

# DEMONETIZATION: A PROGRESSIVE APPROACH TO NEW INDIA

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**ABSTRACT:** The argument postulate in favour of demonetization is that the cash that would be extinguished would be black money and hence, should be impartially extinguished to set right the perverse incentive structure in the economy. While the facts are not available to anybody, it would be reckless to argue that this is the only possibility. Therefore, it is imperative to evaluate the short run and medium-term impacts that such a shock is expected to have on the economy. Further, the impact of such a move would vary depending on the extent to which the government decides to remonetise. This paper explains the impact of such a move of demonetization taken by Central Government of India on 8th November, 2016 with respect to its reasons and effects on different sectors in India such as on the availability of credit, spending, level of activity and government finances. The area covered in these sectors is Micro Businesses, E-Wallet businesses, online retail stores and so on. This research is based on secondary data collected from different newspapers and online sources, mentioned in references. 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, E-WALLET, MICRO BUSINESS, GOVERNMENT, ECONOMY.

## INTRODUCTION

### Brief Introduction of Recent Demonetization

On the evening of 8th November 2016, Indian Prime Minister Mr. Narendra Modi announced a sudden denomination of ₹ 500 and ₹ 1000 rupee notes. Instead of RBI Governor Urjit Patel, surprisingly Prime Minister announced the news of demonetization that these banknotes would not be legal tender after midnight of the 8th November. means the high value notes will not be legal for transaction. Although the old notes can be exchanged till 31st December 2016. There were set an upper limit of cash withdrawals from bank is ₹ 10,000 per day (up to ₹ 20,000 per week) per account and from ATM ₹ 2000 per day per account from 10 to 13 November which is changed from 14 Nov. to ₹ 24,000 per week from bank and ₹ 2,500 per day from ATM per account till 31st Dec., although a needy person can withdraw with valid reason. According to RBI report on 31st march 2016, ₹ 500 and ₹ 1000 banknotes consist around 86% of total cash circulation having value of ₹ 15.44 lakh crore. In this process 97% of old notes around ₹ 14.97 lakh crore were deposited in bank before 31st December. • Motivation In last year, Demonetization was a major economic incident and a bold move by the government. As soon as the PM announced about demonetization, a debate started in the whole country. On the news channel, at the offices, everywhere everyone wanted to understand the effects of demonetization as it was not so obvious. I was also one of them who were interested, curious and excited about the recent event. I thought that I should understand the economic point of view of such a big event as economics student. All these things inspired me to dig into this topic.

**Objective of the Study** The aim of this study is to study the previous instances of demonetization round the world. In these cases, what were the aims of the countries and what happened to them next, is also collected in the study to understand the possible outcomes of our demonetization to reduce the negatives and to maximize the positive ones by learning from the good decisions taken by the various countries as well as by the mistakes made by them. This study also takes the views of many other authors and collects them to make a perspective about the possible effects of the demonetization, explanation of them according the economics theories and suggestion made by them. One of the most important part of this paper is the one where broker's fee concept is used to explain the behavior of people at the time of demonetization, and the effect of it further on savings and investment.

This study would help in understanding the cost benefit analysis of demonetization in India. This study would also help in finding out the sectors that are affected due to demonetization and appropriate actions could be taken by the government by modifying the policies accordingly. This study also shows the way to government to take the decision by observing the objectives and the results of demonetization done in many countries in past.

## LITERATURE REVIEW

### History of demonetization

Paper Money as a legal tender was first introduced in the late eighteenth century. The Victoria portrait series was initially issued in few denominations of 10, 20, 50, 100 Rs.1000 and Rs.10,000 currency notes were circulated between 1938 and 1946. In India, demonetization has occurred thrice. The first was on 12th January 1946, second on 16th January 1978 and the third was on 8th

