

INDIAN DEMONETIZATION: A BOON OR A BANE?

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Abstract: *That very evening of Eighth of November 2016, which made that day to be a landmark in the history of the Indian economy, when the Indian Government represented by the PM Mr. Narendra Modi made an improbable announcement declaring the demonetization of the 500 and the 1,000 rupee banknotes. To have a better understanding of the effects of demonetization on the Indian economy one needs to actually understand the proper meaning of the term. Demonetization means to strip a currency unit of its status as a legal tender thereby rendering that currency illegal or of no use. It normally occurs whenever the government of a nation tries to change the national currency of that nation. Thus, the current form/s of money is scrapped or phased out from circulation and thereby replaced with new form of notes or coins which are substantially different from the old retired notes. However, there is another related concept of remonetisation which also needs to be understood. Remonetisation is nothing but the anti-podal of demonetization meaning the restoration of the demonetised currency as a legal tender in the nation's currency system.*

Key Words: *Demonetization, legal tender, remonetisation, counterfeited.*

1. INTRODUCTION:

The Indian government claimed that the pivotal role of the demonetization would be a surgical strike to the ever increasing corruption in Indian economy that has ever since been making the country dilapidated. Here are some plausible reasons as to why the nations demonetize their local units of currency which are as follows:

Firstly, to check the inflation rate in the economy

Secondly, to strike out corruption and consequential crime involving illegal acts such as counterfeiting, tax evasion, etc.

Thirdly, to facilitate, promote and expand trade

Fourthly, to make the nation a cashless economy i.e. encouraging the citizens of the country to get rid of being cash dependent and adopting new ways of online transactions

2. EXAMPLES OF DEMONETIZATION:

The concept of demonetization is not novel as there have been few instances across the world when some of the nations have implemented this concept in their respective economies for one or the other major reasons. Among those instances, one of the most striking is the Coinage Act of 1873 that demonetized silver as the legal tender in the United States of America in order to fully adopt the gold standard. In consequence to the above mentioned act several coins which included two-cent piece, three-cent piece and half dime were all phased out. The impact which led thereafter resulted in a heavy contraction of money supply which further subsequently led to a five-year economic depression throughout the nation. The nation constantly witnessed the ever-mounting pressure from the silver miners and refiners and the farmers with each passing day. Thus, to bring the nationals of US out of such a dreadful situation of depression finally the Bland-Allison Act of 1878 remonetised silver as legal tender in US.

Another glaring example of demonetization was found when in the year 2015, the government of Zimbabwe demonetized its dollar in order to combat the condition of hyperinflation flowing in the country which was recorded at a whopping 231,000,000%. It almost took three-months for Zimbabwe to expunge the old Zimbabwean dollar from the country's financial system and thereby settling with the new currencies of the U.S. dollar, the Botswana pula and the South African rand as legal tender in Zimbabwe.

3. EFFECTS:

Since nearly 90% of the Indian population does transactions in cash therefore due to the sudden nature of the announcement, which was an unscheduled live telecast made by our Prime Minister, the aftermath that followed was in the form of prolonged cash crunches for a much longer time period creating a lot of chaos and significant disruption throughout the country threatening the economical output. People in the state of panic by the sudden announcement were compelled to stand in lengthy and snaky queues outside the ATMs and the banks. This not only disturbed the public mentally but also physically which resulted in few deaths also due to the exchange cash rush. Initially in the earlier stages, however, the demonetization move received an overwhelming support throughout the nationwide including the people of the country especially the lower and the middle class as well as several bankers and some international commentators. The move was later on criticised as being poorly implemented with several lacunae which

led with several protests, litigation in the form of PILs and frequent strikes against the government's move in several places across India. Heavy debates involving the concern for the effects of demonetization were frequent on-going programme in both the houses of the Parliament.

