
DEMONETIZATION AND ITS IMPACT ON INDIAN ECONOMY

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Abstract :

On November 8, 2016, Government of India demonetized INR 500 and INR 1000 notes through the live televised address by Hon'ble Prime Minister Shri Narendra Modi. Mainly it was done to blow a sudden stroke on corruption, smuggling, money laundering and funding to terrorist activities. This step of the government towards Indian economy was appreciated by few bank executives, some industrialists but strongly criticized with thunder agitations to cancel back demonetization by many political leaders, oppositions and general public. The writer of this article tries to study this step as a measure to purify the economy and understand its success and impact on Indian economy.

Key words :

Demonetization, Corruption, Plastic money, Digitalization Transparency.

Introduction :

Demonetization is an action of ceasing a currency unit of its status as a legal tender. Demonetization of INR 500 and INR 1000 bank notes was a strategy initiated by the Government of India on 8th November 2016. The announcement of demonetization was made by the Prime Minister Narendra Modi in an unscheduled live televised address on 8th November 2016 at night 10.15 that notes of Rs.500 and Rs.1000 will not be used as a legal tender. Old notes were accounted for 86% of the total circulating cash in the country. One month period had been given to replace the notes with new Rs.500 and Rs.2000 notes. This surgical demonetization was done to crack down on black money, corruption and to stop use of current bank notes for funding terrorism, drug trafficking, smuggling and such other evils in the society and promote cashless economy for opening the doors of transparent online digital payments.

The surgical demonetization was done with a little warning, hence chaos ensued in the cash-dependent economy (As per RBI 87% of all Indian customer transactions are in cash), as long, snaking lines formed outside ATMs, and banks which had shut down for a day. The new rupee notes have different specifications, size, thickness, requiring re-calibration of ATMs, hence only 60% of the country's, 2,00,000 ATMs were operational. Even those dispensing bills of lower denominations faced shortages. Moreover the Government's restriction on daily withdrawal amounts added to misery, though a waiver on transaction fees did help a bit. The people and businesses faced lot of inconveniences due to it. Demonetization has given a great stroke to general public, poor, poverty stricken and small businesses in India. Therefore we can conclude that the surgical demonetization has failed in this objective,

Definition of Demonetization :

'Demonetization' means "the withdrawal of a coin, note, or precious metal from use as Legal tender".

"It is the act of stripping a currency units of its status as legal tender it occurs whenever there is a change of national currency. The current forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the

old currency with new currency". www.wikipedia.com. Demonetization may be a slow or a surgical.

Historical Background :

Demonetization of bank currency is not for the first time in India. Earlier Indian governments had withdrawn bank notes. In January 1946 bank notes of Rs.1000 and Rs.10,000 were demonetized and new notes of Rs.1000 and Rs.5000 and Rs.10000 were introduced in 1954. During the period of Janata Party coalition government led by the then Prime Minister of India Morarji Desai had again demonetized bank notes of Rs.1000, Rs.5000 and Rs.10000 on 16th Jan. 1978, as a means to curb counterfeit money and black money. Thus India has done withdrawal of bank notes thrice in its history 1946, 1978 and recently in 2016. In the past BJP had opposed withdrawal of bank notes and also the Central Board of Direct Taxes (2014).

Objectives of the study :

1. To understand recent demonetization of November 2016.
2. To study its impact on Indian economy, society at large and suggest a conclusion.

Methodology :

The descriptive methodology has been used to collect information. The information is collected from experience, opinion, general observation. Secondary data has been collected from various published sources, reference books, journals, periodicals, newspaper, internet websites. Thus the study is based on the analysis of the primary and the secondary data published in the various books, magazines and websites.

Limitations of the study :

1. The researcher has mostly considered only secondary data.
2. The researcher has considered period from 8th November 2016 to date i.e. only the recent demonetization done by the government.

Hypothesis :

For the purpose of this study following hypothesis is set.

"The Surgical Demonetization has not achieved expected success due to -

- 1) Lack of planning for Demonetization
- 2) Lack of co-ordination between Government and banks
- 3) Improper Implementation

Review of Literature :

There are various literature, books, websites, articles, Journals, periodicals, News papers Report and say of experts etc. written and published on demonetization from their view for the purpose of this paper.

The surgical demonetization of 2016 had created a big chaos, shortages of funds, interruption in bank working, long queues to get and exchange currency, several deaths were linked to the rash to exchange cash. The decision met with mixed reactions. International response was positive. IMF (International Monetary Fund) issued a statement supporting Modi's efforts to fight corruption by the demonetization policy. The President welcomed the Demonetization more by calling it as bold step. Finance Minister Arun Jaitley had explained the reasons behind demonetization that it's a step against Black Money, Increase in Income tax and Availability of more money for economic growth. The humble Prime Minister Narendra Modi said that "the queues due to demonetization were the last queues that would end all other queues". The

Hindu reported that "RBI had urged citizens to switch to alternative modes of payments such as pre paid cards, credit and debit cards, mobile banking and internet banking".

