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Postmath of demonetisation on banking sector

Selvanatchiyar. R and Francis Mercy N.M.

PG and Research Centre of Commerce,

Jayaraj Annapackiam College for Women, Periyakulam- 625601, Thend Dt.,
Tamilnadu, India.

Abstract

The biggest cleanliness drive against the black money in the history of Indian Economy was announced by government of India in the name of demonetization on the eve of 8th November 2016, the date remembered by every Indian. Demonetization is the act of divesting a currency unit of its status as legal tender, and in some cases replacing it with new currency units. Our Indian Government took the bold step, on 8th November 2016, of instantly stripping the 500 and 1000 – Rupee currency notes of their status as legal tender (these notes constituted over 86 per cent of the currency in circulation). The reasons given included the curbing of the hoarding of 'black money', the elimination of counterfeit currency, the reduction in cross-border terrorist incursions, the enhancement of the digital economy; and the inducement of more of the population in to the formal, taxable economic grid.

Key words: Demonetization, Black Money, Indian Economy, Digital Economy

1. Introduction

Demonetization is the act of divesting a currency unit of its status as legal tender, and in some cases replacing it with new currency units. Our Indian Government took the bold step, on 8th November 2016, of instantly stripping the 500 and 1000 – Rupee currency notes of their status as legal tender (these notes constituted over 86 per cent of the currency in circulation). The reasons given included the curbing of the hoarding of 'black money', the elimination of counterfeit currency, the reduction in cross-border terrorist incursions, the enhancement of the digital economy, and the inducement of more of the population in to the formal, taxable economic grid. The Prime Minister, Mr. Narendra Modi declared demonetization with new currency units of 500 and 2000-Rupee denominations.

Demonetization has impacted Indian society like no other event in the country's financial history. The effects on businesses and financial institutions have also been pronounced.

Country, with a population of over 1.3 billion people, has the potential to become a leader among the innovative economies of the world-particularly in the knowledge intensive fields of science and technology. Over 95 percent of all transactions in India are conducted in the form of cash. Demonetization clearly made an immediate impact on many areas of the economy. Businesses shut down, farmers couldn't buy seeds, taxi and rickshaw drivers didn't have any way to receive payments, employers had no way to pay their employees, fisherman watched their catch wither up and rot, common people had difficulty in buying food, and wedding throughout the country were cancelled. Farmers were unable to sell recently-harvested crops, or purchase seeds for the upcoming winter season. Thus prices crashed and wages fell

The effects have been felt in both the formal and informal economies. After the announcement of Demonetisation, it quickly became apparent that the banks were unprepared for the transition, owing to the unavailability of the new notes. Initially the amount of defunct currency that could be exchanged over the counter at banks was set at 4000 Rupees; five days later this was increased to 4500 Rupees; in late November 2016 over-the-counter exchanges ceased altogether. The situation was complicated by the fact that the Reserve Bank of India introduced different rules for District Central Cooperative Banks and Primary Agricultural Credit Societies, two primary financial institution used by the rural population.

One of the aims of demonetization was the acceleration of the digital economy. It is interested to note that in November and December 2016, there was, according to the Reserve Bank of India (RBI) a marked increase in digital payments-particularly point-of-sale (POS) card transaction. This monumental financial measure made a deep social impact. The present study portrayed the effect of demonetization on banking sector.

society could potentially address many of the country's fiscal issues, since all electronic transactions are recorded, all payments will be monitored and processed in real time. Thus, reducing the risks of tax evasion and money laundering, not to mention diminishing the costs of maintaining the infrastructures on which paper currency relies. Indeed switching to a digital payment ecosystem, rather than relying on a traditional banking system, can, over time, not only reduce financial exclusion, but can increase tax revenue from a more diverse workforce. An important consideration for realising these goals and reaping the benefits is the need for investment in a reliable telecoms network, and the provision of the population with inexpensive, easy-to-use means of effecting digital payments. Even though demonetisation move created adverse short term policy impact, the real impact of demonetization must be assured in the medium or long term. At this point of juncture one cannot precisely conclude whether demonetization is a failure or success.

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