This article would highlight the **impact of the demonetization step on the Indian economy both in the short as well as the long run which are both positive as well as negative.**

POSITIVE IMPACT

• DIGITALISED ECONOMY

Normally the Indians, especially the youth, have a mindset to ape the west and thus exhibit a lot of attraction towards the western culture. The western nations are basically cashless economies. So the move of demonetization syncs with the western culture as the aim of scrapping the high denomination notes in India was primarily making the Indians non-dependent on cash i.e. basically a cashless society plan to be promoted in the Indian economy. Such a digitalisation would not only help a specific class of people or a specific age group of people but the entire society would reap its benefits. This move would prove to be of a great help to the poor class who are now and then exploited at the hands of the rich. The government's programme of financial inclusion along with the digital payments and direct transfer of subsidies will definitely ameliorate the existing conditions of the 'have not' class of people. Moreover, the Finance ministry, RBI and NITI Aayog had announced a scheme of incentives to boost online or cashless transactions. This was basically done to reduce some of the problems that resulted due to acute shortage of cash in the economy. Some of these incentives included:

- Making provisions of cash backs that ranged from 0.25-0.75% on several transactions like govt utility bills, paying fuel charges, property registrations, stamp papers, etc.
- No Service Tax was to be levied on cashless transactions below the amount of Rs 2000
- Reduction of the self-assessment tax from 8% to 6% on such businesses having an annual turnover of less than Rs 2 crores
- Monthly jackpots were announced for people who were using cashless transactions in government services
- Encouraging the use of Point-of-Sale (PoS) machines and services of mobile wallets like PayTM both by individuals and businesses

Due to all such incentives it was found that the use of mobile wallets and cashless transactions, on a whole, had shown an increase of nearly about 300% since the demonetization drive. However major increment was noticed in the urban areas where people had ready access to internet banking, PoS machines and mobile wallets.

• BLACK MONEY

Another major goal of demonetization was to wipe off the stock of the cash supply in the black market and also to drive the counterfeited notes out of the economy and then to convert this black money into legal, banked and taxable portion of the economy. The black market which is supposed to be cash-centric almost ceased to function after the announcement made as a result of the nullification of a bulk of its currency. There was a onetime removal of counterfeited or fake currencies from the economic system. Due to this the black money got drastically reduced and the prices of the black money intensive sectors like real estate and gold jewellery went tremendously down.

• COMBATING ILLEGAL ACTIVITIES

Although the aftermath of the demonetization move led to disturbance in society but the move had advantageous effects at the micro level. The foremost success was the curbing of all sorts of illegal activities including terrorist financing which was almost completely hit after the declaration. Most importantly, demonetization also helped in combating counterfeiting problem of Indian currency by the hostile nations. It has also been said that the new currency notes are quite less vulnerable to the acts of counterfeiting as they have much more advanced security features. The circulation of fake currencies had slowed down considerably after the move since the infrastructure which was set up to print fake currency notes in the terror group countries had been rendered useless by the demonetization blow. Undoubtedly, the availability of cash had surely declined among the terror groups.

• SEVERE BLOW ON CORRUPTION

Indian government claimed that the primary objective of the demonetization step was to wipe out corruption to the maximum possible extent and also to check upon the practice of tax evasion in the nation's real estate market. This led to a fall in the growth of returns in the cash-intensive sectors such as construction, real estates and FMCG which were badly hit in the short tenure period as the purchasers were deferring purchases. This further led to the situation of the real-estate market to come to a standstill position. There was heavy decline in the prices of the property due to the possible tax inquiries which followed that affected both consumption and investment in the formal and informal sectors. However, this is considered to be a positive impact over the medium term as there would be substantial benefits through higher government spending and greater financial inclusion.

• CIRCULATION OF MONEY

The provision to exchange the old currency notes with the new ones with certain well defined limits was short lived. The people were then left with the only option of depositing all the cash which they had in hand especially the ones who had piled heaps of notes packed in their respective houses. Such people with the fear of losing their amount were forced to open accounts to get their money saved in various banks. It was estimated that the banks had opened

about more than 50 lakhs of new accounts since the day when demonetization was declared. India's largest bank, the State Bank of India (SBI), with its 17,097 branches, half of which are in the rural and semi-urban area, kept opening nearly about 50,000 accounts a day during the demonetization period. The leading consumer internet companies in India namely the Ola, Oyo Rooms, Flipkart, Snapdeal, Shopclues, CC Avenues, etc. had praised the demonetization move stating that it shall definitely pave the way for more and more online payments thereby helping in making the Indian economy digitised and thus aid the process of financial inclusion. This would bring about an overall transformation in the economy which shall yield long-term benefits for the Indian industrial sector. Payment companies like the PayTM and the Freecharge witnessed a substantial increment in the adoption of their digital wallets. According to the reports by the market experts the increment in the digital payments and wallets is considered to be the first phase of the impact of the demonetization move which shall boost the practice of lending and credit as the digital records of merchants shall expand and would create more demand in the second phase. Multiple crores of money in the high denomination notes of 500 and 1000 which was lying with the public had returned to the banks.