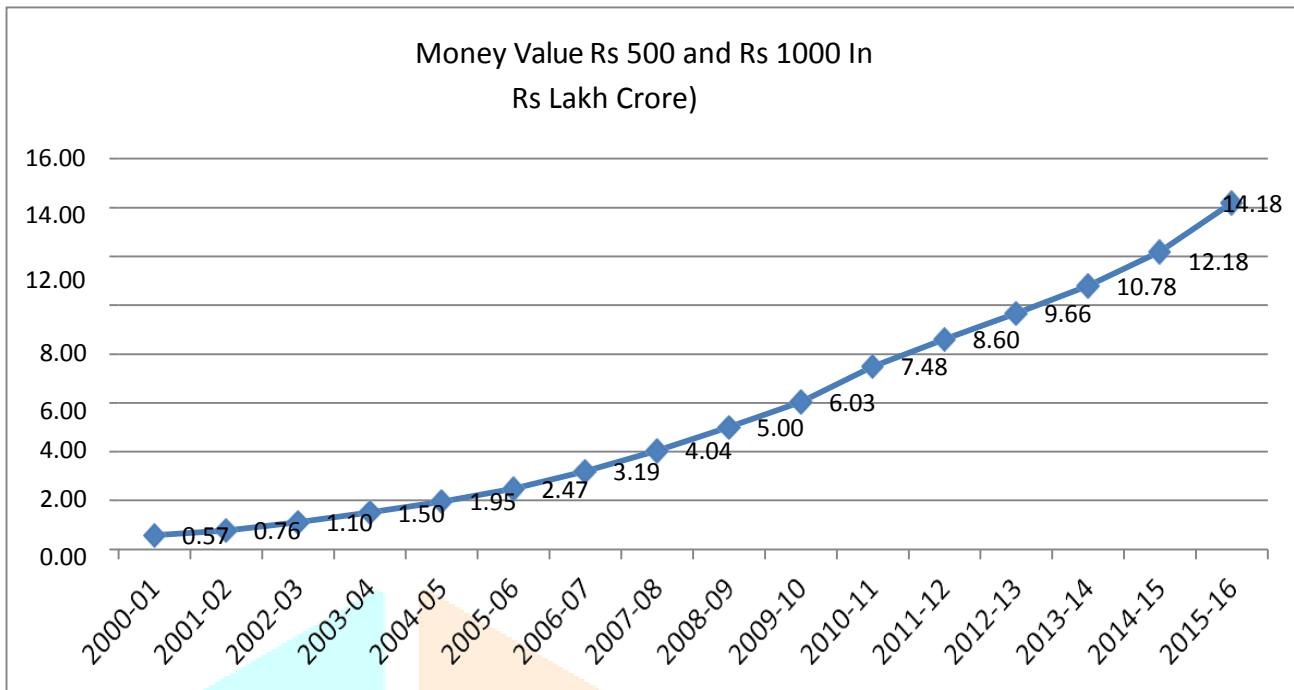
November 2016. In India, there were many occasions when high denomination banknotes were demonetized. RBI printed the highest denomination notes of ₹ 10,000 in 1938. After that government demonetize ₹ 1,000 and higher denomination banknotes in 1946. Higher denomination banknotes (₹ 1,000, ₹ 5,000, ₹ 10,000) reintroduced in 1954 and all of them were demonetized in 1978 to curb unaccounted money. First time ₹ 500 banknotes were introduced in 1987 in order to restrain over increasing banknotes, due to inflation and in 2000 again ₹ 1000 banknotes came back in circulation in order to contain the volume of bank notes in circulation, due to inflation. However, ₹ 2,000 banknotes were first time introduced in Nov 2016. Along with India many countries in the world had done demonetization in the history. Almost countries that had done demonetization had some common objectives of demonetization which were to curb corruption and black money and their government decided to demonetize their higher denomination notes to rid of these problems. Here is the list of some countries that had done demonetization:

**Table -1 List of countries in the world that had done Demonetizations**

Country Name	Year	Objective	Results
Nigeria	1984	To fix, debt burdened and inflation- ridden economy	Economy collapsed
Soviet Union	1991	Fight against unearned income, smuggling and corruption	The economic system of the USSR was essentially crushed
Ghana	1982	To control black money	People turned to foreign Currency
Myanmar	1987	To curb black money	led political dispute and died thousands of people
North Korea	2010	To lower down the market of black Money	Miserably Failed
Zimbabwe	2010	Sliding out from Hyperinflation	Failed
Australia	1996	To the curb black money crisis and improve security features on the notes	Success
Britain	1971	To bring uniformity in currency	failed in other countries except Britain
Zaire	1990	A plan to withdraw obsolescent currency from the system	Failed
USA	1969	Due to black money	Success
Pakistan	2015	To get rid from Black Money, Counterfeit Currency	Messed Up
Germany	1923	Due to high domestic prices	Inflation fell
Philippines	2016	To preserve the integrity of currency	--

### **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 neighbouring countries, and as an attack on the black money in the country. The move was claimed as an initiative to curb corruption, trafficking of drugs, and smuggling across borders. 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 The Southern Regional Conference on Management Education – A Global Perspective, Organized by PSG Institute of Management, Coimbatore – 06.01.2017 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. Some include combating inflation or corruption, and to discourage a dominative cash system.



