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A STUDY ON DEMONITIZATION OF 500 AND 1000 RUPEE NOTES & ITS IMACT ON THE VARIOUS SECTORS AND ECONOMY

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Introduction

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. This study aims at identifying the reasons for the withdrawal of the existing notes of Rs. 500 and Rs.1000.the study also makes an attempt to identify the impact of demonetisation on the various sectors. The study also highlights the immediate effects on the economy.

OBJECTIVES OF THE STUDY

1. To identify the reasons for the withdrawal of high denomination currency notes
2. To find out its impact on the economy as a whole
3. To study the sector wise impact of demonetisation
4. To identify Measures taken by the government to rectify the imbalances if any

Research Methodology: The data was collected from secondary source of information. The paper also took help of Secondary data like various newspapers, journals and online data base. The collected data was analysed, was interpreted to draw conclusions keeping in mind the set objectives of the study.

Scope and Limitations: The research study was conducted to identify the problems faced by government because of the circulation of high denomination notes beyond the required limit. The study revealed that nearly 87% of the total Indian currency which was in circulation was high denomination notes of Rs.500 and Rs. 1000. And more over most of fake currency in circulation was also in high denomination currency notes of Rs.500 and Rs.1000

The limitation of the study is it relied only on secondary sources of data for research analysis.

REASONS FOR DEMONITISATION OF INDIAN CURRENCY

BLACK MONEY

Prime Minister Narendra Modi has promised to bring every penny of black money stashed abroad back to India. But bringing this unaccounted for money back, or indeed even its discovery, is a difficult task, leave alone legal intricacies of tax treaties. While previous governmental efforts have resulted in disparate estimations, some scholars even argue that this money has been laundered back into India through foreign investments. Here are four charts that provide a quick recap of the black money problem.

Table no 1

Country	Illicit flows as % of GDP
India	3.11
China	2.97
Brazil	1.49
Russia	8.21
Indonesia	4.16
South Africa	3.85

Estimates of black money in India fluctuate wildly. A World Bank report puts India's shadow economy at close to one-fifth of economic output. Another study on illicit financial flows by Global Financial Integrity (GFI), a non-profit organisation, puts these at 3% of economic output for India between 2002-11. This difficulty in measurement is because black money is generated through a raft of complex, sophisticated activities for the purposes of tax evasion, crime and corruption. This makes it inherently difficult to measure black money accurately.

Some studies exclude certain sources of black money. For example, the GFI excludes criminal activities and a part of corporate tax evasion, both massive sources of black money. Hence, its estimates are naturally more conservative. This study also mentions that in the developing world, including India, corporate tax evasion is responsible for 60% of overall black income, criminal activities are responsible for 35%, while corruption, which has caused much furore in India, accounts for only 5%. While the reduction in personal income tax rate from nearly 100% in the 1970s to under 30% now has reduced tax evasion, it has been offset by higher rates of corporate taxation.

Table no 2

Total money (in Rs. crore) held by Indians in Swiss banks

Year	Money (crores)
2006	41400
2007	27500
2008	15400
2009	12600
2010	12450
2011	14000
2012	9000
2013	14000

There is near unanimous agreement among scholars that most of the black money generated in India is no more in Swiss banks. They argue that this has either come back as white money to the country through a process called round-tripping, or has moved into tax havens. A large chunk of black money might well be invested in real estate and bullion. A 2011 study on foreign direct investments (FDI) in India by Chalapati Rao and Biswajit Dhar estimates that up to half the investments could be a result of round-tripping. Money held by Indians as a share of total money in Swiss banks was 0.29% in 2006 and slipped to 0.13% in 2010, clearly showing that Indians are not among the biggest clients of Swiss banks.

Table no.3

Year	Total money seized	Undisclosed income admitted
2007	364.64	3612.89
2008	427.82	4160.58
2009	550.23	4613.06
2010	963.5	8101.35
2011	774.98	10649.16
2012	905.61	9289.43

To curb the menace of black income, Prevention of Money Laundering Act (PMLA) was introduced on 1 July, 2005. About 1,437 cases had been registered under PMLA till the end of financial year 2012. Moreover, 23,118 cases had been registered till 31 March, 2012 under Foreign Exchange Management Act (FEMA), and penalties worth Rs.1,678 crore had been levied. But that is hardly a drop in the ocean, argue critics.

Clearly, more needs to be done. Perhaps it would be prudent for the government to focus more on curbing further generation of black money.