The Chief Minister of West Bengal Smt. Mamata Banerjee called it a 'drama'. Former World Bank Chief Economist, stated that the damage is likely to be much greater than any possible benefit. Former Prime Minister of India Dr. Manmohan Singh expressed " the demonetization move as a 'Organized loot, legalized plunder of the common people". On 11th Nov. 2016 it was declared by some experts that "It is a different matter that no industrialist, banker or opposition part has got into voicing a contrary view. The move has already created chaos. Former Finance Minister Yashwant Sinha on 22.12.2018 said, "Demonetization of 2016 It is his biggest failure, it is also an unoriginal idea". It led to "tax terrorism". Time to punish Modi for Demonetization fiasco". Expert economist stated that "Catching fake notes already in circulation neither helps trap the terrorists. Over 99% of the banned notes returned to banks. 1000 currency notes has ended. However, the analysis is in India and abroad has claimed that Demonetization of November 2016 has failed.

Global Scenario :

In some of the world countries such as Norway, Sweden, Denmark, France, Britain etc. more than 90% of total transactions are through plastic money only 3% to 5% transactions are on cash basis.

The Prime Minister Modi and Finance Minister A. Jaitely encourage use of debit cards, credit cards, internet banking and Mobile apps. such as Bhim app for carrying out day to day transactions.

Impact(s) and effects of Demonetization of Indian Economy :

Demonetization was a generations memorable experience. Its impact is felt by every Indian citizen. It has affected the Indian economy through the liquidity side. It had created a situation of currencies jams, consumption, investment, production, employment etc. The intensity of its effects clearly depends upon the duration of the liquidity shocks. Demonetization created a great chaos through the country. Following are the salient impacts on the Indian economy.

1. Liquidity shortage :

The surgical demonetization results in cash shortages throughout India that led chaos and people holding old banknotes faced difficulties to exchange them. Insufficient volume of the cash affected on a number of small business, agriculture, transportation. SENSEX and NIFTY STOCK indices crashed for the next two days. The endless lines outside banks and ATMs across India became a daily routine for millions of people waiting to deposit or exchange old bank notes. ATMs were running out cash after a few hours of being functional and around half the ATMs in the country were non-functional. People attacked bank premises and ATMs. Many people were reported to have died in queues waiting to exchange their bank notes. Sporadic violence's were reported in metropolitan cities. There were transportation halts and highway toll junctions saw long queues as toll plaza operators refused the old notes.

2. Consumption :

Day to day consumption of people especially poor across India had been adversely affected due to cash shortages in the following days of demonetization.

3. Agriculture :

The Transactions in the Indian agricultural sector are heavily dependent on cash and were adversely affected by the demonetization of Rs.500 and Rs.1000 bank notes. Many farmers had

insufficient cash to purchase seeds, fertilizers and pesticides needed for plantation of rabi-crops usually sown around Mid-November. Protest rallies were conducted by the Unions of farmers in Gujarat, Punjab, Maharashtra and Muzzaffarnagar against demonetization as well as restrictions imposed by the RBI on district co-operative central banks which were ordered not to accept or exchange the demonetized bank notes.

4. Stock Market :

The Share Market indices dropped to an around six month low in the week following the demonetization. BSE SENSEX and NIFTY stock indices crashed for the next two days. By the end of the intraday session on 15th November 2016, the BSE SENSEX index was lower by 561 points and the NIFTY 50 index was below 8100 intraday.

5. Banking sector :

Within 8 days i.e. between 10th November to 17th November banks reported exchange and deposits of demonetized bank notes worth Rs.8.45 trillion and exchange of Rs.339.48 billion and deposit of Rs.8.11 trillion. During this period an amount of Rs.2.16 lakh crores had been withdrawn by people from their accounts. It was also reported a large amount cash deposits in dormant accounts. The SBI reported to have received more than Rs.300 billion in bank deposit in first two days after demonetization. A spike in the usage of debit card and credit card in post demonetization was also reported. The debit card transactions increased by 108% and large sum of cash in defunct accounts were seized. According to the Economic Times, more than 80% fake currency in India originates from Malda district in West Bengal. The demand for point of sales or card swipe machines increased. E-payment options increased. In different parts of the country New Rs.2000 notes were seized from different states such as Goa, West Bengal, Karnataka.

Tax Evasion :

Evasion attempts such as purchase of gold, donations to temples, private exchange on percentage took place. Sales of gold increased through the price was raised multiple transactions at different bank branches were made. Advance salaries to domestic servants were paid. Revenue collections of the local civic bodies reached to dizzy heights. Money laundering using back dated accounting was carried out by co-operative banks and credit societies, jewelers, money lenders, sellers of i-phones and several other businesses across India.

Income tax raids and cash seizures :

The finance ministry ordered all revenue intelligence agencies to join the crackdown movement of demonetized currency notes. Income tax departments raided various illegal tax-evasive business in Delhi, Mumbai, Chennai, Kolkata, Chandigarh, Ludhiana and other cities that traded with demonetized currency. The enforcement Directorate issued several FEMA notices to forex and gold traders. Large sum of cash were seized in different parts of the country.

