate is expected to fall by upto 20 % and stabilize once interest rate come down
- Equality will benefit due to shift from real estate sector, growth of organized sector and lower inflation and lower borrowing costs. Short term stock markets can be

very volatile, in medium to long term; they are expected to do well.

### **Impact on common man:-**

No doubt the common is hit hardest, especially those who are daily wage earners and have no hoard of cash. Even their meagre cash assets have been immobilised and are facing problems to meet their daily essential needs. The labour class who earned saved their income is 500/1000 note were hit because they didn't have money to purchase from the market. People with medical emergencies and weddings have been hit hard due to cash crunch. At least 100 people were died due to demonetization.

### **Impact on fake currency:-**

As per RBI Report during 2015-2016 fake currency of Rs. 406 crore was seized mainly in high demonetization knowing how difficult is for common man to detect fake currency, which at times can pass scrutiny of even bankers, one can only guess the amount of fake currency in circulation. SES can only say that even if detection level was high at 10% (which is very high in opinion of SES), amount of fake currency in circulation would be Rs. 4000 crore. Such a large amount of money which is mainly used for anti-national activity and supports terrorism and nexalities and other organization pose danger.

## **CONCLUSION**

The demonetization undertaken by the Modi's Govt. was a large shock to the economy. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency is circulation extinguished. Due to this step GDP growth is expected to be negative in next six months. It effects to a large extent on a common man. At least 100 people were died by this demonetization. The aim of demonetization was to eradicate the terrorist funding and make unaccounted cash worthless.

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