TERROR FUNDING

Fake Indian Currency Notes (FICN) network will be dismantled by the demonetisation measures. Taking out 500 and 1000 rupee notes out of circulation will have a lasting impact on the syndicates producing FICN's, thus affecting the funding of terror networks in Jammu and Kashmir, North-eastern states and Naxalite hit states.

As many as 250 out of every 10 lakh notes in circulation are fake, according to a study conducted by the Indian Statistical Institute. Typically, at any point in time, banknotes with a face value of Rs 400 crore are in circulation in the country. The study revealed that fake currency notes with a face value of Rs 70 crore are infused into the system every year, and law enforcement agencies are able to intercept only a third of them — a fact that is acknowledged by the agencies themselves.

The detection rates of fake 100- and 500-rupee notes were found to be about the same or 10% higher than the detection rate of 1,000-rupee notes. The study added that fake 1,000-rupee notes constitutes about 50% of the total value of fake notes.

Pakistan’s military spy agency, the Inter-Services Intelligence (ISI), has been raking in an annual profit of around Rs 500 crore by circulating counterfeit notes in India, according to a report prepared by the IB, R&AW, Directorate of Revenue Intelligence and CBI.

The ISI has been making a profit of 30-40% on the face value of each counterfeit Indian note produced in Pakistan, according to the report. The cost of printing a Rs 1,000 counterfeit note, for instance, is Rs 39 (the RBI spends Rs 29 to print a Rs 1,000 note), but it is sold at Rs 350-400, according to the report. The total fake notes that came into India in 2010 from abroad was pegged at Rs 1,600 crore, and going by this estimate, the report put the ISI’s total profit at Rs 500 crore.

Table no 4

DELHI TOPS RECOVERIES OF FAKE INDIAN CURRENCY NOTES

	2013-14		2014-15		2015-16	
States	No. of notes*	Face value**	No. of notes	Face value	No. of notes	Face value
Delhi	2,15,092	10,35,86,240	1,83,405	9,09,80,880	1,90,686	9,31,13,960
Maharashtra	1,04,621	6,07,17,475	96,431	5,98,43,020	38,622	1,44,73,530
Uttar Pradesh	70,221	2,88,10,310	77,814	3,01,23,140	86,298	3,28,60,790
Gujarat	49,480	2,90,02,540	55,084	3,21,66,390	48,972	3,01,80,920
Andhra Pradesh	75,944	3,57,42,390	53,699	2,38,69,040	37,954	1,90,73,530
Tamil Nadu	58,800	3,78,15,110	49,614	3,08,40,350	41,661	2,19,50,450

*Recovered and seized **In rupees. Source: Figures presented in Parliament*

According to data submitted by the Home Ministry to Parliament on May 3, there has been a slight decrease in the circulation of fake Indian currency notes (FICN) in the country in the three years beginning 2013. In calendar year 2015, investigative agencies and RBI seized and recovered 6.32 lakh fake currency notes with a face value of Rs 30.43 crore. While the number of fake Indian currency notes was down 10% from a year ago, in value terms, it was down 15% in the same period. In 2015, various agencies filed 788 FIRs in cases of smuggling and circulation of FICN, in which at least 816 people were accused. Data show that Delhi and Uttar Pradesh together accounted for over 43% of recovered and seized FICN in 2015.

As Indians struggle to come to grip with the second de-monetisation of currency since independence (the previous one was in 1978 and restricted to Rs1,000, Rs5,000 and Rs10,000 notes), the scale and scope of this action is significantly bigger.

The demonetisation move seems to have widespread support from ordinary people; however there are pockets of hardship despite attempts by the government to exempt crucial needs such as hospitals, tolls, chemists, crematoria and petrol pumps.

Analysis of the sector wise effect of demonetisation

Real estate

Real Estate will be one of the most affected sectors. Everyone believes the same and hence the Nifty Realty Index closed at 175.2, down 11.60%.It is a popular bet in the fresh and resale market dominated by black money holders. The number of buyers will come down and low demand will bring about lower prices in the short term. However, it will subsequently help in improving the sector's prospects. Unorganised builders will be most affected and the sector will drag down cement and ceramic sectors also along with it New residential properties will see lower demand due to negative market sentiment & perceived uncertainty Builders will face a cash crunch due to sudden drop in sales To attract buyers & maintain sales volume, builders are expected to introduce attractive offers/freebies & other benefits like never before Builders are NOT likely to reduce prices .But they will be willing to negotiate on prices with serious buyers across the table & offer considerable value for the same price (in form of modular kitchen, free car park etc.). If you are salaried/self-employed and looking to buy your first home, next 6 months is a wonderful opportunity to save big. Your bargaining power with the builder has just gone up a few notches .Resale & Land segment will see a direct impact from demonetization since cash component plays a big role in these transactions. Unaccounted cash dominates in resale & this is what most articles refer to when they talk about demonetization impacting real estate Demonetization has sucked out most of the unaccounted cash from the system. Affluent buyers who could pay cash & buy are out of the market. Temporarily! This leaves just the end users with sufficient loan eligibility in the market. Lower demand would mean pressure on sellers to reduce prices Sellers with immediate need of money will go for a distress sale & be ready to sell off at a lower price. If you get hold of such a deal in the next 6 months, you will reap the rewards in the long term

