

A Study on Impact of Demonetization on Indian Economy

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ABSTRACT

The idea of demonetization may be new to the 20th century's generation in India, but it is not new to the country. India has faced the effects of demonetization in 1946 and 1978 both of which were done with the motive of curbing black money and removal of corruption. Demonetization simply means Withdrawal of a particular form of currency from circulation. The old unit of currency must be removed and substituted with a new currency unit. Demonetization is the act of stripping a currency unit of its status as legal tender. On 8th of November, 2016, the Prime Minister of India, Narendra Modi announced the demonetization of all Rs.500 and Rs. 1,000 denomination banknotes of the Mahatma Gandhi Series. The demonetization announcement made the use of Rs.500 and Rs.1000 banknotes invalid past midnight of November 8. It was announced that the new Rs.500 and Rs.2000 banknotes of the Mahatma Gandhi new series would be introduced in exchange for the old banknotes. Notes of one hundred, fifty, twenty, ten, five, two and one rupee will remain legal tender and will remain unaffected by this decision. The motives behind demonetization have been elaborated a bit to include the battle against the circulation of counterfeit money, combat against the financing of terrorism and an aim to become a cashless economy to the existing one of exposing black money. The paper is an explanatory paper. This paper will provide an insight into the demonetization process. This study will help us to know about the positive and negative impact of note ban decision taken by Indian government and their significance in the economic development of India by comparing with other countries as well as human life. Thus, the findings of this study reveal that, India will achieve a significant growth by adapting the demonetization strategy and it will create a huge positive impact on the entire economy in a long run.

Keywords: Demonetization, Indian economy, Black Money, Government, Corruption & Currency Etc.

I. Introduction

Money is the life blood of every economy. With the growth of civilization and mankind, the needs of human beings increased. In order to fulfill humans unlimited wants barter system emerged. But over a period of time, the invention of money became a strong pillar to build an economy. Money exchange appears to be more convenient than barter because it obviates the "double coincidence of wants" and is capable of sustaining relatively complex economy. Money exchange facilitates ease of doing business, facilitates taxation and national integration. All activities such as production, exchange, distribution, services etc. form an economy. It is called formal economy. An informal economy is neither economic activity/activities that is neither taxed nor monitored by Government, contrasted with a formal economy. Presence of corruption, black money, counterfeit currency, poor governance etc. promotes and establishes parallel economy

Meaning of Demonetization

The dictionary meaning of DEMONETIZE is "To deprive (a metal) of its capacity as a monetary standard" or "To withdraw from use as currency" So, demonetization is the act of stripping a currency unit of its status as legal tender. It is the act or process of removing the legal status of currency unit. A currency on which Governor of RBI on behalf of Central Government guarantees by making statement "I promises to pay the bearer, the sum of money" which

empowers it a legal status. From the date of demonetization, all old currencies which are demonetized will cease to be a legal tender. Such currency cannot be used as money to do any transaction henceforth, but to replace with a new currency. Currency is a commonly accepted form of money, including coins and paper notes, which is issued by a government and circulated within the economy. As used a medium of exchange for goods and services, currency forms the basis for any trade. The opposite of demonetization is called as remonetization in which a form of payment is restored as legal tender.

