

Demonetization & its effects in India

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Abstract

On 8th Nov.2016 Indian government has taken a bold step of demonetization. There are so many reasons behind this step like control inflation rate, resist corruption and make a cashless and digital economy. Its impact is felt by every Indian citizen. This decision is considered as hard step against the black money in the Indian history. The main aim of this paper to study about the positive as well as negative impact of demonetization in India. This study is purely based on secondary data which is collected from magazines, journals and from relevant websites.

Index Terms: - Demonetization, Counterfeit, Digital Economy, Cash Crunch, Tax Evasion.

Introduction

Demonetization is a word which is not so common in our society. It refers to an economic policy where a certain currency unit ceases to be recognized or used as a form of legal tender. In other words, a currency unit still losses its legal tender status as a new one comes into circulation. In 2016, the government of India decided to demonetize the rs.500 and rs.1000 notes. These notes accounted for 86% of the country's circulated cash. On 8th November 2016, India's Prime Minister Sh. Narendra Modi announced that those notes were worthless. There are many reasons why this step has been taken by the government:

- . To control inflation
- . To control crime and corruption (counterfeiting, tax evasion)
- . To facilitate trade
- . To discourage a cash – dependent economy
- . To eliminate terrorist financing activities

Objectives of Paper:

- . To study the history of demonetization in India.
- . To study the impact of demonetization in various countries in past years.
- . To study the consequences of demonetization in India.

Research Methodology

This paper is based on secondary data. The data has been collected from internet, newspapers etc.

History of Demonetization in India: -

The first demonetization in India was taken out in Jan.1946 when rs.1000 and rs.10000 were removed from circulation but this ban not have too much impact on society because the currency of such higher demonetization was not hold by common people. In this time the measure didn't succeed; out of a total issue of rs.143.97 crs. of the high denomination notes, notes of the value of rs.134.9 crore were exchanged. Thus notes worth only rs.09.07 crs.were probably 'demonetized', not having been presented. It was really not a revolutionary measures and not served tool towards black marketing. Later, these notes were reintroduced in 1954, with an additional currency rs.5000.

The second demonetization came again in 1978; when the Prime Minister of India Morarji Desai banned the currency of rs.1000, rs.5000, and rs.10000. The main objective of this ban was to drive away black money from the country. In that time, amount worth INR 1.46billion, representing just 1.7% of total notes in circulation was demonetized of this only 68% was tended back. Hence, The High Demonetization Bank notes (Demonetization) Act was implemented. According to this law any action that is against a law or rule including false declaration by depositor and others punishable- with a fine or three years imprisonment.

History

- India had previously implemented demonetization. In January 1946, banknotes of Rs. 1,000 and Rs. 10,000 rupees were withdrawn and new notes of Rs. 1,000, Rs. 5,000 and Rs. 10,000 rupees were introduced in 1954.
- The Janata Party coalition government had again demonetized banknotes of Rs. 1,000, Rs.5,000 and Rs. 10,000 rupees on 16 January 1978 as a means to curb counterfeit money and black money.



On 8th november 2016, the Prime Minister of India announced demonetization (Surgical strike on black money) of all rs.500 & rs.1000 bank notes of the Mahatma Gandhi series. There were 1716.5 crores pieces of rs.500 and 685.8 crores pieces of rs.1000 in circulation, totalling rs.15.44 lakhs crores. According to RBI data rs.16000 crores out of demonetize notes of rs.15.44 crores did not come back to RBI. Rs. 15.28 lakhs crores have returned to the system and around rs.16000 crores is yet to be deposited back to banks. This report shows that about 8.9 crore pieces of the demonetize rs.1000 notes worth rs.8900 crore, had not come back into the system. On the day of demonetization, 632.6 crore pieces of rs.1000 currency notes in circulation. This shows that just 1.4% of rs.1000 notes did not return after demonetization. After this demonetization government bear too much cost regarding printing of new bank notes. The total cost incurred on printing notes stood at rs. 7965 crore for current year as against rs. 3420 crore during financial year 2015-16. According to former Finance Minister P.Chidambaram, RBI 'gained' rs.16000 crore but 'cost' rs.21000 crore in printing new notes!