- **BETTER TAX COMPLIANCE**

The tax-to-GDP ratio of India is quite low at 16.6% as compared to the other developing economies. The estimates reflected that since more money which included the black money as well had been accounted for this which led to an increase in the tax compliance owing to better targeting of income. Therefore due to all this one could calculate a positive impact on the Indian taxing system as the taxes were lowered due to the widening of the tax base which encouraged people to start paying taxes. Moreover, the digital drive of the government also resulted in the indirect tax revenue to be higher which was in the form of service tax. Even the businesses that used to under report their returns earlier have now to a much extent properly disclosed their received revenues either through cashless or digital means.

4. NEGATIVE IMPACT:

- **ANGUISH AND CHAOS IN PUBLIC**

Since cash has always been the preferred mode of transaction in India with only less than half the population using either online mode of payments or banking system for monetary transactions an immediate public anguish emerged against the mismanagement of the banking systems. There was shortage of the new currencies in the banks to distribute in exchange for the old retired notes. Not only this, there was even a shortage of the notes of lower denominations such as Rs 100 and Rs 50 that were not phased out and remained legal tender as people had started conserving whatever cash they had in hand. In the earlier days of the demonetization period the move was highly appreciated across the nation especially the objective to hinder black money was quite praised all over by the general public but then what was getting more and more difficult to tolerate was the manner in which it was being carried out. The poor implementation of the provisions regarding the issue of new currency has actually caused a lot of hardship to common people and therefore due to this the move was highly criticised. To give a voice to the hardships of the commoners a Public Interest Litigation (PIL) was filed in the Madras High Court by M Seeni Ahamed, General Secretary of the Indian National League, to annul the decision. However, the High Court dismissed the PIL stating that it could not interfere in the monetary policies of the government. Not only this, there were several PILs filed in the Supreme Court of India too.

- **CONVERSION**

To mitigate the impact of the sudden collapse in the commercial sector a notification of 50 days time period was ensued where an opportunity was provided to the Indian population to exchange the old notes for the new ones or to deposit the old cash in the banks. However, regarding the deposition of old cash in the various banks the government had set certain limits. It was observed that the cash component formed just 6% of the black money in the Indian economy so the demonetization process targeted just that 6% of the black income. According to various reports most of the black income had been converted into white through different channels. There was heavy deposition in the Jan Dhan accounts and in the personal accounts of various individuals. Not only this, people were breaking large amount of money into smaller chunks and depositing them daily till the time period specified by the government. High profile people exchanged the old currency for the new ones through the hawala dealers or by buying luxury items like jewellery and high priced mobiles in the last few hours of 8th November evening. Some people even went forward in paying advance wages to their employees. Housewives and those who were to be exempted from paying tax, their deposits were not be scrutinized as declared by the government which in another way provided a way out for these black money hoarders to convert their money into white. However, demonetization will not be able to prevent future generation of black money since the problem of black money is more of a cultural mindset in India than a legal problem. Gradually with the passage of time it will become easier for the corrupt and black money hoarders to deal in the new currency of 2000 notes as compared to the 500 and the 1000 notes since high currency value notes are easily portable. Gigantic amount of money in multiple crores had been seized by the Income Tax authorities since the demonetization drive. This reflected that if on one hand black money was getting unearthed then on the other new currency notes were being constantly leaking which most probably according to several reports was being through the banking system itself.

- **COMMERCIAL BREAKDOWN**

The demonetization move caused a sudden breakdown in India's commercial sector and the informal and the unbanked economy was hit quite hard. The informal sector of India comprising a majority of the worker class where most of the transactions are made in cash was heavily disrupted thereby endangering the employment and livelihood of the poorer sections of society. Thus, the lives of those ordinary people were disturbed to a great extent that led to widespread need and major job losses for the poor. The trade sector in all aspects of the economy had been interrupted especially the sectors like fishing; agriculture and the huge informal market were almost closed during the initial days of the declaration. The BSE SENSEX and NIFTY 50 stock indices fell over 6 percent on the day after the announcement.