History in India

India had an experience of demonetization of its currency twice before. The first was on the 12th of January 1946 (Saturday), second on 16th of January 1978 (Monday) and the third was on 8th of November 2016 (Tuesday). In the January of 1946, notes of denominations 1,000 and 10,000 rupees were withdrawn from circulation and new notes of denominations 1,000, 5,000 and 10,000 rupees were introduced in 1954. The highest denomination note ever printed by RBI in India was Rs. 10000 note introduced for the first time in the year 1938. The second phase of demonetization was done on 16th January 1978 when an ordinance was promulgated to phase out notes with denomination of Rs. 1000, Rs 5000 and Rs. 10000. On 12th January 1946 demonetization was resorted to but the Direct Tax Enquiry Committee in its interim report observed, "Demonetization was not successful then, because only a very small proportion of total notes in circulation were demonetized in 1946 and its worth was Rs. 1,235.93 crores". On 16th January 1978, demonetization of high denomination notes was introduced. The high demonetization notes as on that day amounted to Rs. 146 crores and total notes tendered to RBI amounted to Rs.125 crores as per data available till August 1981. The demonetization of denominations Rs. 500 and Rs. 1,000 banknotes was a policy decision carried out by the Government of India on 8th of November 2016. In the declaration, the use of denominations of all Rs. 500 and Rs. 1,000 banknotes of the Mahatma Gandhi Series would be invalid after the midnight of the same day, and was also announced that the new Rs. 500 and Rs. 2,000 banknotes of the Mahatma Gandhi New Series will be issued in exchange for the above mentioned old currency notes. The move was claimed as an initiative to curb corruption, trafficking of drugs, and smuggling across borders.

Need And Importance Of Demonetization In India:

The Indian government claims that the demonetization effort is to stop the counterfeiting of the current currency notes allegedly used for funding terrorism across the border by the neighboring countries, and as an attack on the black money in the country. The supply of currency notes of all denominations has seen an increase by about 40% during the period between 2011 and 2016, the Rs. 500 and Rs. 1,000 denomination notes has increased by 76% and 109% respectively during this period due to forgery. This forged cash is usually used to fund various terrorist activities against India. The outcome of the decision is to eliminate the currency notes of selected denominations has been taken (Governor of the Reserve Bank of India, Urjit Patel, and Economic Affairs secretary, Shaktikanta Das). Nations demonetize their local units of currency for various reasons. The government's aim was to wipe out the counterfeit currency, scrap tax evasion, abolish black money generated out of money laundering and terrorist funding activities, and to promote a cashless e-economy. By announcing the larger denomination notes to be useless, the individuals and various black money launderers with huge collection of black money generated from the parallel black cash systems were affected and made to convert the cash money through a banking system which requires tax information from the entity. In case, if the entity is not providing any proof of paying any tax on the cash, a 200% penalty of the tax owed was imposed. Besides combating black money, the purpose mentioned is also to curb fake currency (financing terrorism) and also corruption.

The size of the economy, the growth rate of the economy and the role of the private sector and services sector to economic growth and development was small in the year 1946 and 1978 as compared to the year 2016. The number of people within the net of the income-Tax was also not so large during 1946 and 1978. There are more than 11 Crore PAN card holders now and the number is on increase. In the year 1948 and 1978 Public were already aware that the demonetization will be introduced by the government sooner or later, therefore, the demonetization at that time could not produce any substantial gain to the economy. One of the key features of the demonetization in 2016 that it was kept very secret, so that the black money holders could not get any time to convert their black money and counterfeit currency into white money.

Review of Literature

Arpit Guru and Shruti Kahanijow (2010) researcher analyzed the black money income. Need for amendment in DTAA & ITEA and analyzed that black money is spread everywhere in India. The researcher also identified how black money had caused menaces in our economy and in what ways it is used.

Sukanta Sarkar (2010) conducted a study on the parallel economy in India: Causes, impacts & government initiatives in which the researcher focused on the existence of causes and impacts of black money in India. According to the study, the main reason behind the generation of black money is the Indian Political System i.e. Indian govt. just focused on making committees rather than to implement it. The study concludes that laws should be implemented properly to control black money in our economy.

Tax Research Team (2016) in their working paper stated in favor of demonetization. The main objective is to analyze the impact of demonetization on Indian economy. This paper shows the impact of such a move on the availability of credit, spending and level of activity and government finances.

Objectives of the Study

- To describe the demonetization concept in India.
- To know the objectives behind the idea of demonetization.
- To study the impact of demonetization on common person of India
- To study the impact of demonetization on economy of India.
- To know the impact of note ban decision on the Indian economy.

