

Impact of demonetization on Indian Economy

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Abstract

Demonetization is a tool to battle Inflation, Black Money, Corruption and Crime, discourage a cash dependent economy and help trade. On November 8, 2016, the Prime Minister of India, Narendra Modi, announced the demonetization of Rs.500 and Rs.1000 notes, withdrawing overnight 86% (by value) of cash in circulation, with a stated three-fold objective of fighting corruption, eliminating black money and countering money laundering. In place of the existing Rs.500 and Rs.1000 currency notes, new notes were introduced into the monetary system; the old Rs.500 note was replaced by new note of Rs.500, Rs.1000 note was discontinued and instead a new denomination of Rs.2000 note was introduced. The Government issued a deadline of 31st December 2016 to exchange all old notes for new notes at banks and placed several restrictions on withdrawal of money from banks and ATMs during this switch over. In the three to four months that followed the announcement, there was severe shortage of currency with banks being unable to meet the currency demand of their customers and Reserve Bank of India (RBI) falling short of printing new notes on a timely basis to supply to the banks, leading to empty ATMs and crowded banks for weeks on end and amounting to mismanagement of the monetary economic system at the highest level. The highly impacted period due to demonetization was experienced especially during November and December 2016. This impact was moderated prominently in the month of January 2017 and immoderate to a longer extent by mid of February 2017. As an impact of demonetization on Indian banks, there is a positive change in the financial statements of scheduled commercial banks. The quantum of amount deposited in the banks has raised and created surplus liquidity conditions. A significant increase in total number of accounts opened under the scheme of Pradhan Mantra Jan Dhan Yagna and the amount deposits in these accounts have also increased. A significant impact of demonetization has also been monitored in the use of electronic banking transactions. This study is descriptive in nature and the data has been taken for the period of pre-demonetization and post demonetization.

KEYWORDS: Demonetization, Black Money, Real State, Decline in fake currency notes, Push to Digital Economy

I Introduction

Demonetization refers to the act of stripping a currency as legal tender. In demonetization, the current form of money is removed from circulation and retired. Furthermore, the replacement of this form of money occurs with new notes or coins. Sometimes, a nation completely introduces a new currency in place of old currency. Most noteworthy, demonetization is a move in which a government bans the notes or coins of a certain denomination. First of all, demonetization significantly reduces corruption from taking place. It certainly puts a full stop to corrupt practices. Demonetization significantly hampers individuals dealing in black money from carrying out their evil ideas. Most noteworthy, corrupt people in the future will

feel scared of hoarding cash. Demonetization improves the banking system significantly. Demonetization would certainly infuse more sophistication in the banking system. The economy of a nation will move into a cashless direction due to demonetization. Moving in the cashless direction would mean better access to credit and revamping of financial operations. Another notable advantage of demonetization is reduced liability for the government. This is because demonetization reduces the risk and liability of liquid currency. Furthermore, handling soft money is far easier than handling hard money. Also, every note is a liability for the government. Hence, demonetization reduces this liability by removing certain notes from circulation. Therefore, the old currency becomes useless for those who don't disclose their income. Demonetization will lead to fewer instances of tax avoidance. This certainly is a massive advantage of demonetization. Money that is deposited will be taken track of by income tax authorities. Therefore, people will hesitate to use tax avoidance tactics. Furthermore, the loan transaction will also be under scrutiny. Consequently, there would be an increase in the flow of taxes. This would certainly result in government undertaking more public welfare measures.

II. Literature Review

Challenges in Demonetization

The first challenge is the internet connection and availability. Due to demonetization, many people would go cashless. Therefore, they would resort to E-cash and E-payment. However, in many developing nations, internet connectivity is quite poor. Hence, this forms a major challenge for any government which intends to implement demonetization. Cash shortage is a natural consequence of demonetization. The scarcity of cash can certainly lead to chaos. This is exactly what took place during the 2016 Indian banknote demonetization. Furthermore, people face various difficulties in depositing or exchanging the demonetized banknotes. Also, the ATM's can run short of cash for many weeks or months. Areas face huge trouble due to demonetization. This is because rural areas and the agricultural sector highly depend upon cash. Furthermore, these people lack the financial literacy to handle the situation. Moreover, most people in such areas are ignorant of computing technology and the cashless economy. To sum it up, demonetization is certainly a revolutionary step in a country's economic system. It is something that has been practiced by countries from time to time. Furthermore, the objectives for demonetization remain more or less the same the world over. Most noteworthy, the decision to demonetize should come by keeping the national interests at the forefront. Demonetization happens when a government legally bans the coins and notes of a certain denomination. The currency which is banned may or may not be replaced by the new currency. The aim of Demonetization is to target multiple problems like illegal activities and their funding source, terrorism, tax evasion, and counterfeit currency.

