

Financial Reform to Reflect the Need of India Demonetisation-An Inductive Study

B.Gayathri¹ and K.Rajini²

¹ Research Scholar, Department of Business Management, Sri Vasavi College, Erode.TN, India.

² Research Supervisor, Associate Professor, Department of Business Management, Sri Vasavi College, Erode.TN.

Abstract: Demonetization of currency means discontinuity of the particular currency from circulation and replacing it with a new currency. The term demonetisation is already experienced by the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetised in January 1946 and again in January 1978, according to RBI data. Demonetisation did not have a big impact on the country as less than 5 percent of population in India had access to such notes and most banks never had such currency notes. In the recent it is the banning of the 500 and 1000 denomination currency notes as a legal tender. The objective behind the demonetization policy stated by the government are first, it is an attempt to make India free from corruption. Second it is done to restrain black money, third to control escalating price rise, fourth to stop funds used in illegal activity, fifth to make people accountable for every rupee they possess and pay income tax return. Finally, it is an attempt to make a cashless society and create a Digital India. It was decided to curb the illegal use of high denomination currency which was used for corrupt deals in the country. Undoubtedly the common public and bankers are facing hardship with the latest round of demonetisation, More than 85 percent of currency in circulation has been rendered illegal. Demonetisation surely would hamper the current economy in the prevailing situation and will also have impact on India's growth in the forth coming years and to have the positive long lasting effects.

Keywords: Demonetisation, Black money, Digital society, Income tax returns

I. Introduction

Demonetization of currency means discontinuity of the particular currency from circulation and replacing it with a new currency. The term demonetisation is already experienced by the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetised in January 1946 and again in January 1978, according to RBI data. Demonetisation did not have a big impact on the country as less than 5 percent of population in India had access to such notes and most banks never had such currency notes. In the recent it is the banning of the 500 and 1000 denomination currency notes as a legal tender. It was decided to curb the illegal use of high denomination currency which was used for corrupt deals in the country. Undoubtedly the common public and bankers are facing hardship with the latest round of demonetisation, More than 85 percent of currency in circulation has been rendered illegal. Demonetisation surely would hamper the current economy in the prevailing situation and will also have impact on India's growth in the forth coming years and to have the positive long lasting effects.

Objectives

The objective behind the demonetization policy stated by the government,

1. It is an attempt to make India free from corruption.
2. It is done to restrain black money,
3. To control escalating price rise,
4. To stop funds used in illegal activity,
5. To make people accountable for every rupee they possess and pay income tax return.
6. It is an attempt to make a cashless society and create a Digital India.

II. Demonetisation to curb black money

Demonetization of currency of high value say Rs.1,000 could help to unearth the black money to a large extent. However, in order to solve the problem arise on account of demonetization, proper step should be taken. It is advocated for eroding a substantial part of black liquidity on the presumption that black income held in cash will not be presented for conversion.

In 1978, Government cancelled currency note of Rs.1,000 denomination. But again it brought out the currency note of Rs.1,000 denomination for circulation. Demonetization may succeed in reducing the quantum of black money but it cannot prevent the generation of black money altogether.

- Firstly, it renders all illicit cash in the form of these notes worthless at the end of December 30, 2016.
- Secondly, it immediately invalidates all fake currency floating within the country. But more importantly, it forces black money hoarders to find new and innovative way to stash their ill-gotten wealth.
- Currently Rs 17,54,000crore worth of notes are in circulation, according to the RBI's database. Rs 500 notes comprise almost 45% of this, while 39% of the notes were of the Rs 1,000 denomination, in value terms. In volume, Rs 10 and Rs 100 notes constituted 53% of the notes in circulation.
- Expect the demand for gold and other such investment avenues such as diamonds and silver to shoot through the roof not just until the deadline, but well after that. That is, until the government finds a way to tap sale of gold across the country as well.
- The prices of property, already hitting the trough, are likely to go plummet further as nearly half of all property transactions in India are believed to be done through black money and benami transactions.

III. Need to control Escalating price rise

In an economy like India where there is no catastrophic hyper-inflation that is destroying the economy, but rather a steady but low rate of inflation, of around 5-6 percent, the reason for concern over inflation is that it may nonetheless be hurting the poor. If money wages remain constant, then even a 5-6 percent rise in prices, entails an erosion of real wages and hence an increase in the distress of the poor. But if the evil of inflation is seen essentially in terms of its damage to the living standards of the poor, then it follows that inflation-control must be defined in terms of controlling the damage to these living standards.

