

Demonetisation Scheme

1) Introduction

- The demonetization of Rs 500 and 1000 notes announced on 8 Nov is a key part of the overall battle against corruption, black money and fake currency.
- Historically, demonetisations have been resorted to during hyperinflation, as in Weimar Germany, or periods when windfall profits were made, as in British India during World War II.
- The U.S. stopped issuing \$500 notes in 1969, the European Central Bank halted 500-euro notes early this year, and Singapore killed its \$10,000 note and Canada its \$1,000 note in 2000.
- Rs 500 and Rs 1,000 denominations account for over 80% of all currency in circulation by value.

2) The necessity of Demonetisation

- The move was necessary to stop terrorists and drug cartels “in their tracks.”
- It has long been alleged that terrorists and drug cartels from neighbouring countries have been supplying high-value fake currencies into India.
- The security features of the present notes are weak and there is rampant counterfeiting, there is a need to replace these with new notes that have better security features.
- In India, the problem of fake rupee notes has been noticed for many years.
- India has one of the highest cash to GDP ratios at 12 per cent
- Bulk cash transfer plays a role in more complex drug trafficking and money-laundering schemes.

3) Benefits

- This will result in a reduction of inflation as conspicuous consumption will come down.
- eliminate black money and the growing menace of counterfeit currency notes
- move will benefit the poor, middle class and aspirational middle class by increasing opportunity and bringing real estate and higher education within their reach
- The government’s move will benefit companies in the cashless economy.
- There could have been no bigger catalyst for digital economy and for digital wallets in the country
- wider tax-base, better tax compliance, reduced transaction costs and enhanced efficiencies in various supply-chains
- Macroeconomic indicators are likely to improve too as inflation slows, fiscal balances improve and interest rates soften further on the ground.
- In the long-term, benefits of GDP growth will outweigh the short-term transitional impact.

- Tax collection will increase and accordingly more money will be available to the government for development expenses.
- Surge in digital payments will be seen even for small value transactions.
- Banks will stand to gain in long term as they will attract higher deposit (savings) balances and transaction volumes, lower cash handling costs and strengthening of digital payments ecosystem.
- Funding of political parties through black money will minimize and disbursement of cash benefits to weaker sections of society for influencing voter's decision may also disappear.
- Funding of terrorist activities including Maoist movements, and Criminalization in politics will also fade gradually.
- Internationally, the country's index of black money free economy will increase.
- Commodity price fluctuations will be controlled or minimized.
- The international image of the country in terms of FDI, collaboration, investments etc will increase.
- The parking areas of black money like property, gold, bullion, etc will be discouraged and consequently the related business will see sea change in their overall segment.
- An honest businessman who was always struggling with tax evaders engaged in undercutting of prices will now have a level playing field.

4) Impact on Real Estate Sector

- Real estate prices would come down in the short to medium-term as land would become cheaper, say experts
- Land transactions and luxury residential segment would be impacted the most because they employ the maximum black money.
- Land transactions are mostly done in cash. This will put an end to it.
- On a long-term basis government's decision to curb black money would reduce corruption and bring transparency into the sector.
- bringing down land prices and would thus be beneficial to the organised construction sector
- The demonetisation, coupled with the passing of the Real Estate Regulatory Act, would weed out the black money elements from the real estate sector

5) Demonetisation will hit terror financing hard

- As per a study done by the Indian Statistical Institute, Kolkata, in 2015, at any given point of time Rs. 400 crore worth fake notes were in circulation in the economy.
- Officials in the security establishment expect that crimes like terror financing would be severely hit by the move.

- The fake notes can be detected only when they enter the banking system. If it is in circulation in the open market, then it's hard to calculate the number
- demonetisation would impact the terror financing, particularly in Jammu and Kashmir
- The terror funding module in place right now, will be affected as the terrorist operatives always store money in the form of big currency notes

6) Short-term pain, long-term benefits

- there will be some contraction in money supply and thus a slight deflationary impact, which will cause some inconvenience in the very short term
- In the longer term, it will lead to a greater proportion of the economy shifting from black to white.
- It may also raise permanently the cost of holding cash by adding a risk premium.
- This may encourage people to take the certainty of paying taxes in lieu of the uncertainty of holding black cash.
- The incentives for honesty have been improved, dramatically, with this reform measure

7) Moving towards Cashless economy

- RBI has been goading people to use electronic modes of payments.
- Such usage will alleviate pressure on the physical currency and also enhance the experience of living in the digital world
- There is mounting interest in electronic payment mechanisms, with mobile payment firms Paytm, Ola Money and Mobikwik reporting increased downloads of their apps.
- India is largely using its plastic cards to withdraw cash, which it spends later
- Mobile wallets which offer ease of transaction to customers are still in the starting phase of adoption as only around one-fifth of India's population has a Smartphone where these services can be used.
- Unified Payments Interface (UPI) is yet to fully take off
- Only about 20-25% of all transactions that happen in India are cashless.
- With this demonetization drive, we should see this rising and people opting for mobile wallets more
- The infrastructure for acceptance is still an issue that needs to be overcome.
- Another factor that works against cashless transactions is the perceived security problems.

8) Concerns

- If unaccounted money by Indians is held in the form of foreign bank accounts, the present scheme can do nothing about it.

- As long as agricultural income can be used as a route to avoid taxes and indirect tax rates have multiple rates and exemptions, the problem of tax evasion is unlikely to go away.
- On the negative side, the disruption in transactions could hit the emerging growth of consumer demand.
- The impact on the economy of sharp monetary contraction is evident, and the greatest sufferers are the rural population, and the urban poor and middle class.
- The first impact is on the supply chain of goods and services which is disrupted, and this is then feeding back to impact production.
- Traders and retailers have been deprived of the funds to carry on their business
- With the severe loss of purchasing power, the country is being driven into an artificially created recession and the level of economic activity is declining.

9) Need for Further Action

- we would need a policy that checks the generation of black incomes at source
- Central government should step in and legislate that all transactions in gold and property go through banks.
- The government should take steps to increase mobile penetration, pre-bundled with cash apps, which will make it easier for those who wish to go digital.