Gold prices:

As investors rushed to invest in safe havens, Gold Futures touched a high of Rs31,376 and was trading at Rs30,500 up 2% immediately after demonetization. Local shops have stopped selling gold in exchange of old notes and prevailing prices are Rs31,800 per 10gm against Rs30,700 per 10gm. The demonetisation move seems to have brightened jewellers' fortunes, with many selling gold at 40-60 per cent premium, against accepting the banned currency notes. Even after the note ban, gold imports have been strong. According to estimates by GFMS Thomson Reuters, gold worth $2.8 billion has been imported in the first 17 days of November. Of this,$2.1billion worth of gold was imported nine days after demonetisation.

In November last year, 98 tonnes of gold valued at $3.54 billion was imported. In October2016, imports stood at 84 tonnes worth $35billion. Bullion traders are giving multiple reasons for this. First, the gold market has been destabilised. While gold sold soon after demonetisation was being replaced to meet marriage season demand, there were income-tax raids on many jewellers, who were using demonetisation as an opportunity to make money. Donald Trump's victory in the US Presidential election was considered a bullish sign for gold, too. However, in a few days after his win, gold prices started falling sharply and traders placed further import orders at lower prices.

The government has started issuing notices to those who have deposited high amounts of cash. In such cases, clarity is emerging that selling gold against old currency notes with predated billing practices will stop. However S Subramaniam, CFO of Titan Company contradicted saying "The Indian jewellery market will be the worst hit with the ban on Rs500 and Rs1000 currency notes. This is due to the preference of shoppers to pay amounts over Rs2 lakh in cash."

Banks:

Banks are the back bone of this entire process and also the biggest beneficiaries. Post complete exchange of currencies, banks should benefit from higher deposits and transaction volumes, lower cash handling costs and greater acceptance of digital channels. There are likely to be secondary benefits for the insurance, asset/wealth management companies through higher financial savings. While the Nifty closed 1.31% down, Bank Nifty closed higher by 0.09% giving a confirmation of the same. With demonization, more people are depositing money into the banks. This means the banks have more liquid funds and more money to lend. Many banks have also slashed their deposit rates including SBI, ICICI Bank, HDFC Bank.

- Canara Bank, ICICI Bank and HDFC Bank have cut their fixed deposit rates by up to 1%. State Bank of India cut their fixed deposit interest rates by 0.15% on select maturities.
- HDFC Bank and ICICI Bank have cut their deposit by up to 0.25%.
- United Bank of India has slashed their rates by 1% only on the short-term deposits.

In the banking world, when deposit rates are cut, it generally means the lending rates will also be slashed down. Since banks are paying lower deposit rates to customers, this allows them room to charge lesser on loans. Once interest rates come down, this would translate into a lower EMI. The timeframe for loan rates to come down could take anywhere between 3 months and 6 months.

Entertainment/Restaurants:

One of the most common areas, where undisclosed income is utilised, is the entertainment and restaurant industry. There are plenty of restaurants out there that accept Credit and Debit Cards. Since a majority of the transactions are in cash form in here, it will be exciting to see how people react to it.

Tourism:

Favourite foreign Tourist Destinations of Indian people like Thailand, Singapore, Malaysia, Maldives, Hawaii, Vietnam, Sri Lanka, Nepal, China, Indonesia and Dubai will see negative impact in tourism revenues all black money sponsored trips will come to a halt. Indian Local Tourism will also get affected as they lose large chunks of the pay-in-cash-only clientele. Illegal foreign currency conversion is also reported to be badly hit, because they were big acceptors of Rs500 and Rs1000 denomination currency.