- **STEP-DOWN OF INDUSTRIAL AND AGRICULTURAL SECTOR**

As we know that the Small and Medium-sized enterprise (SME) sector is a big chunk of the Indian economy which gives employment to more than 80 million people year on year thereby contributing almost 8% to the GDP growth. Since the mode of the payment of wages to the labourers of this sector is mainly in the form of cash so with demonetization coming in the situation of these people got adversely affected. There was a decline in the demand of the SME goods as the purchasing power of the consumers had contracted in the short term. Other related sectors like restaurants and transport operators were also negatively impacted due to a decline in the economic activity as well as the factor of less cash availability.

Regarding the agricultural sector the wholesale vegetable markets also faced declining demand which led to the prices of tomatoes and other food items to fall drastically making them economically unviable for the farmers to produce such crops. Obviously agriculture is that one sector where almost all the transactions are made in cash and especially the excessive use of the high denomination notes. The sudden withdrawal of these notes got the mandis under pressure which created problems for the farmers to sell their produce which is again dependent upon both the parties agreeing on the same mode of payment. Also as there was acute shortage of the new 500 denomination currency note in the earlier days it creates another set of problems which was to arrange change for the high denomination of Rs 2000 notes that were not readily available with the vegetable and fruit vendors. This factor repelled the consumers from purchasing commodities from the vendors and rather going to big retail markets where change of high denomination notes was comparatively easily available thus making a negative impact on the livelihood of these vendors.

- **REDUCTION IN ECONOMIC GROWTH**

The GDP growth of India which was 7.6% in the financial year of 2015-16 has **slowed down by 0.5%** as per reports of various agencies and has come down to 7.1% in the financial year of 2016-17. This was obviously due to the less availability of cash in the **cash-intensive sectors of manufacturing and real estate**. Also automobile industry which was reportedly growing in a rapid progress witnessed a contraction in the quarter of October-December of 2016. In the market the purchasing power of the consumers had been adversely affected due to the mere reason being that there was no cash being readily available as we know that still more than 80% of people are in the habit of doing transactions in cash. Thus the move is considered to have reduced India's GDP as well as its industrial productivity.

- **BANK ACTIVITIES AFFECTED**

As we know that the banks are not only endowed with the sole function of depositing and withdrawing of money but are also engaged in several other types of functions through which the banks earn their benefits and prosper. But with the demonetization stepping in the banks had been focusing on the single task of deposit and withdrawals which resulted that their **central function of issuing loans was adversely affected**. Often the customers mainly the business owners who now and then need big amounts of cash at short notice have their current accounts opened in the respective banks. During the demonetization phase such customers faced a lot of problems as they were not able to access cash and credit owing to the notified restrictions on withdrawals laid by the government.

- **RISE IN UNEMPLOYMENT**

Due to the slowing down of the demand from the consumers consequently the industrial production also declined which has directly made an adverse impact on the generation of the **employment**. Since the highest employment is found in the manufacturing sector comprising of the skilled and the semi-skilled labourers the sector has witnessed a slowdown in the production rate. This all scenario had resulted in not only less jobs at hand but lay-offs too that took place at a much higher rate. The industrial sector faced temporary as well as permanent job losses due to demonetization, as the production was badly hit especially in the cash-intensive or the labour-intensive sectors like the textiles, leather, garments and jewellery. Lakhs of daily wage earners either lost their jobs or were shunned from their workplace temporarily or permanently due to the lack of payment from their employers.

- **CONTINUATION OF ILLEGAL ACTIVITIES**

In the initial days the government had repeatedly claimed that the new currency notes consist of very high security features and that they are almost impossible to replicate. However, this claim couldn't stand for long as many stories

of counterfeiting came to light since the banning of old notes. However in the short term, illegal activities faced an acute shortage of cash resources and the illegal business heavily came down but then with the passage of time again illegal business started booming as was seen in various incidents which were brought to light by the media. Terrorism again started swinging with its full strength. While the initial reports showed that the terror relating acts of the militants in J&K did witness a considerable and a noticeable halt in the days that followed the demonetization drive which included those stone pelting days by misguided youths but then the Nagrota attack that followed showed that terrorism was still continuing in the valley.

