



# ANALYSIS OF DEMONETIZATION IMPACT ON INDIAN ECONOMY.”

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## **Abstract:**

The objective of the study is to investigate the impact of demonetization on Indian economy. The study traces the practice of demonetization adapted by other developing economies including India. “Demonetising is the act of removing the current currency from the economy and replacing it with new currency.”<sup>1</sup> It is also defined as “the act of stripping a currency unit of its status as legal tender.”<sup>2</sup> Demonetisation was also adopted by Ghana, Nigeria, Myanmar, Soviet union, Russia, North Korea and India mainly for reducing black money, black market and anticorruption measure. Regarding implications of Demonetisation there are positive and negative view expressed by the persons form different sectors, have also been reviewed by the study.

## **Introduction:**

The parliamentary, standing committee on Finance in March 2019 tabled its 73<sup>rd</sup> report on the status of unaccounted wealth. As the actual estimates of the size of the black money in India varied from 7 percent to 120 percent of Gross Domestic Product (GDP) tend to be a matter some concern. In India mostly dealing with illicit financial flows across international borders “Cross border illicit financial flows (IFFs) may happen due to tangible illegal activities like trafficking of drugs or wildlife, illicit trade or due to intangible activities, such as corruption, betting in sports and piracy or import of service related to software or consultancy. However the most sensitive sectors prone to illicit cross-borders trade in goods and services, although in case of India, gold and jewellery diamond, and software and consultancy imports tend to be more sensitive. According to UN COMTRADE (International Trade Statistics Database) revealed that, over the past ten years, in terms of quantity 75 to 85 percent of India’s gold jewellery export was made only to two countries, namely to UAE and the US. Similarly in the context of diamond trade 3/4<sup>th</sup> of Indian rough diamond imports in quantity terms were from Belgium and UAE, and these two countries also stood as prime destinations for Indian exports of finished diamonds. While estimating black money a closer look along with these two countries is necessary. In the context of Intangible sectors, such as, software , consultancy and tours and travels result in out flow of foreign exchange which is desirable for genuine transactions but when these imports of services take forms of fake transactions may be used for laundering money. The use of intangibles is preferred because it is difficult to establish whether services were actually offered or not, due to the absence of any physical evidence of such transactions.”<sup>3</sup>

1. Abhani D K (2017): “A Study on Impact of Demonetisation over the banking sector with reference to Vera val City” in “ International Journal of Marketing and Financial Management” Vol. 1, No.3, pp 21-26.
2. D Mounika and R. Kadhirvel (2017): “Impact of Demonetisation in E-Banking” in “International Journal of Scientific and Financial Management Vol5, No.3. (<http://www.ijser.org>).

The Enforcement Directorate (ED) has been unable to act against a large numbers of high-profile individuals named in global leaks, such as the HSBC Swiss case, Panama Papers and others under the Prevention of Money Laundering Act (PMLA), because no prosecution compliant has been filed in any of these cases under the Black Money Act.<sup>3</sup> There are few cases which ED is probing in the HSBC Swiss leak case under The Foreign Exchange Management Act (FEMA), which restrained the enforcement agency from initiating Criminal proceeding against the entities concerned. FEMA deals with forex contravention which is treated as Civil in nature. In 2017, CBDT had said that the investigation in the Panama Papers leak case had resulted in the IT department detecting undisclosed wealth of Rs.792 crore till then and probe in the cases was full swing. Earlier in 2019 undisclosed assets of the order of Rs.6000 crs were detected, under the foreign black money law, as replied to Parliament.

Black money promotes corruption and adversely affects the right of common man by reducing him to a lesser human being in the society. The impact of black money tends to be widespread affecting economic, political and socio-cultural lives and reduces the very foundations of honest human behavior. India has massive physical cash in circulation amounting to Rs.17 lakh crore or 12% of the GDP. As the physical cash increases greater tends to be generation of black income. Hence, Government actions such as demonetisation, complete financial inclusion through a seamless banking system, can help to move a cashless economy free from black money.”<sup>4</sup>

## **Demonetization:**

The Government of India, on 8<sup>th</sup> November 2016 announced cancellation of legal tender character of all Rs.500 and Rs.1000 notes and the time was extended till the end of December 2016 to exchange the old notes for new Rs.2000 notes. The main objectives of demonetization were to reduce black money, lower cash circulation to reduce corruption in the economy, eliminate fake currency and terrorism funding. The Government had given sufficient time and relaxation on tax payments (IDS) were also announced by the Prime Minister before declaring demonetizations to encouraging the holders did not respond as expected.

The developing countries had also to face the problem after demonetizing their currencies. For examples, Ghana adopted the policy of demonetizing in 1982 to address tax evasion and reduce liquidity but in effect it was observed that black money increased and rural population had to travel a long distance for exchanging money within given time period. Nigeria in 1984, issued new bank notes with different colour, forcing replacement of old ones within specified period, as an anticorruption measure. But in effect debt burden and inflation failed to meet the objectives. Myanmar in 1987, adopted demonetization policy for reducing black market activities, by invalidating 80% of the black market, but it resulted into economic unease, mass protest across the nation and even protest by students leading to killing of a large number of people. Soviet Union adopted this policy in January 1991 by withdrawing 50 and 100 ruble notes, to reduce black money and improve currency value, but it led to economic collapse and Soviet break-up. Russia in 1998, adopted policy of Redenomination of rubble; which was successful to some extent. Even North Korea adopted demonetisation policy in 2010 by removing two zero from the facing value of old currency.