Luxury items:

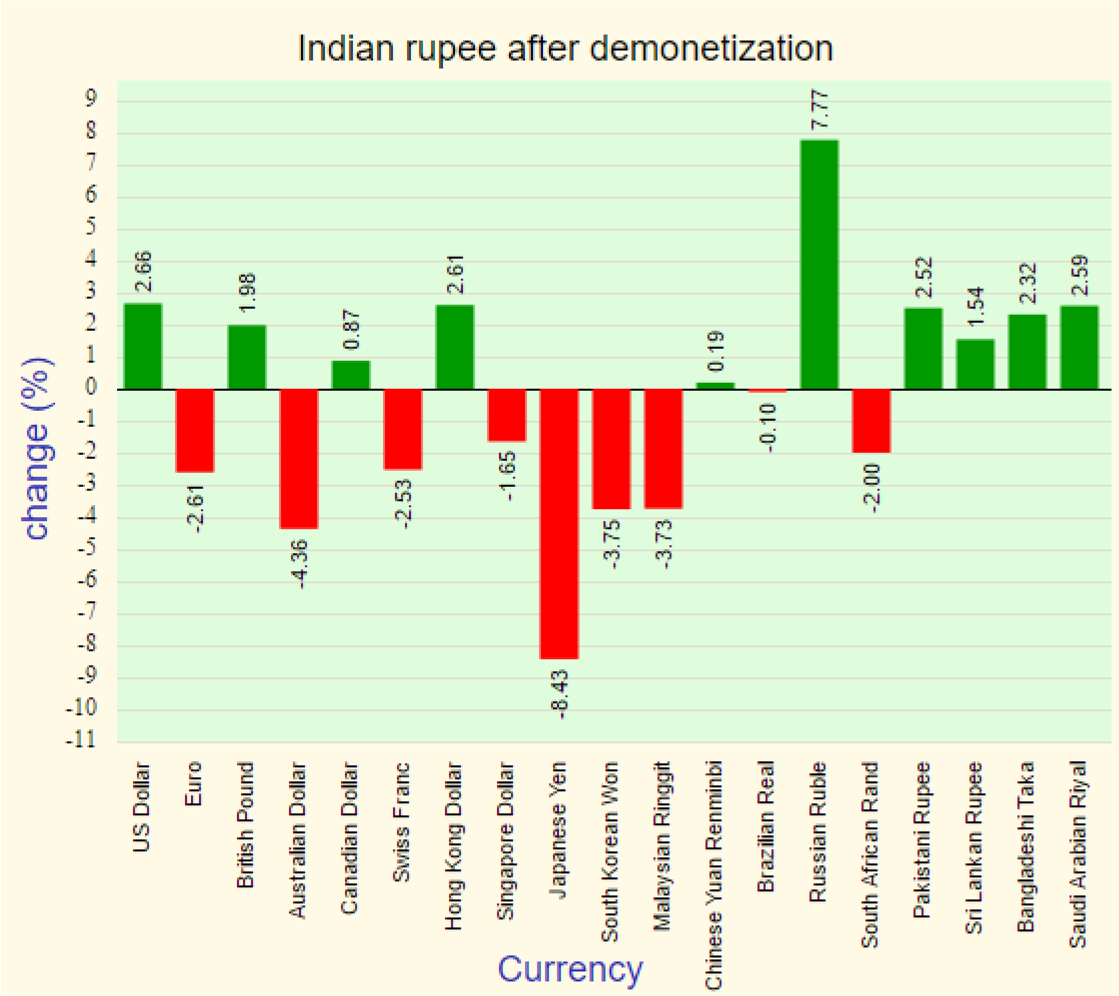
will have a drastic negative impact. Majority of the people spend their undeclared income on such products. After the decision, it is likely that all luxury segments like clothing, electronics, luxury car, furnishing and allied business will take a hit. Media and hospitality industries are also likely to get affected.

ON Indian Rupee

After demonetization of Indian currency on 08 nov 2016, rupee has became weaker than currency of 96 countries or economies. Out of 161 countries' currency, rupee has became stronger than 60 currencies and is at same exchange rate with 5 currencies. If we take data for past 6 months before demonetization from 08 may 2016 to 08 nov 2016, rupee has became stronger than 125 currencies. But after 26 days of ban on Rs 500 and Rs 1000 notes, rupee has became stronger than only 47 currencies.

Rupee has became weaker by 2.66% against US Dollar ($) from 66.40 to 68.17 INR per unit US Dollar. Rupee has become weaker against some popular currencies like British Pound, Canadian Dollar and Hong Kong Dollar too. But also became stronger than Euro, Australian Dollar, Swiss Franc, Singapore Dollar and Japanese Yen.