Countries which have implemented demonetization earlier: -

Many countries adopted demonetization earlier for their devolopment, removal of black money, controlling inflation, corruption etc. but some countries succeed in demonetization and some countries faced failure. These are as follows: -

Serial No.	Country	Year	To Address	Result	Reasons
1.	U.S.A	1969	Black Money	Successful	Stepping stone for Development of American banking System.
2.	Ghana	1982	Tax evasion, Corruption, Excess Liquidity	Unsuccessful	People support black market and Investment in Physical assets.
3.	Nigeria	1984	Corruption	Unsuccessful	Inflation and debt Ridden economy.
4.	Myanmar	1987	Black Market	Unsuccessful	Mass protest.
5.	Soviet Union	1991	Black Money, Inflation	Unsuccessful	Poor Harvest.
6.	Australia	1992 & 1996	Black Money/ Counterfeits	Successful	Paper Currency replace with Plastic Currency.
7.	European Union	2002	Introduction of common Currency Euro	Successful	Economic Growth.
8.	North Korea	2010	Control the economy,	Unsuccessful	People left with

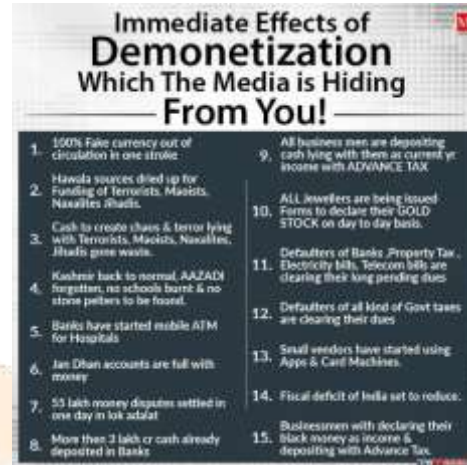
9.	Zimbabwe	2015	Black Market Hyper Inflation @ 231mn%	Successful	no food & shelter. Govt. reduced it To single digit.
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Effects Of Demonetization:

Demonetization is a landmark in the history of the Indian economy. International Monetary Fund has said that demonetization caused some temporary disruptions in India's economic activity due to cash shortages, but the effects are dissipating.



Source: www.indiamoney.com



Source: www.pbs.twimg.com

Consequences of Demonetization: -

It was a strong step taken by Indian Government and its impact on all the citizens of the country because of it all notes of Rs.1000 and Rs.500 have become a just piece of paper which has no value if you don't exchange it with new currency or deposit it in the banks. In order to understand demonetization let's take a look at some pros and cons of it.

Positive Consequences: -

- Getting fake currency out of economy: -** The process of demonetization is an attempt at solving the problem of fake currency. This is a strategic way to getting rid of fake money. As per RBI report it was found that detection of counterfeit notes was 20.4% higher in financial year 2016-17 than the previous year. Since, November 2016 end until the end of May 2017, a total of rupees 17526 crore has been found as undisclosed income and Rs.1003 crore has been seized.
- Control Inflation: -** This helps the economy to bring down inflation rate. According to Vice Chairman of Niti Aayog, when the black money goes out of the system the money supply will reduced to some level and this will reduce inflation rate in the absence of any open market interventions by the RBI.
- Tax Collection: -** After this there is a substantial increase in the number of income tax return filed. It increased to 24.7% compared to a growth rate of 9.9% in August 2017 compare to previous year. Advance tax collection of personal income tax showed a growth of about 41.79% and personal income tax under self-assessment tax grew at 34.25% over the corresponding period in financial year 2016-17.
- Black Money: -** Govt. found number of companies which are engaged in hiding black money and hawala transactions. More than 400 benami transactions upto 23rd may 2017 have identified and the market value of properties under attachment is more than Rs.600 crore. Transactions of more than 3lakh registered companies are under the radar of suspicion while 1lakh companies were struck off the list.
- Reduction of Borrowing Rate: -** Because of an excessive inflows of deposits in banks and a poor demand for credit forced the banks to reduce their lending rates. This was not happened immediately but it takes a long time.
- Digital Payments: -** After demonetization every month about 7 crore successful payments are made by the poor using their Aadhar identification. The Bhim App has been created for a secure and seamless digital payment. Digital payment has increased by 56%. In Oct 2016 the amount of digital transaction was 71.27 crore and in May 2017 it was 111.45 crore.



Source: www.youtube.com

7. **Saving Habits:** - The saving in the form of investment in equity, mutual funds, Life Insurance Plan, Bank Deposits etc. increased. The total assets under management of mutual funds rose by 54% from March 2016 to end of June 2017. Number of Pradhan Mantri Jan Dhan Yojna (PMJDY) accounts increased with rural accounts comprising 60%. Zero balance accounts under PMJDY declined from 76.81% to 21.41% in August 2017.
8. **Better Governance Policies:** - Policies improved with demonetization ease doing business and is also a measure of good governance.
9. **Income Management:** - People will opt to invest their money in properties such as real estate or deposit cash in banks to safeguard against some negative effects of demonetization.
10. **Introduction of GST:** - After demonetization GST (Goods and Services Tax) was launched at midnight on 1st July 2017. It is a single indirect tax levied on supply of goods and services from the producer to consumer. It is based on 'One Tax One Nation'.
11. **Reducing illegal activities:** - Demonetization was the surgical strike on terrorism funding and drug money. According to govt. sources the number of terror related activities have reduced by almost 60% in Jammu Kashmir post demonetization. The large amount of cash held by the terrorist has turned into just a piece of paper because the change in the design of new notes have effected printing of fake currency notes.