**Chart 1 Rs 500 and Rs 1000 Notes: From 25% to 85% of Cash Economy in India**

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.

**RESEARCH METHODOLOGY :** This Research is based on Secondary data.

### **EFFECTS OF DEMONETIZATION**

Demonetization created effect on different sectors in different manners resulting into boom for some sectors like E-Wallet businesses and somewhere resulting into temporary slowdown like micro businesses like vegetable vendors or some small seasonal businesses, where most of the transactions are on cash basis. Selected sectors have been covered for the study which, according to me, can have major effects of demonetization.

**a) Online retail stores temporarily stopped cash on delivery facility-** Successful online retail stores in India like Flipkart, Amazon, Snapdeal and other online retailers have either temporarily stopped offering cash on delivery services. According to a research firm named Redseer Management, about 70% of the e-commerce orders are still paid for in cash. Such a move may temporarily impact the volume of business because cash on delivery is the most popular mode of payment for shoppers in India, industry experts said. Flipkart Ltd, Snapdeal and Shopclues have put a cap on the maximum value of cash-on-delivery transactions, while Amazon India has temporarily stopped cash on delivery, the companies said in statements.

The companies are instead encouraging consumers to resort to payments through debit and credit cards enabled by the point of sales devices carried by delivery personnel. According to industry experts, the absence or an upper limit on cash on delivery may lead to cancellations or clog logistics networks. There are many orders which are in the pipeline to be delivered and for which mode of payment is cash on delivery. But unless a new model where wallet transaction replaces cash on delivery, many of them may not be executed, or clog the logistics network with significant delays in delivery.

**b) Disbursement Rate Microfinance Institutes' slow down-** Micro finance institutions (MFIs) are important institutes which provide financial assistance to micro businesses. Such MFIs have seen their disbursement rate slowing after the government's decision demonetization of the notes of Rs 500 and Rs 1,000. The MFIs have acknowledged that the move may result in a delay in collection of installments from the clients in the near future. Demonetization and unavailability of cash can also have an impact on disbursement especially cash disbursement.

**c) Effect on Micro Businesses** - Indian Micro Small and Medium Enterprises (MSME) sector contributes considerable share in India's GDP. But amongst all the three, medium sized enterprises have share of around one per cent and they generally use online mode for their payment and receipts. But Small and Micro, especially micro businesses faced lot of problems as most of the transactions take place on cash basis, because many people are not that educated and tech-savvy. So the move demonetization has hampered micro businesses in a bad manner resulting into slowdown in micro enterprise sector.

**d) E-wallet firms could gain good business** - A digital wallet is an electronic device which allows an individual to make electronic commerce transactions like payment of bills or online bookings etc. An individual's bank account can also be linked to the digital wallet. The examples of wallet in India are- Paytm, PayU India, MobiKwik, and Freecharge and so on. Such E-wallets are expected to be the biggest beneficiaries of the decision of demonetization taken by central government.

