

A Study on Impact of Demonetization of Currency in Indian Banking Scenario

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Abstract-

The aim behind the government's action was to combat tax cheating, counterfeiting and corruption. Eliminating large denominations makes it harder to hide large amounts of cash. The government's demonetisation of Rs 500 and Rs 1000 notes is a contentious issue, but is understandable. Such schemes may have not worked in the past, but a political commitment had to be honoured. The question is not whether the government is right for demonetising the currency; instead, the concerns are centred on why they adopted this chaotic and surreptitious approach. It is a radical financial step in which a currency unit's status as a legal tender is declared invalid. This move is usually executed when old currencies have to be replaced by new one's or whenever there is a change of national currency. However, given the extent to which the project has to be executed, the move has to be well planned in advance.

Keywords: demonetization, financial environment, currency scarcity, political situation etc.,

I. INTRODUCTION

The aim behind the government's action was to combat tax cheating, counterfeiting and corruption. Eliminating large denominations makes it harder to hide large amounts of cash. The official date for deposit of old notes is now over. Only a specific set of people can deposit old notes during the grace period of the next 6 months. ATM withdrawal limit has been increased to Rs 4,500 per day per card from January 01, 2017. At Present it will be increased to Rs.10, 000.

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Demonetization is the act of stripping a currency unit of its status as legal tender. The demonetization of 500 and 1,000 banknotes was a policy enacted by the Government of India on 8 November 2016, ceasing the usage of all 500 and 1,000 banknotes of the Mahatma Gandhi Series as legal tender in India from 9 November 2016.

The announcement was made by the Prime Minister of India Mr. Narendra Modi in an unscheduled live televised address at 20:00 Indian Standard Time (IST) on 8 November. In the announcement, Mr. Modi declared that use of all 500 and 1,000 banknotes of the Mahatma Gandhi Series would be invalid past midnight, and announced the issuance of new 500 and 2,000 banknotes of the Mahatma Gandhi New Series in exchange for the old banknotes. However, the banknotes of 100, 50, 20, 10 and 5 of the Mahatma Gandhi Series and 2 and 1 remained legal tender and were unaffected by the policy.

II. ORIGIN OF DEMONETIZATION

Historically, previous Indian governments had demonetized bank notes. In January 1946, banknotes of 100 and 1,000 rupees were withdrawn and new notes of 100, 500 and 1000 rupees were introduced in 1954. The Janata Party coalition government had again demonetized banknotes of 1,000, 5,000 and 10,000 rupees on 16 January 1978 as a means of curbing counterfeit money and black money.

On 28 October 2016 the total banknotes in circulation in India was 17.77 trillion. In terms of value, the annual report of Reserve Bank of India (RBI) of 31 March 2016 stated that total bank notes in circulation valued to 16.42 trillion of which nearly 86% (around 14.18 trillion) were 500 and 1,000 banknotes. In terms of volume, the report stated that 24% (around 22.03 billion) of the total 90266 million banknotes were in circulation.

The Government of India devised an Income Declaration Scheme (IDS), which opened on 1 June and ended on 30 September 2016. Under the scheme, the black money holders could come clean by declaring the assets, paying the tax and penalty of 45% thereafter.

III. TELEVISED ADDRESS

On 8 November 2016, an announcement was made by the Prime Minister of India Narendra Modi in an unscheduled live televised address to the nation at 20:15 IST. In the announcement, Modi declared circulation of all 500 and 1,000 banknotes of the Mahatma Gandhi Series as invalid effective from the midnight of the same day, and announced the issuance of new 500 and 2,000 banknotes of the Mahatma Gandhi New Series in exchange for the old banknotes.

After the official announcement by Prime Minister Modi, the Governor of the Reserve Bank of India, Urjit Patel, and Economic Affairs secretary, Shaktikanta Das explained in a press conference that while the supply of notes of all denominations had increased by 40% between 2011 and 2016, the 500 and 1,000 banknotes increased by 76% and 109% respectively in this period owing to forgery. This forged cash was then used to fund terrorist activities against India. As a result, the decision to eliminate the notes had been taken.

IV. SUPPORT

The decision met with mixed initial reactions. Several bankers like Arundhati Bhattacharya (Chairperson of State Bank of India) and Chanda Kochhar (MD & CEO of ICICI Bank) appreciated the move in the sense that it would help curb black money. Businessmen Anand Mahindra (Mahindra Group), Sajjan Jindal (JSW Group), Kunal Bahl (Snapdeal and Free Charge) also supported the move adding that it would also accelerate e-commerce. Infosys founder N. R. Narayana Murthy praised the move.

Finance Minister Arun Jaitley said that demonetisation would clean the complete economic system, increase the size of economy and revenue base. He mentioned the demonetisation along with the upcoming Goods and Services Tax (GST) as "an attempt to change the spending habit and lifestyle."

V. EFFECTS AND AFTERMATH

Cash rush

The scarcity of cash due to demonetisation led to chaos, and most people holding old banknotes faced difficulties exchanging them due to endless lines outside banks and ATMs across India, which became a daily routine for millions of people waiting to deposit or exchange the 500 and 1000 banknotes since 9 November. ATMs were running out of cash after a few hours of being functional, and around half the ATMs in the country were non-functional. Sporadic violence was reported in New Delhi, but there were no reports of any grievous injury, people attacked bank premises and ATMs, and a ration shop was looted in Madhya Pradesh after the shop owner refused to accept 500 banknotes.