Unaccounted Wealth and Black Money :

Black money operators run a parallel economy in the country. India Ratings and Research has concluded that only 12% of the ill-gotten money could be extracted with idea of demonetization while 88% of the black money is still in circulation in Indian markets. It is evident that the decision of the demonetization has not been able to hit ill-gotten money holders hard, instead some of them have used it to legitimize their black money. With Govt's demonetization move, all domestic black money will either be deposited into the banks with heavy penalty or be simply destroyed. The recent surgical demonetization has failed in respect to deal with unaccounted wealth. 4-5 trillion "black money" would not return to the system.

Note bank politics :

Govt's demonetization move, had become a shock and awe for the political parties and politicians for whom black money is a lifeline. The pulling out of the old Rs.500 and Rs.1000 currency notes had helped to make the election process for some period and to some extent clean and transparent.

Loss of economic growth :

India is a developing, fastest growing and largest economy in the world. Reduction in consumption demand, income, investment, production, unemployment, tax revenue etc, due to cash shortages adversely affected to reduce India's GDP growth on large extent. Substantial economic growth was expected with demonetization but the GDP plunge from 7.9% to 5.7% proves that demonetization did not help in boosting economic growth.

Industrial Sector of India :

Scarcity of cash due to demonetization, forced many small scale industries to burn own to ashes. Commercial banks found it very difficult to bridge the gap between the supply of banned notes from people and the supply of new currency notes from the RBI . Moreover, the National Statistical Commission revealed that demonetization hampered the growth of the construction industry, which is the second largest employment generating industry in the country.

Corruption :

Corruption in India is not merely an evil of the society, but an accepted part of every person's life in the country. Removing corruption with banning and changing currency proved impossible by the demonetization. However the cashless economy through digital payment could reduce corruption by bringing transparency in the transaction. According to transparency International's Corruption Index, even though India is still the most corrupt country in Asia. Corruption related reports have reduced by 10% since 2015. But corruption is still continued across India it proves that demonetization did not help to reduce corruption in the country.

Real estate cleansing :

It is said that real estate is an industry built on black money. The impact of demonetization is expected to dip in land and property prices. But the prices of land and properties have not lowered down.

Counterfeit currency :

Demonetization had not dealt a death blow to the counterfeit Indian currency. In different parts of the country New Rs.2000 fake notes were seized in the following days of demonetization.

Terror financing :

Terror financing is sourced through counterfeit currency and hawala transactions. It was expected that demonetization will cripple the hawala rackets to stop terror financing, money laundering, satta (gambling), smuggling of drugs, opium and arms by using fake Indian currency notes and black money. Demonetization was thought to be an effective measure to crack down terrorism, but terrorism is still on the rise.

Suggestions :

Demonetization has short term and long term impacts on any economy for its success which is to be supplemented by other factors. The following suggestions are made to reap its benefits and bring transparency.

1. Planning is the foundation of success. Rigorous prior planning was the necessity for surgical demonetization of bank notes 2016.

2. It is suggested that proper co-ordination is very essential to decide the key policy like demonetization. As per RBI's note, the decision to demonetize high value currency was taken mutually by both RBI and the central government. Not even the banks were notified in advance about the plan, even no one others have got into voicing a contrary view.
3. Fighting corruption and handle illegal money were the main brands of demonetization. But plan flopped, as almost all of the recalled notes were officially returned and accounted one way or another. In addition chaos took place across the country in the following days of demonetization. It resulted improper implementation of the withdrawal plan through the weak Indian banking and administrative system.
4. Goods and Service Tax Act, Income Tax Act etc. should be implemented effectively to bring transparency in trade and commerce.
5. Internet Pay apps. should be made easily available user friendly and brought in tax net.

Conclusion :

This move by the Indian government to demonetize old currency and replacing it with the new currency has taken the country by wonder. It was an effort to deal with illegal money, corruption, terror funding and counterfeit currency cleverly. The decision in respect of demonetizing the old currency was considered as a surgical strike against the undeclared money in the history of Indian economy, which may be a movement towards the cashless economy. The demonetization is followed by a cash shortage in the country, banks and ATMs across the country faced sever cash shortages with detrimental effects on Indian masses, small businesses, agriculture and transportation. Currency ban by the government of India created chaos as most of people with old currency notes faced several difficulties exchanging them in long ques outside banks and ATMs across India. The total value of old currency notes in circulation was to the tune of Rs.14.2 trillion, which constitute about 86% of the total value in circulation. The RBI has indicated that 99.3% of the demonetized currency or roughly Rs.15.31 lakhs was returned. A little over Rs.10,000 crore is still out there or destroyed. The black money has either been accounted by paying heavy taxes and penalties or has reached the bank accounts through direct or indirect channels. The middle class common people, poor and Indian masses had paid a high price for this negligible benefit of demonetization to the Indian economy. Therefore the Indian Politicians, administrators, executives and the rich class of India will have to change their attitude and play a proper role towards the reformation of Indian economy. Demonetization has just brought a positive impact on Indian economy as it encourages the digital mode of payments such as E-wallets and apps, online transactions using E-banking, usage of plastic money etc. It is useful for the economy in the medium to long term in future.

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