



## **INDIA DEMONETIZES INR500 AND INR1000 NOTES – MOVING TOWARDS A CASHLESS ECONOMY**

### **Major Reform**

In a big bang reform, effective midnight of November 9, 2016, the Indian government has banned INR500 and INR1000 currency notes (the “**Banned Notes**”). The decision has been taken to root out fake currency and cash (black) money, and eliminate corruption, terror funding and money laundering, which has been hurting India’s economy for decades.

Going forward, the Banned Notes cannot be used for transacting business in India and will not be regarded as legal tender. However, currency notes and coins of INR100, INR50, INR20, INR10, INR5, INR2 and INR1 will continue to be usable.

To reduce the inconvenience for the general public, the government has allowed petrol pumps and government banks to accept the Banned Notes for the next 72 hours. Further, railway ticket booking counters, ticket counters of government buses and airline ticket counters at airports have also been directed to accept Banned Notes in this interim period. All banks and ATMs are shut today, and ATMs will be shut on November 10, 2016. Until November 11, 2016, there will be a cap of INR2000 on ATM withdrawals per card per day, which will be increased gradually.

The RBI will begin issuing new currency notes of INR500 and INR2000 from November 10, 2016. The government has given a 50 day time period from November 10, 2016 until December 30, 2016 to exchange the Banned Notes at post offices and banks. Those unable to submit Banned Notes within the deadline will be able to do so at the Reserve Bank of India by March 31, 2017 by providing a declaration.

### **Background**

The Indian economy uses too much cash for transactions. The ratio of cash to gross domestic product at about 12.42% is one of the highest in the world, especially when compared with 9.47% in China or 4% in Brazil. Press reports suggest that the number of currency notes in circulation in India is much higher than in other large economies; India has about 76.47 billion currency notes in circulation compared with 34.50 billion in the USA. One big reason many Indians use cash intensively is that half of them do not have bank accounts

Despite the recent expansion in digital wallet usage as well as the introduction of specialized payments banks, there is still a lot of cash in the system.

### **Our Comments**

The Indian Prime Minister is trying to stamp out cash (black) money from the system and move everybody to an electronic payment platform. The main advantage will be that a record of all economic transactions through electronic means will make it very difficult to sustain a parallel underground economy. Cash (black) money hoarders, who avoid paying tax by indulging in cash hoarding and use, will be under immense pressure. The biggest impact is likely to be on the real estate market, which usually runs on



mostly-cash deals from people who like to park undeclared money in real property or take cash on resale deals to reduce capital gains tax. For buyers, the attraction of cash deals is that they can report a lower value to the registration office and reduce the stamp duty burden. This practice will reduce considerably.

On the flip side, however, the common man will see some inconveniences. People in cities have access to ATMs as well as banks, but people living in rural areas generally do not have bank accounts and usually keep cash at home. Therefore, they will have some difficulty in transacting until they open a bank account. However, it is felt that this will be for a short period of time.

In our view, the Indian government is walking the talk to ensure that the menace of cash (black) money and corruption in India is overcome. The first decision of the Modi government was the formation of a special investigation team on black money. A law was passed in 2015 on disclosure of foreign bank accounts. In August 2016, strict rules were put in place to curtail benami transactions (transactions conducted in the names of third parties). During the same period a scheme to declare cash (black) money was introduced. The efforts have borne fruit. The Indian government's efforts have led to India emerging as a bright spot in the global economy.