II. Research Methodology

The paper is based on secondary data. The data has been collected from library, text books, and journals, articles from news papers and from relevant websites available on internet.

Objectives of Demonetization:

- The main objectives of demonetization are: Abolition of Fake money
- To stop the use of counterfeit cash to fund illegal activity and terrorism
- To combat corruption
- To stop money laundering activities
- To curtail the black money running as shadow economy
- Control the Inflation
- Reduce the Rate of Interest
- Transparent money transaction
- To promote a Cashless economy
- To eradicate counterfeit currency

Impact of Demonetization on Indian Economy

Positive impact

One of the biggest achievements of demonetization has been seen in the drastic control on terrorist activities as it has stopped the funding the terrorism which used to get a boost due to inflow of unaccounted cash and fake currency in large volume.

Demonetization will help India to become corruption-free as it is difficult now to keep the unaccounted cash.

Black money inflating the price of major assets like real estate, gold etc. due to demonetization demand of these assets decrease result into decreasing price.

Money laundering will eventually come to halt as the activity can easily be tracked and the money can be seized by the authorities.

Demonetization will stop the running of parallel economy due to circulation of fake currency as the banning of Rs.500 and Rs. 1000 notes will eliminate their circulation.

The unaccounted cash can be deposited in the Pradhan Mantri Gareeb Kalyan Yojana after paying 50% tax. The money will remain deposited for 4 years with the bank without incurring any interest. However, after 4 years the amount will be returned. This amount can be utilized for social welfare schemes and making the life of low income groups better.

Good amount of tax is received which can be used by the government towards betterment of society.

Demonetization has driven the country towards a cashless society. Lakhs of the people even in remote rural areas have started resorting to use the cashless transactions. The move has promoted banking activities. Now even the small transactions have started going through banking channels and the small savings have turned into a huge national asset.

The Public Sector Banks which were running short of funds have suddenly swelled with lot of money which can be used for future finances and loans after keeping a certain amount of reserve as per RBI guidelines.

The people who opened the Jan Dhan accounts will now use their accounts and become familiar with banking activity. The money deposited in these accounts can be used for the developmental activity of the country.

The high rising price pattern and inflationary trends which the Indian economy was facing are taking a down turn making the living possible within low income group reach.

The biggest advantage is that it helps the government to track people who keep unaccounted money in cash on which no income tax has been paid, they kept these money at their houses and in some secret place. These money do not value after demonetization.

Negative Impact

The very next day of announcing the demonetization, the BSE Sensex and NIFTY 50 stock indices fell over 6%. The severe cash shortages brought detrimental impact on the economy. In just four days, the Indian banking system handled almost 180 million transactions. The State Bank of India reported to have received about Rs. 300 billion (US\$4.5 billion) as deposits after just two days of demonetization. A sudden hike in the online transactions with the usage of debit and credit cards was also reported.

People trying to exchange their bank notes had to stand in lengthy queues causing many deaths due to inconvenience and rush.

Deaths were also accounted for the lack of medical facilities or preparations due to denial of old currency notes by the hospitals.

India's vast services sector, which accounts for two-thirds of GDP, is worst hit.

According to former US treasury Secretary Lawrence Summers withdrawal of high denominations of currency from circulation is affecting ordinary people rather than striking corruption. India is an agriculture based economy. Due to the cash crunch, the farmers especially small and marginal who largely depend on cash to buy seeds, fertilizers and to pay for sowing, borrowing water for irrigation and for other related agriculture equipments remained worst affected and could not complete the crop related activity.

Since small branches of the banks were also not supplied with adequate cash within time of sowing season of the crop, farmers could not get their crop loans disbursed. This added to the woes of the farmers leading to a weak agriculture production the coming year.

For construction sectors cash is the basic form in which payments are paid.

Real Estate sector came to a stand still and is still gasping for buyers of the constructed and half constructed inventory without buyers. This has resulted in poor cash flow leading to a poor demand.