Stock market crash

As a combined effect of demonetisation and US presidential election, the stock market indices dropped to an around six-month low in the week following the announcement. The day after the demonetisation announcement, BSE SENSEX crashed nearly 1,689 points and NIFTY 50 plunged by over 541 points. By the end of the intraday trading session on 15 November 2016, the BSE SENSEX index was lower by 565 points and the NIFTY 50 index was below 8100 intraday.

Transportation halts

After the demonetisation was announced, about 800,000 truck drivers were affected with scarcity of cash, with around 400,000 trucks stranded at major highways across India were reported. While major highway toll junctions on the Gujarat and Delhi-Mumbai highways also saw long queues as toll plaza operators refused the old banknotes.

Nitin Gadkari, the Minister of Transport, subsequently announced a suspension of toll collections on all national highways across India until midnight of 11 November, later extended until 14 November and again until midnight of 18 November, and yet again till 2 December.

Agriculture

Transactions in the Indian agriculture sector are heavily dependent on cash and were adversely affected by the demonetisation of 500 and 1,000 banknotes. Due to scarcity of the new banknotes, many farmers have insufficient cash to purchase seeds, fertilisers and pesticides needed for the plantation of Rabi crops usually sown around mid-November. Farmers and their unions conducted protest rallies in Gujarat, Amritsar and Muzaffarnagar against the demonetisation as well as against restrictions imposed by the Reserve Bank of India on district cooperative central banks which were ordered not to accept or exchange the demonetized banknotes.

Banking

In the first four days after the announcement of the step, about 3 trillion (US\$45 billion) in the form of old 500 and 1,000 banknotes had been deposited in the banking system and about 500 billion had been dispensed via withdrawals from bank accounts, ATMs as well as exchanges over the bank counters. Within these four days, the banking system has handled about 180 million transactions. The State Bank of India reported to have received more than 300 billion in bank deposit in first two days after demonetisation. A spike in the usage of debit card and credit card post demonetisation was also reported.

Between November 10 and November 27, banks reported exchange and deposits of demonetised banknotes worth 8.45 trillion, exchange of 339.48 billion and deposits of 8.11 trillion. During this period, an amount of 2.16 lakh crore had been withdrawn by people from their accounts.

In Malda, a district believed to be a transit-point for fake Indian currencies, a large sum of cash deposits in dormant accounts was also reported. According to The Economic Times, more than 80 percent of fake currency in India originates from Malda district in West Bengal.

Business

By the second week after demonetisation of 500 and 1,000 banknotes, cigarette sales across India witnessed a fall of 30–40%, while E-commerce companies saw up to a 30% decline in cash on delivery (COD) orders. Several e-commerce companies hailed the demonetisation decision as an impetus to an increase in digital payments. They believe that it would lead to a decline in COD returns which is expected to cut down their costs.

The demand for point of sales (POS) or card swipe machines has increased. E-payment options like Pay TM and Pay Money has also seen a rise. According to data of Pine Labs, the demand for its POS machines doubled after the decision. Further it states that the debit card transactions rose by 108% and credit card transactions by 60% on 9 November 2016.

Income tax raids and cash seizures

The Finance Ministry instructed all revenue intelligence agencies to join the crackdown on forex traders, hawala operators and jewellers besides tracking movement of demonetised currency notes. It was reported that the Prime Minister's Office (PMO) and the Prime Minister Modi himself were directly coordinating the raids conducted by the Income Tax, Enforcement Directorate (ED) and other agencies. As of 23 December, PMO received around 700 calls giving information about black money and it directly forwarded the information to various law enforcement agencies for further action.

Gold purchases

In Gujarat, Delhi and many other major cities, sales of gold increased on 9 November, with an increase of 20 to 30% premium surging the price as much as 45,000 from the ruling price of 31,900 per 10 grams.

Multiple bank transactions

There have also been reports of people circumventing the restrictions imposed on exchange transactions and also attempting to convert black money into white by making multiple transactions at different bank branches. People were also getting rid of large amounts of banned currency by sending people in groups to exchange their money at banks. In response, the government announced that it would start marking customers with indelible ink. This was in addition to other measures proposed to ensure that the exchange transactions are carried out only once by each person. On 17 November, the government reduced the exchange amount to 2,000 to discourage attempts to convert black money into legitimate money.

Backdated accounting

The Enforcement Directorate raided several forex establishments making back dated entries. Money laundering using backdated accounting was carried out by co-operative banks, jewellers, sellers of iPhones, and several other businesses.

VI. CONCLUSION

The summary way demonetization has been effected is leading to a riot like situation in the country. We demand that the Government ensure that common people have immediate access to enough money to pay for their daily needs and health emergencies. Failing which, we demand the rollback of demonetisation or suspension of demonetisation to enable the common person to make adequate arrangements for daily needs and for more orderly phasing out of the old notes. The role of the Government is to undertake honest tax administration and not to treat the common person like a criminal making him/her stand in line and filling forms to access his/her own legitimate money.

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