5. FAVOURITISM:

India's demonetization move has not only been appreciated in India but globally as well. The World Bank CEO Kristalina Georgieva has said that the decision to ban high-value banknotes as part of efforts to stamp out corruption will have a profound and positive impact on India's economy. She further said, "What India has done will be studied (by other countries). There hasn't been such demonetization in a country so big".

The RBI which kept its reactions on the demonetization step to a minimum for quite a long time period came with a surprising announcement in the earlier days of the month of March. The RBI Governor Urjit Patel, in a statement said that the note ban move did impact various sectors of the economy but whatever adverse impact it made was short-lived and felt mainly in the time period of November-December. The shock to the system was light and that too fleeting. Whatever the impact of demonetization had dissipated by and large by mid-Feb due to the accelerated pace of remonetisation which it carried out in the emergency conditions. He also highlighted positivity of the move and reported that there is significant improvement in the use of digital payments post-demonetization however the base is still very small.

6. CRITICISM:

The Apex court of India in one of the several cases which were brought to it being filed against the sudden demonetization declaration observed that it "appears to be a carpet bombing rather than a surgical strike" which the union government repeatedly is claiming it to be. Indian economist, the Nobel Laureate, Amartya Sen, has severely criticised the demonetization step calling it a "despotic action" among several other things. Former Senior Vice-President and Chief Economist of the World Bank, Kaushik Basu, called the move as a 'major mistake' further stating that the resulting damage would likely be much greater than the expected possible benefits. Nobel laureate, Paul Krugman, also held a critical opinion stating that it is quite difficult to see any substantial gains from demonetization while there may be significant costs to it. The Harvard Business Review called it "a case study in poor policy and even poorer execution".

According to the Parliamentary panel report in April 2017 the rural households and the honest taxpayers were hit by the demonetization to the maximum. According to the panel, demonetization created significant disruption throughout the economy the major reason being behind it that it was carried out without any prior study or research. This encouraged the critiques to call the action as being nothing valuable but only a pointless suffering on the poor section of India.

7. CONCLUSION:

Any revolution which is initiated with an aim to bring about a fundamental reformation in the society might bring chaos and disturbance in the initial phases but in the long run it definitely starts bearing its fruits. In the same way if one sees the demonetization step in the short-term one would definitely not come across satisfactory results but if one really wants to assess its impacts then it must be weighed in the medium or the long term. One cannot deny the truth that certainly the economic growth potential has reduced but in order to boost the economic growth in the upcoming years the move needs to be followed up by such actions as to make it remain strong and effective. The actions which are needed to be taken up in future should be designed in such a way that relates to the structural changes which is able to make the system more lawful and powerful thereby reducing the excess of bureaucracy and enabling the tax system to be more simple and transparent. Well effectuated efforts are needed for the inclusion of the informal sector and to combat all kinds of illegal activities such as the generation of the black money and the related corruption should not in any way be reverted into the economy. However, it needs to be remembered that demonetization is a one-time event and as such shall not be able to cast an everlasting effect. Therefore it isn't sufficient to counter the problems of black money and corruption in the country rather other efficient measures like bringing the offshore tax evaders, then very much needed raid on benami properties, donations to political parties must be open to public scrutiny.

However, one considers the fact that it is not very easy for the Indians to come to cashless and digital terms so soon. Cash transactions are still going strong in rural areas that involve informal sectors. These sectors rarely use digital modes of payment but with the passage of time and with the declarations made by the government to use digital means would definitely bring about a change in the transaction pattern of the Indians. People in the real sense need to understand that demonetization will not be able to alter the behaviour of the crooked. It may not even change everyone

but still shall push gently a certain fraction of the population in the right direction and encourage them to pay taxes and to make online transactions. It will help in rebuilding the faith of disappointed people who are staying invested in a system that is rotten from its core. It will try to make the system fairer for all by not giving a chance to the crooks to exercise their power and influence in the system.

Demonetization in the Indian scenario has been viewed as the mother of all reforms. Viewing in favour of nation's betterment we as the citizens of India must consider it as our duty to cooperate with such reforms by bearing some hardships. One could see the determination of the bank employees who worked overtime to make this step a successful one. In this way though not directly but indirectly the citizens can give their contribution in strengthening their nation.

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