

## **BUSINESS ENVIRONMENT**

### **UNIT-2**

### **PART-IX**

#### **What is demonetization?**

Demonetization is a process of stripping a currency unit of its status as a legal tender. In simple words, demonetized notes are no longer valid as legal currency. Usually, a new currency replaces the old currency unit/s.

#### **Demonetization**

When did demonetization happen in India before 2016?

- ✚ 2016 is not the first instance of demonetization in India. In fact, demonetization happened in India even before 2016.
- ✚ In 1946, the Reserve Bank of India had demonetized Rs. 1,000 and Rs. 10,000 currency notes which were then under circulation.
- ✚ In 1954, the Government introduced new currency notes of Rs. 1,000, Rs. 5,000, and Rs. 10,000.

- ✚ In 1978, the Moraji Desai Government demonetized Rs. 1,000, Rs. 5,000, and Rs. 10,000 to curb illegal transactions and anti-social activities.
- ✚ Why did the Government demonetize 500 and 1000 notes in 2016?

**The objectives and outcomes of the scheme in 2016 were:**

- ✚ To plug financing to terrorists.
- ✚ To help unearth black money. The unearthed black money will expand the fiscal space of the government.
- ✚ To help reduce interest rates in the banking system
- ✚ To help formalize India's informal economy. It will reduce the extent of cash transactions and help in the creation of a less-cash economy.
- ✚ The government also offered several incentives to induce people to use digital transactions.

What can demonetization achieve?

The possible benefits are as follows

**Increased Savings** – As a result of demonetization, people will tend to deposit their cash in the bank rather than at home. This will help them save more.

**Lower lending rates** – With currency demonetization, money moves from people to banks and financial institutions. Thus, there is a better circulation of money.

This will lead to a lower cost of funds which translates into lower lending rates.

Better economy – As more cash is with the banks, there is a higher circulation of money in the economy. The government receives more taxes and can undertake more development projects. This leads to a better-performing economy.

Curbing anti-social activities – Usually, cash is the mode of transaction for anti-social activities. Thus demonetization curbs these activities. It also forces anti-social units to find ways to get rid of the old notes. As a result, there is better control over the unaccounted money in the economy.

Reducing counterfeit currency notes – Banks check if the old notes are genuine or counterfeit before accepting them. Thus, this allows the government to weed out counterfeit notes from the market.

### **IMPACT OF DEMONETISATION**

Some of the notable short-term impacts of demonetisation are discussed below.

- A slowdown in the growth process was witnessed as demonetisation reduced both, demand and supply in the market due to lack of liquidity, reduced working capital availability and increased uncertainty with a major impact on cash-intensive sectors like agriculture, real estate, jewellery etc.
- A decline in the stock of black money could be seen as some holders came into the tax net
- There was a sharp rise in the bank deposits and financial system savings. Government's revenue from taxes increased because of increased

disclosure. Payments to local bodies increased as demonetised notes remained legal tender for tax payments/clearance of arrears

- There has been a decline in the indirect and corporate taxes, to the extent of slowdown in the growth process. However, in the long run, taxes are expected to increase as formalization expands and compliance improves.

Demonetisation is an effective tax administration measure as black money holders are not left with any choice but to declare their wealth and pay taxes as penalty. Through this measure the government seeks to communicate that tax evasion shall not be accepted and allowed any further. However, it involves huge cost in the process of withdrawal of old currency circulating in the economy and printing of new currency notes. The long term benefits of demonetisation can be reaped only if it is followed with fast, demand-driven remonetisation, digitalisation and growth oriented tax reforms.