Period	Stronger	Weaker	Same
After 50 days of demonetization (08-11-16 to 28-12-16)	60	96	5
6 month before demonetization (08-05-16 to 08-11-16)	125	32	4
In Modi government (26-05-14 and 28-12-16)	94	65	2
In Modi govt before demonetization (26-05-14 and 08-11-16)	93	66	2



Negative effects of demonetization

1. Rural and semi-rural citizens in India are very cash dependent, lots of people depend on and regularly use cash for their transaction. Fewer than 20% of India's approximately 2,15,000 ATMs for instance are in rural centres. So any idea of moving to cashless transactions any time soon is a pipe dream. Unfortunately many commentators live and work in rural areas and they can buy even 100 Rs worth of vegetables in a local supermarket and pay by credit card. Less than 5% of Indians have a credit card. In April 2015 there were only 21 million credit cards.
2. A huge swathe of economic activity will therefore be disrupted. Everything from marriages, funerals, festivals, purchases of essential goods, discretionary household consumption will be postponed and or cancelled.
3. A great deal of the wholesale market in agricultural products is conducted in semirural markets where settlement is in cash. This is not black money. Its just that the people haven't got around to using electronic payments partly because the infrastructure is not there.

4. An unknown number of the un-banked sector who may have sums of money stored away for a rainy day may be forced to travel to a nearby town to open a bank account to put the money in before March 2017. They will be subjected to harassment and exploitation by officials and touts. Some may even lose their money if they can't do it by 30 Dec. For them it's more than a few thousand rupees; it may be their life-savings. As soon as they can they may well take their money out.
5. Elementary maths shows the gap clearly. Assuming the existing 500s and 1000s are to be replaced like for like by value, we'll need 11.4 billion new 500s and 2.54 billion (half of 5.08)to be printed distributed to banks and put into circulation (i.e people's hands). Not to mention that there will also be a new 1000 note coming out soon.
6. Here's the killer point: In 2014–15,- an entire year - the RBI had ordered from the printing presses the following numbers of currency notes:
   INR 500s: 5.4 billion notes
   INR 1000s: 1.5 billion notes
7. That means that even if all the printing press capacity was diverted to just 500s and 1000s it would rather more than a year to replace the notes that have been trashed by the edict of Nov 8th. And you just cant print only high value notes because lower denomination notes (100s and 50s and 20s and 10s) are not only needed for everyday transactions but also need to be replaced faster for obvious reasons.
8. To say that the move will migrate a country of 1.2 billion people to the digital payment infrastructure is more of wishful thinking. Banks don't exist for miles in rural India, India has an absymally low <u>1,082 PoS terminal for a million people</u> and digital wallets are largely an urban phenomenon. To expect such infrastructure to magically appear overnight to facilitate cash conversion as well as migration to a "digital" economy is downright bizzare. It's fairly visible that the <u>ATMs in India can't deal with this</u>, and there are people dying while trying to withdraw cash.
9. This was neither necessary to root out black money nor is it sufficient. In terms of its effect on black money it will be at best marginal. In terms of the unintended consequences the effects will be major especially on the poorer less well educated un-banked, rural, cash-economy dependent citizens of India who are now queuing up not for love of country or ruler, but to salvage their own meagre savings.
10. People are already buying and selling the old notes in a parallel black market. People desperate for cash are already exchanging 500 notes for 400 INR - for the seller of the new notes it's a windfall gain. A lot of wealth will simply be transferred to people who own legitimate currency and are willing to sell it at a premium.
11. Emphasis on cashless economy ignores the point that not many people have smartphones in the first place. The government needs to take concrete steps to ensure the vegetable seller on the streets or *kiryana* store don't lose considerable

business over a long period of time to the richer franchises who have facilities for PayTM / card readers. It's one thing to lose business due to competitive disadvantages and another to lose them due to structural disadvantages introduced by sweeping government changes.

Conclusion

Demonetization was an effort to stop counterfeiting of the current banknotes allegedly used for funding terrorism, as well as a crackdown on black money in the country. In the days following demonetisation, banks and ATMs across the country faced severe cash shortages with severe detrimental effects on a number of small business, agriculture and transportation. The scarcity of cash due to demonetization led to chaos and most people holding old banknotes faced difficulties exchanging them due to endless lines outside banks and ATMs across India.

Demonetization is a deep psychological strike on Black Money. The move was also described as an effort to reduce corruption, the use of drugs and smuggling. This decision was considered as biggest cleanliness drive against the black money in the history of Indian Economy and we might move towards digital economy. Demonetization seeks to bring in a sharp, sudden but long lasting behaviour change that encourages electronic payments. Demonetization is advantageous in short, medium and long term.

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