Demonetization has made the situation become chaotic. As everyone is in rush to change their money there is a situation of Chaos which lead to law and order problem and chaotic situation as these money can be exchanged from banks and ATMs only. They also ran out of cash only after a few hours of being operational, and about half of the ATMs in the country were not functional.

Due to the inability to pay cash to poor daily wage workers, the small employers have stopped their business activity.

The poor planning on the part of the government has also added to the woes of the common people with low incomes. The Rs.2000 currency note does not find many takers as it is difficult to get the balance back when you are buying daily needs like vegetables, milk, bread or paying for petty expenses like bus fare. While rs.100 currency notes were not available in sufficient number, Rs.500 note arrived in the market very late.

Demonetization is the two-way sword in regard to incurring the public expenditure. On the one hand huge cost is to be incurred on printing the new currency and on the other hand managing the lakhs of crores of old currency volume has also become a big expenditure incurring item. Destruction of old currency and printing of new currency involve costs, these cost has to be borne by the government, if the cost is higher than benefit, then there is no use of demonetization.

Invalidation of 500 and 1000 notes threatens to push Asia's third largest economy into liquidity crisis.

Demonetization affected severely as it led to cash crunch which will ultimately result in GDP growth crashing to 0.5% in the second half of financial year 2016-17 meaning hereby it would decelerate 0.5% down from 6.4% in the previous six months. Growth from October to December quarter it will show negative growth (as per reported by Ambit Capital, Mumbai based equity research firm).

Disruption in Supply chain Management

Evading techniques like Gold purchases, Donations, Multiple bank transactions, depositing in the Jan Dhan Scheme bank Accounts, Railway bookings, Municipal and local tax payments.

III. Suggestions

Demonetization should be a continuous exercise by the government and be repeated at suitable intervals to discourage the hoarding of Black Money in the form of cash.

The self help groups (SHGS) can be of great help to the people in the promotion of digital banking systems in the rural areas. More and more (SHGS) must be given the charge of Bank Mitras (friend) who can extend their help to the bank, post offices and Bank corresponding for proliferation of digital economy.

Like Pulse Polio Campaign, the Digital India Campaign twice or thrice in a year in a mass scale can be conducted in the country. It is appropriate way to propagate the digital India campaign both in rural as well as urban areas.

Strong political will among both the ruling and opposition parties is necessary for the implementation of any economic reforms including demonetization and cashless economy in the country.

IV. Findings And Conclusion

The demonetization of the highest denomination note undertaken by the government is a big shock to the Indian. It is a bold decision taken by government. The main purpose of demonetization is to eradicate the black money and reduces the corruption. Government of India has achieved success to some extent. Most of the black money has been crushed. This decision also helps to encourage projects like digital India or cash less India. The motives behind demonetization have been elaborated a bit to include the battle against the circulation of counterfeit money, combat against the financing of terrorism and an aim to become a cashless economy to the existing one of exposing black money. It cannot solve all the problems of India as the government expected. However it is unfair to expect because it is a first step to cashless society which is good for country. The step that the government had taken is right which is going to give a positive impact on economy or country not in immediate way but definitely it will support the Indian economy. In future banks will able to do more and more loans to the individual and to the industrial sectors so that production will grow in our country, employment will be generate, and our country can develop at very fast rate. It is also found that although many inconveniences people do not criticized government decision. Although Demonetization has create so many hurdles for the

citizens of India. Citizens of India faced so many problems due to the demonetization like they faced queue problems in the banks and ATM'S for depositing and withdrawing money. Citizens of India faced problem of less consumption of goods due to the lack of cash liquidity. Several businesses disrupted due the lack of liquidity, business owners as well as consumer faced so many problems. This affects adversely to the daily wages worker and small business. But almost people stand by the government decision. It is also found that people who own black money find various methods to convert this money into white. And at last but not least as "every coin has two sides" this decision also do have their own positive and negative impact. So the paper concluded by identifying various pros and cons of demonetization.

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