Consider an example. If with money wages constant, prices rise by 5 percent, then we have inflation hurting the poor. But if with prices remaining constant, the money wages fall by 5 percent then too we have the poor being hurt, even though we have no inflation. Hence if the 5 percent rise in prices is sought to be controlled through a 5 percent reduction in money wages, then we do not really have inflation control, even though price rise has been controlled. The question to ask therefore is: would demonetisation cause a decline in inflation without using some means for doing so that would have the same consequence of squeezing the poor that inflation has? If it can cause a decline in inflation without using for this purpose means that achieve the same squeeze differently then we can indeed say that demonetisation can control inflation.

IV. Demonetisation Has Broken The Back of Terror Funding

Within days of Prime Minister Narendra Modi's demonetisation announcement, two terrorists killed at Bandipora in Kashmir were found with new Rs,2000 currency notes. The incident clearly showed the umbilical link between terrorism and money.

The Indian taxpayer was the biggest source of funding for the terrorists. In Kashmir, it was routine to pad all contracts with at least 10 per cent extra cost. This was paid to the terrorists as protection money. Government servants, school teachers and traders all paid this protection money. In the 1990s it was common knowledge that forest department trucks were used to ferry ammunition for the terrorists. Without this oxygen, terrorism could not live. 19 years have passed, but the ground reality has not changed much. That is till November 8 when the Modi government in one fell swoop abolished Rs 500 and Rs 1,000 notes. Terrorists and separatists have to perforce keep a large part of their loot in cash. They need money to pay their cadres to hurl stones, attend rallies, hire transport for the 'cause' and finally to bribe corrupt officials to turn a blind eye to their activities.

The effect of the cash crunch faced by the separatists in Kashmir is for everyone to see. The Kashmiri separatists are not the only ones to face the heat of demonetisation. The Naxalites are equally hard hit. The Naxals have been running a thriving protection racket in the tribal dominated states for years. Has there been ever an attack on privately owned mines or foreign companies? The answer to this is negative as all of them pay protection money to the Naxals. Since this money has to be used to pay 'salaries' to cadres and sympathisers, it has to be perforce in cash.

According to a rough estimate, the Naxals have suffered a loss of close to Rs 7,000 crore (Rs 70 billion) due to demonetisation. Anyone remotely familiar with the situation in the north-east knows that every single truck passing through insurgent-hit areas pays 'tax.' The insurgents even issue receipts. The parallel government in some of the north-eastern states is so institutionalised that the 'tax' is deducted directly from the salaries of all government servants. Even governors and ministers are known to pay this 'tax.'

What applies to the terrorist groups and insurgents is also true of organised crime. The criminals who operate protection rackets, smuggle drugs and arms also need liquid cash. It is also well worth remembering the close linkage between corruption and terrorism. After all, it was a corrupt custom official who facilitated the landing and transport of RDX explosive used in the March 12, 1993 blasts in which over 300 people lost their lives.

Since the Rs 500/1,000 currencies were convenient to carry and distribute, most of the cash reserves of terror groups, insurgents, Naxalites and organised crime gangs were held in these denominations. When the

government made these notes defunct overnight, all these groups took a financial hit. It will take them a while to recoup their losses.

Finally, the issue of fake Indian currency. It is well known that our neighbour has been pumping huge quantities of fake currency to pay for anti-national activities. These currencies were being pumped into India from Nepal, Bangladesh, Sri Lanka, Thailand and some other countries.

As the Indian economy moves more towards cashless transactions the problem of detecting fake currency will become easier. Anyone who has traveled abroad will have experienced that when one presents say a \$100 note, it is scrutinised very carefully since most transactions are in plastic money. Once the volume of cash in the Indian economy is reduced, similar checks will be possible. Presently, the sheer volume of cash in the market defeats this measure. It is true that a large portion of black money or gains from illegal activities like corruption and other crimes is invested in gold or real estate. The Benami Properties Act that came into force on November 11 will take care of this as well.

Irrespective of other economic factors, one thing is certain: Demonetisation has broken the back of terror funding in the immediate future. It has thus saved many lives by preventing terror attacks. The desperation of the insurgent groups is already evident by the attempts at bank robberies. Demonetisation has given a shot in the arm for the fight against terror funding.