Negative Consequences: -

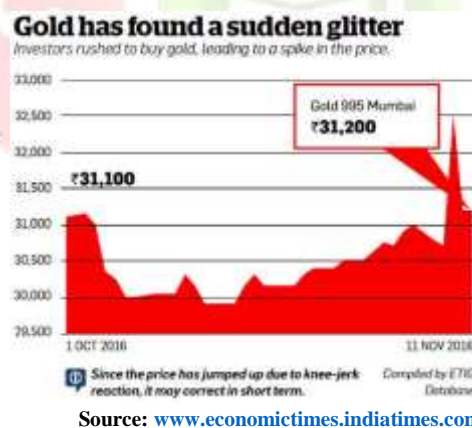
1. **Sectoral Impacts:** - There was a negative impact on auto and auto ancillary, hospitality, infrastructure and real estate sectors. Sales of two wheelers, commercial vehicles, luxury cars and SUVs were negatively impacted. Real estate sales were also dropped because people have fear of recession because most of the money used in realty sector is black. Even at present people have no clarity in terms of buying a building, house and land.

Car	Dec-15	Dec-16	Percentage Change
Alto	23320	17351	-25.6
Dzire	17218	14643	-15.0
Swift	14594	14538	-0.4
WagonR	15566	14176	-8.9
Grand i10	11059	10519	-4.9



Source: www.autoportal.com

2. **Cash Crunch:** - There was a huge cash crunch after demonetization. Because small denominations are accounted to only 14% to 15% of the total currency in the market and more and more small denominations have been supplied. The currency may not be supplied in a large number, because of ideology of cash less economy.
3. **Corruption in Banking Sector:** - This step lead to many banking frauds and illegal transactions across the country. Poor people also prone to corruption. There were bulk deposit in Jan Dhan Accounts, Bank accounts of BPL(below poverty line) people, which shows that poor people were corrupted and were ready to save the corrupted people. Even one bank was also highlighted for fake transactions named Axis Bank New Delhi Branch.
4. **Digital Laws:** - After demonetization govt. has taken a new step towards a cash less economy which has to bring more laws in digital banking. There were high charges for digital transactions and uneducated people faced many problems because of digitalization.
5. **Inconvenience to the Public:** - The ordeal had begun for the common man. Massive serpentine queues began forming outside banks and ATMs, with people waiting for hours for their turn. Due to lack of new currencies in ATMs people had to return home without any money after standing whole day in queues.
6. **Economic slowdown:** - Demonetization has largely affected the growth of GDP. Its rate of 8.01% in 2015-16 fell to 7.11% in 2016-17 after demonetization. This was due to lack of liquidity in cash intensive industries like manufacturing and construction.
7. **Death:** - Multiple death have been reported in India in the aftermath of demonetization. Due to unavailability of cash many people take a step of suicide.
8. **Black Money:** - This step was taken with the intension of curving black money. According to some estimates, size of black money in India ranges from 20% to 60% of GDP and more. According to RBI, after demonetization Rs.8.11 lakh crore have been deposited in banks and Rs. 33498 crore (3%) have been exchanged.
9. **Recalibration of ATMs:** - It was not done at a great pace as it has to be done in such critical situation. May be cash crunch and recalibration of ATMs are both wontedly done in order to get people into digital mode.
10. **Daily Wages Workers:** - A major portion of the Indian workforce is daily wage worker. They use their daily cash to meet all their expenses. After demonetization lot of workers lost their jobs due to unavailability of cash. As per CMIE's Consumer Pyramids Household Surveys (CPHS) approx. 1.5 million jobs were lost during the final quarter of the financial year 2016-17.
11. **Effect on Gold:** - After demonetization there was sudden increase in demand of Gold because people started purchasing of gold to convert their currency. On the night of demonetization 8th Nov. 2016 gold was sold by jewelers at very high rates. But, later the demand of gold was decreased due to strict govt. actions.



Conclusion

Government decision of note ban of higher denomination currency is one of the major step to combat with black money and terrorism. The main purpose of demonetization was to control black money, corruption, inflation etc. Govt. of India achieves their purpose to some extent. The fake currency obviously has been eliminated from the economy but further a regular check will be needed. It is a beneficial process even though it has some positive consequence as well as negative. It alone cannot fight to eliminate black money and corruption. Several other supportive measures are required by the govt. to change the economy for good. Demonetization can be a chance for a fresh new start or it can be something that causes unnecessary confusion for a country. Hence, a public support must be sought for the overall success of this policy.

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