



WWJMRD 2017; 3(9): 84-87
www.wwjmr.com
International Journal
Peer Reviewed Journal
Refereed Journal
Indexed Journal
UGC Approved Journal
Impact Factor MJIF: 4.25
e-ISSN: 2454-6615

Dr. B. S. Kadam

M.COM; M.PHIL; G.D.C&A;
PH.D. Associate Professor in
Commerce, Anantrao Thopte
College Bhore, Pune, India

Snehal B. Kadam

B.E., Computer Science,
M.B.A. (Appearing), Anantrao
Thopte College, Bhore, Pune,
India

Demonetization in India: Issues and Challenges

Dr. B. S. Kadam, Snehal B. Kadam

Abstract

In this paper an attempt has been made to study the history of demonetization in various countries as well as in India. The legal base in India for demonetization is given u/s 26(2) of the RBI Act 1934. The role of Government and RBI is explained in this paper.

The study has been made regarding the impact of demonetization on common man, financial impact on common man, political impact, and social impact. The main objective of this study is to find out various issues and challenges due to demonetization. Infrastructural issues, consumer behaviour issues, accessibility in language, mode of payment and spending behaviour issues are the issues of demonetization in India.

Keywords: Demonetization, currency, common man, social, political, infrastructure

Introduction

On 8th November 2016, the Prime Minister of India announced demonetization of old Rs. 500 notes and Rs 1000 and after, new notes of Rs. 500 and Rs. 2000 notes were pumped in to economy. The concept of demonetization is relatively less common among the Indian people. In this paper an attempt has been made to study the history of demonetization in various countries as well as in India. The main objective of this study is to find out various issues and challenges regarding demonetization in India. The special efforts are made to study impact of demonetization on Indian economy.

Objectives of the study

- To study the history of demonetization
- To study the legal base of demonetization
- To study the impact on demonetization
- To find out issues of demonetization
- To find out challenges of demonetization

Research methodology

This paper is based on the secondary data. The secondary data was collected from various published sources like journals, research papers, magazines and reports etc.

Review of Literature

Prof. P. B. Adarkar, Formerly Economic Advisor in the Ministries of Labour, Finance and External affairs and later Minister, India, delivered speech on 3rd Sep. 1973; on the topic "Rising Prices, Black Money, and Demonetization" He said "Demonetization is not remedy for either rising prices or black money" Tax research team said about issues and impact of demonetization in their research paper "Demonetization: Impact on the economy" On 14th Nov. 2016. Prof. Sandeep Kaur said about the impact of demonetization in his research paper "Demonetization and its impact in India" Published in International Journal of research Vol.3 Issue 17, Nov.2016. Rahul Deodhar explained about demonetization in his paper "Black Money and Demonetization Research paper published on 14th Nov. 2016. Sukanta Sarkar said about black money in his publication "Parallel Economy" published on 2010.

Correspondence:

Dr. B. S. Kadam

M.COM; M.PHIL; G.D.C&A;
PH.D. Associate Professor in
Commerce, Anantrao Thopte
College Bhore, Pune, India

History of Demonetization

The followings are the some countries, who have implemented the policy of demonetization. France, United States of America(1969), Britain (1971), Ghana (1982), Nigeria (1984), Myanmar (1987), Zaire (1990), Congo (1090), Soviet Union (1991), Australia (1996), Zimbabwe, North Korea (2010), Pakistan (2015),etc.

Many countries have experimented with the process of demonetization in the past. Some of them benefited and some failed.

History of Demonetization in India

1. On 12th January 1946, Rs.500, Rs. 1000 and Rs.10000 notes were declared invalid.
2. New notes of Rs. 1000, Rs. 5000 and Rs. 10000 came in to economy in 1954.
3. On 16th January 1978, Rs. 1000, Rs. 5000 and Rs. 10000 notes were declared invalid by Janata Party Government.
4. In 1987 Reserve Bank of India introduced a note of Rs. 500 in to the economy to contain inflation.
5. On 8th November 2016, the old bank notes of Rs. 500 and Rs. 1000 were declared invalid as legal tender and new notes of Rs. 500 and Rs. 2000 were soon introduced.
6. Demonetization of 1,2,3,5, 10, 20 &25 paise were valid up to 30th June 2011n but were then barred. 50 paise coins are in circulation other denominations called as rupee coins.

Legal base in India

Under Section 26 (2) of the RBI Act 1934, The Government of India is given the power to declare that any notes issue by the RBI will no longer be legal tender. The Board of the RBI recommends the same TO THE Union Government.

In 1978, demonetization was carried out under a special legislation, namely the High Denomination Bank Notes (Demonetization) Act. 1978.

Role of Government and RBI in Demonetization

The Prime Minister issued an order to demonetization certain currency with consultation of RBI and the Finance Minister.

The Government of India introduced Pradhan Mantri Jan Dhan Yojana (PMJDY) and Income Discloser Scheme (IDS) to ensure that everyone has a bank account and gets ample time to declare their incomes.