III. Methodology

Effects of Demonetization

Demonetization has long term effects on a nation's economy. The people in the rural areas who did not have access to internet and plastic money were majorly affected. Since centuries, governments have been using it as a tool to reduce corruption and other illegal activities. Thus, Demonetization boosts a nation's economy by removing fake currencies and bringing black money into the mainstream.

Positive Effect of Demonetization on Economy

1. **Break Down of Black Money:** – Black money accumulation impacts a country's economy negatively. Demonetization helps in closing businesses running by black money and destroying the black money savings of the people, thus having a positive impact on its economy.
2. **The decline in Fake Currency Notes:** - A number of fake currency notes circulating in the country have a bad impact on its economy. Hence, Demonetization helps in removing the high-value of fake currency notes.
3. **Increase in Bank Deposits:** - The circulation of the old currency notes is banned and those who have these currency notes should deposit them in the banks so that their money did not get wasted. Hence, cash amounting to trillions of rupees gets deposited in the banks.
4. **Real Estate:** - Real Estate is one industry that runs largely on black money. Demonetization stops the flow of black money in the real estate sector to ensure a fair play.
5. **Increase in Digital Transactions:** - The cash crunch in the market encourages people to make digital transactions. Almost everywhere in the country machines get installed to accept debit/ credit card payments. Over time people start using plastic money. This is a great way to track tax evasions.
6. **Cutting Monetary Support for Terrorist Activities:** - Anti-nationals support terrorist activities in the country by providing monetary support to the terrorist groups. This money is used to purchase arms and plan terrorist activities in different parts of the country. Demonetization helps in cutting down on the monetary support provided to the terrorist groups to a large extent. It thus promotes peace and helps the country prosper at various levels.
7. **Push to Digital Banking:**- A cashless economy is one in the flow of cash within an economy is non-existent and all transactions have to be through electronic channels such as direct debit, credit and debit cards, electronic clearing, payment systems such as Immediate Payment Service (IMPS), National Electronic Funds Transfer and Real Time Gross Settlement in India.

Benefits of Cashless economy

- Reduced instances of tax avoidance because it is financial institutions based economy where transaction trails are left,
- Curb generation of black money.
- IT will reduce real estate prices because of curbs on black money.
- It will place universal availability of banking services to all as no physical infrastructure is needed other than digital.
- There will be greater efficiency in welfare programmers as money is wired directly into the accounts of recipients.
- Reduced cost of printing notes, instances of their soiled or becoming unusable, counterfeit currency.
- Reduced costs of operating ATMs.
- Speed and satisfaction of operations for customers as no delays and queues, no interactions with bank staff required.

Negative Impact of Demonetization on Indian Economy

Most of the positive impacts of demonetization are long term. We may begin to see the country's economic growth after demonetization in a few years from now. However, the negative impact of demonetization on the Indian economy has been tremendous. Many of cash-driven small industries are left starving. Many manufacturing industries suffered huge losses thereby impacting the economy of the country negatively. Also, many factories and shops had to be shut down. This did not only impact the businesses but also their workers. Thus, several people, especially the laborers, lost their jobs. There is a shortage of cash as old money is exchanged with the banks. The government was blamed for poor planning and management. Indian National League also filed a Public Interest Litigation (PIL), in Madras High court, requesting to scrap the demonetization decision. However, the Court refused to intervene in the government's monetary decision.

Conclusion

The demonetization of the currency (Rs. 500 and Rs. 1000 notes) on 8th November 2016 was one of the step taken by government of India. This decision way fetch positive results in the long term. This study concluded that the step of demonetization improved the liquidity position of the scheduled commercial banks in India and banks invested the excess amount in various investment opportunities which helped the banking sector to increase their profitability position. It is also concluded that the objective to open the Pradhan Mantri Jan Dhan Yojna Account has been realized and people used PMJDY accounts during demonetization period which will change the attitude of the customers to use physical currency and customers will shift to digital banking services which will again be helpful for the banking sector as well as customers. Since the past century governments across the world were taking the decisions of demonetization. Though the currency which was demonetized may differ, the objectives largely have remained the same means to remove black money, stop illegal activities, and bring currency into the mainstream. The decision of demonetization was taken by keeping the national interests in priority. Though the decision might have

caused inconvenience to the general population, it definitely had the national interest and economic growth at its core.

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