## **DISCUSSION**

The decision of demonetization has received enormous support by several bankers and from some international economists, though it was criticized by members of the opposition parties, which resulted in many debates in both houses of parliament to the extent of stalling the proceedings throughout the winter session often and triggered organized protests against the current government in front of the parliament and elsewhere across India demanding the prime Ministers' explanation. It was estimated that as on 28 October 2016 the total currency notes in circulation in India was about Rs. 17.77 trillion (US\$260 billion). Based on the annual report of Reserve Bank of India (RBI) as on 31 March 2016 the total bank notes in circulation was valued to Rs. 16.42 trillion (US\$240 billion) in which approximately around 86% (around Rs. 14.18 trillion (US\$210 billion)) were just Rs. 500 and Rs. 1,000 banknotes. It was 24% (around 22.03 billion) in terms of the total volume in the 90266 million banknotes which were in circulation till 8th Nov 2016. The new Pradhan Mantri Garib Kalyan Yojana (PMGKY) announced paves for 50 per cent taxes and also a surcharge on all declarations of unaccounted or untaxed cash deposited in the banks. Declarants also have to park a quarter of the total sum in a non-interest bearing deposit for four years. The Government of India had launched Jan Dhan Yojana for financial inclusion of people having no banking system in August 2014 to encourage and enable all to have bank accounts opened to receive the financial benefits directly in their accounts to curb multilayer corrupt system. The Indian government has declared an Income Declaration Scheme (IDS), which was announced on 1st June 2016 and closed on 30th September 2016. Under this scheme, the black untaxed money holding citizens could come by them to declare their assets, by paying the tax and a 45% penalty. This scheme could yield about Rs. 65,250 crore (US\$9.7 billion) through 64,275 declarations in which the 45% is added to the revenue for the government. The "Unified Payments Interface" scheme initiated by National Payments Corporation of India in the April of 2016 is aimed at encouraging the cashless payments paving way for a cashless economy. Between November 10th of 2016 and November 27th of 2016, all the banks have reported that the total exchange and deposits of demonetized currency notes are of worth Rs. 8.45 trillion (US\$130 billion) (exchange of Rs. 339.48 billion (US\$5.0 billion) and deposits are of Rs. 8.11 trillion (US\$120 billion)). During the same period of time, an amount of Rs. 2.16 lakh crore (US\$32 billion) was withdrawn by the people from their bank accounts. Data provided by the The Southern Regional Conference on Management Education – A Global Perspective, Organized by PSG Institute of Management, Coimbatore – 06.01.2017 Reserve Bank of India shows that between November 10th and December 7th of 2016, new currency notes worth Rs 427,684 crores have been distributed by the banks to the public for circulation either over the bank counters or through ATMs. Historical data clearly state that no country can efficiently handle this demonetization as it is a double edged weapon to destroy the black economy. Though the intent or a dream of a black money free economy and the cashless transactions even at the lowest level possible is a noble one and a necessary evil, the implications of such initiatives should actually be visibly successful and precise in terms of targeting the roots and branches of the black market and not the harming the innocent general public paying much for the cause of a few black money holders being fixed. Demonetization in India also has a considerable impact in International financial Markets especially in Asian Markets.

## **LIMITATIONS**

This study has the inherent limitations added to it by itself as it does not have adequate research being carried out on the phenomenon of demonetization. Hence there is no sufficient review of literature available for the inferences to be made through an exhaustive reference. All the data are already available but this article have them consolidated and organized them in a factual method and order for a clear understanding and study. Added to that time is also a major constraint. As this includes a huge amount of data handling due to its macro economical nature and the availability of the raw data from the valid sources are also crucial in this study.

## **CONCLUSION**

Initially Govt's Objective was to curb black money but if we look at the figure, 97% of ₹ 500 and ₹ 1000 rupees' banknotes were deposited in banks and only 3% (.43 trillion rupees) black money scraped as undeclared income hence we can say a less part of Black Money is in cash so this action isn't effective to curb black money. However, Tax GDP ratio will increase in future. Due to demonetization counterfeiting currency market offhand shut down for a while but they have capability to create new notes' duplicate so we can say in short run their activity will be slowdown but in long run they can rebuilt their market and also it is easy to handle 2000 rupees notes instead of 1000 rupees notes in briefcase to giving bribe. In this study, we have found some important points about the short term effects of demonetization as well as about the long-term effects by observing the previous

cases of demonetization in other countries. We have to be alert and thoughtful to sustain our growth because many countries which have done demonetizations could not sustain the same. In short run, almost all the sector in the Indian economy have been affected negatively due to shorting of cash. However, in long-run Informal Economy would be formalize. So, government have to focus on informal economy and need to make appropriate policies for them. Other than this, we have got the point by using the Baumol's model in this case that the transactions were more difficult to make than it could be simply estimated by the ratio of money supply in demonetization period to the normal period's money supply. Money supply reduction results to fall in interest rate and accessibility of loan will be easier as interest rate decrease. It will be helpful to new entrepreneur for their startup. After demonetization, Indian economy got the momentum towards Case less economy. Long- term effect of demonetization couldn't identify yet due to less availability of information set.

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