The Impact of Demonetization

On the common man

Will November 8, 2016 be remembered as watershed event in the history of India or will it be just another passing event? The demonetization will not only have economic but also social and political ramifications, both from immediate and long term perspectives. Size of Impact: India's GDP is \$2000 billion (Rs. 125 Lac crore) and estimated parallel economy is 23 percent, which makes about Rs. 28 Lac crore. A large percentage of this amount is divided in real estate, gold and cash. Real estate accounts for more than 50 percent are equally divided between cash and gold. Around 68 percent of that cash is kept in denomination of Rs. 500 and Rs. 1000 notes. A calculation shows that Rs. 3 Lac crore or \$45 billion will flow in to India's white economy, which is equivalent to GDP of more than 100 countries.

Financial impact on common man

Financial/ business impact: People with large amount of black money are using unscrupulous means to convert in to legitimate currency.

A tax payer has to stand in to queues to with draw his hard – earned money.

Online companies are having the last laugh as most of the white income class is restoring to online.

Small/ Medium sized business relying on cash transactions are seeing a total demand collapse.

Gems and Jewellery business will be hard hit.

Real estate prices will fall and the transactions volume will drop.

Second hand car market will crash badly.

C A s will have a time of their lives.

Bank will be having a tough time. They will be flooded with cash.

Political Impact

BJP will gain tremendously, Modi's portrait could replace Gandhi's portrait in coming time on the walls of the government offices.

All parties will join hands to paint the demonetization scheme as a big scam.

Normal life may be impacted because of demonetizations.

BJP may do reasonably well in U.P.elections.

No cash doles out in election.

Social Impact

Low income people have been impacted as their payments are delayed.

Some people may commit suicide.

Cashier and bankers will get due respect in society.

Marriages to become cheap. Death of Dowry.

All medicines in white money.

Big blow to gambling.

Death of drug mafia and terror networks.

People now know moral status of their peers and neighbours better.

Impact on Indian economy:

GDP will be impacted as consumption will fall.

Tax collection may be lower.

Disorganised work to move organised sector.

Demonetization may be benefited India in long term.

Income tax rates may come down.

Loan will become cheaper.

Housing will be affordable.

Bond prices will be increase in near future.

Prices of real estate and gold will be fall.

Equity markets will be gain in next six to twelve months.

Fiscal deficit will come down.

Currency will become stronger.

Industry will become more productive.

Inflation will come down as housing prices will drop and food inflation come down.

Tax rates will come down as more people will be in tax net.

Business will be able to borrow at cheaper rates.

FDI to sky rocket.

The society will become more equitable with lesser class distinction.

Prosecution for people, who are engaging in black money.

Some slum dwellers may actually have to pay taxes and lose their BPL status.

Politics may be change forever.

As with all good things, there is a bitter truth here as well. The black money may re-emerge as now there is Rs.2000 notes so paying bribes will be much easier. In fact, if the same government does not come to power again, then there is risk of reversal of some of these policies. Bribes may be paid in gold, foreign currency or smaller denomination notes, or through consumer durables. The whole plan may be boomerang as there is a complete demand collapse and people lose jobs in the unorganised sector in the near term. So there is need for strong administration and effective policy framework to make sure these initiatives are implemented in the same never as they were intentioned.

Infrastructure Issues

There is need for a significant upgrade of the banking system as well as telecom infrastructure that would provide the back bone for digital transactions.

For people to be able to transact at any time and place as well as for them consider it a reliable medium of exchange.

It is important that not only the banking system is upgraded to ensure that transaction can be completed without a hitch, but the supporting infrastructure too is up to the mark.

For instance, in many parts of the economy, there is limited and intermittent supply of electricity as well as mobile connectivity. In these areas, it would be difficult to expect people to shift to electronic medium of exchange.

Consumer behaviour issues

A part from technological issues, there is a behavioural change that is being expected in people from using cash as medium of exchange to using other cash substitutes both for making payments and receiving payments. This transaction requires individuals to make two changes in their behaviour, one agents need to move from tangible means which can be seen and felt to forms which are less tangible or not tangible, and second, they have to learn rely on technologically advanced tools to undertake regular day to day operations. The latter requires agents to be educated to the extent of comprehending the content of transactions. If this transaction is not suitably managed, agents might be tempted to move to non-official cash substitutes.

Accessibility in language

In addition to above, most of the banks and mobile instruments for transaction are currently adopted to a single to two languages. If the bulk of the population of this country needs to come on board, it might be important to make these facilities available in Indian languages to ensure that the user can comprehend the transaction that they are entering in to.

Mode of payment and spending behaviour

There are many substitutes for cash in economy such as cheques, debit cards, pre-paid cards, credit cards, and mobile wallets. These instruments are differing in key characteristics. In a comparison of debit cards with cash, I suggest that with the use of debit cards, the level of consumption tends to be higher. In comparison of credit cards with cash, this effect is more pronounced. Credit cards often are associated with more spending resulting in an increase in debt. Spending with cards seems to encourage spending on non-essentials. These are the changes in consumer behaviour.

Conclusions

Normal life may be impacted because of demonetizations. Online companies are having the last laugh as most of the white income class is restoring to online. Bank had tough time. They were flooded with cash. Low income people have been impacted as their payments are delayed. Equity markets will be gain in next six to twelve months.

Fiscal deficit will come down. The society will become more equitable with lesser class distinction. There is need for a significant upgrade of the banking system as well as telecom infrastructure that would provide the back bone for digital transactions.

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