V. Accountable For Every Rupee They Possess And Pay Income Tax Return.

There is a background to the current decision of demonetization of 500 and 1000 rupee notes. The government has taken few steps in this direction much before its November 8, 2016 announcement. As a first step the government had urged people to create bank accounts under Jan Dhan Yojana. They were asked to deposit all the money in their Jan Dhan accounts and do their future transaction through banking methods only.

The second step that the government initiated was a tax declaration of the income and had given October 30, 2016 deadline for this purpose. Through this method, the government was able to mop up a huge amount of undeclared income. However, there were many who still hoarded the black money, and in order to tackle them; the government announced the demonetization of 500 and 1000 currency notes.

The demonetization policy will help India to become corruption-free. Those indulging in taking bribe will refrain from corrupt practices as it will be hard for them to keep their unaccounted cash. This move will help the government to track the black money. Those individuals who have unaccounted cash are now required to show income and submit PAN for any valid financial transactions. The government can get income tax return for the income on which tax has not been paid. The move will stop funding to the unlawful activities that are thriving due to unaccounted cash flow. Banning high-value currency will rein in criminal activities like terrorism etc. The ban on high value currency will also curb the menace of money laundering. Now such activity can easily be tracked and income tax department can catch such people who are in the business of money laundering.

This move will stop the circulation of fake currency. Most of the fake currency put in circulation is of the high value notes and the banning of 500 and 1000 notes will eliminate the circulation of fake currency. The demonetization policy will force people to pay income tax returns. Most of the people who have been hiding their income are now forced to come forward to declare their income and pay tax on the same.

Even though deposits up to Rs 2.5 lakh will not come under Income tax scrutiny, individuals are required to submit PAN for any deposit of above Rs 50,000 in cash. This will help the income tax department to track individuals with high denominations currency.

This move has generated interest among those people who had opened Jan Dhan accounts under the Prime Minister's Jan Dhan Yojana. They can now deposit their cash under this scheme and this money can be used for the developmental activity of the country

The ultimate objective is to make India a cashless society. All the monetary transaction has to be through the banking methods and individuals have to be accountable for each penny they possess. It is a giant step towards the dream of making a digital India. If these are the merits, there are demerits of this policy as well.

VI. Cashless Society

The government's plan to sell the idea of nation-wide demonetisation as an attempt to make the country "cashless", therefore, seems a bit over-ambitious and somewhat callous. Of course, the depletion in cash has pushed digital and e-transactions to the forefront. E-banking, e-wallets and other transactions through apps using plastic cards are becoming popular. As of March 2016, the Reserve Bank of India declared that the number of debit cards floating in the economy was 661.8 million, while 24.5 million credit cards had been given to bank account holders. However, of late the transfer of dependency from cash transactions to plastic card transactions has caused the latter to crash under the rising burden. In certain parts of the country, including a metropolitan city like Mumbai, there have been reports of card-swiping systems crashing. In fact, there are many people who don't know how to use the cards. The percentage of erroneous transactions via plastic cards

has risen from 8 per cent to 23 per cent due to first-time users putting in the wrong pin number over and over again, particularly in semi-urban areas, who've never used plastic cards before.

While the government may be hell bent on making the country dependent on debit/credit cards and mobile-dependent online transactions instead of physical cash exchange, the process should have been done slowly and organically. The government, however, is insisting that this move will strengthen the banking sector, boost the e-commerce business and it will encourage more people, particularly in rural villages to open bank accounts. To suddenly impose such a demand through demonetisation in a country where only a small percentage of citizens have access to debit/credit cards, can only be attributed to uninformed thinking.

VII. Creating Digital India

“India’s digital prowess will strengthen the economy. India cannot become a superpower with 50 per cent of the economy running on cash. This large, bold and historic initiative was taken by the prime minister keeping in mind the long-term economic future of India, and the soft power that it can create,” was observed. The government, was pushing for more use of IT and digitisation. Several schemes including digital lockers are all happening simultaneously. Ongoing project like 1,25,000 post offices and common service centres have been opened all over the country and 1.5 lakh panchayat areas will also be co-habited by common community service centres are to be digitized and also nature of job would also change. The existence of IT in technology / information technology will be the future of India, the IT in India’s tomorrow, India has acquired capabilities that are tangible and which would create soft power.

VIII. Conclusion

It is essential to note here that although it is an excellent move towards curbing corruption, the plan can by no means be a conclusive step. The government has initiated a war against corruption and black money but this must be treated as a beginning and further steps should be taken to stop generation of black money and the need to do so. Only then will this decision of demonetising high denomination currency hold the significance the government has intended it to.

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