3. Singh P K (2019): “Black hole in the economy” ‘Business Standard, Pune Edition’, Vol. XIV, No.87, pp -9.

4. Aggarwal Ritika (2017): “An Analysis of Black Income in India” in “International Journal Finance” Vol. 11, No.5, May pp 07-2

The objective was to achieve economic control and to close black market. But, it leads to adversely affecting agricultural population which resulted in shortage of food supplies. Thus, it can be observed that, in these cases demonetization policies failed to achieve desired objective and making such policies unpopular.<sup>5</sup> Hence, systematic planning and effective procedure need to work out before actual implementation of such policies.

## **Demonetization in India:**

Demonetisation is not new to India as in January 1946, bank notes of 1000 and 10,000 Rs. Were introduced in 1954; and people had given time period of ten days to exchange notes, but it had only insignificant effect. By the end of 1947, out of 143.07 crs of Rs only

Rs 134.9 crs were exchanged. Thus, notes worth Rs 817 crs were demonetized. The Second currency ban was made on 16<sup>th</sup> January 1978, as a mean to curb counterfeit money and black money by way of Rs.1000, 5000 and 10000 notes out of circulation, and the time given to the people was only three days for exchanging the notes. This lead to demonetisation of Rs. 73.10 cores. In 2012, The Central Board of Direct Taxes recommended against demonetization stating in a report that “demonetization may not be a solution for tackling black money in economy which is largely held in the form of benami properties, bullion and jewelry.” The third demonetization was announced on 8<sup>th</sup> November 2016 by Prime Minister Narendra Modi by demonetizing the currency notes of Rs. 500 and 1000 and the Government instructed the hospitals, petrol pumps, airports etc. to accept the old denomination notes till 11<sup>th</sup> November 2016.

### ***Impact of the ‘Note Ban’ on main sectors of Indian Economy:***

Denomination of Rs 500 and Rs 1000 notes, covering 86% of all currency notes in India, on November 8, 2016 had impact on certain sectors of economy which has been summarized on follows..

“The Objectives of the Government were unearthing black money, cracking down of counterfeit currency and chocking terror financing. Now in 2019 the status is as stated below.<sup>6</sup>

**I) Digitization:-** In India digital transactions increased by 440% since demonetization. The Central Government insisted for a less cash society by increasing infrastructures to allow digital payment in tier II and tier III town, where digital payments had doubled since the ban. Global tech giants such as Google, WhatsApp, to a few country’s biggest mobile wallets, including Paytm, MobiKwik all adopted the digital payment system around the time demonetization took place.

**II) Factory Investment:-** Investment in factories of India decreased by 10.3% in 2016-17 showing their worst performance since 2010-2003.

**III) Farm Income:-** Farm income from cultivation and wages of laborers continued to contract from 2016-17 to 2018-19 despite above-normal monsoon in some of the years.

**IV) Jobs:-** In 2017-18 rate of unemployment was 6.1% which was higher as compared to earlier 45 years.

**V) Real estate:-** Total no. of developments in the top 9 Indian cities decreased over 50% by 2017-18.

**VI) Tax Filing:-** The no of taxpayers had increased by to 84.52 million in 2018-19, a rise of 38% over 61.38 million in 2015-16.

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5. T Narayanswamy and Muthulakshmi A P (2017): “Demonetisation to E-monetization in India: The Way Forward” in “Indian Journal of Finance” Vol. 11, No.5, pp 30-39.

6. Business Standard Web Team: Note-Ban, 3 year on- ‘Weekend Business Standard (Pune Edition)9/10 November 2019, pp 21-26.

### ***Demonetization, Success & Failures:***

Economic Survey of India in 2018 claimed that the economy has done away with all negative impact of Demonetization, but economic experts are of the view that the economy still suffers from the effects of demonetization and only the objectives achieved by this policy are not much significant, and its impact has turned out to be protracted than initially expected. According to the experts when promoting digital economy is to be achieved, there was no need for the government to take steps to put about 86% of all currency out of circulation. Studies have concluded that, very little black money was caught. The RBI in its report on Demonetization, in August 2017, stated that 99% of the banned notes came back into banking system. This implies that, either the black money held in cash was very low or the government could not implement the demonetization policy efficiently which resulted in all the black money held in Rs 500 and Rs 1000 bank notes came back to the banking system. The views of the experts about Demonetization can be classified into Positive Impact and Negative Impacts on Indian economy.

## **Positive Impact:**

- i) Economic Survey( 2018-19) claimed that the cash to GDP ratio has stabilized so that equilibrium has been achieved, and GDP is set to grow at 7 to 7.5% in 2018-19, which shows increased as compared to earlier estimate of 6.75% growth.
- ii) Economic Survey has stated that exports and imports data reflects that the demonetization effects was now over, as export growth achieved 13.6% growth in 2018 and deceleration of import growth to 13.1% is in line with global trends.
- iii) The unaccounted cash could be deposited in the Pradhan Mantri Garib Kalyan Yojana after paying 50% tax.
- iv) Deposits with the Public Sector Bank have significantly increased.
- v) Demonetization has stopped funding for terrorism.
- vi) Money laundering has been reduced.
- vii) Demonetization has also stopped the working of parallel economy as circulation of fake currency as a result of banning of Rs 500 and Rs 1000 notes will eliminate their circulation.
- viii) Those people who had opened the Jan Dhan accounts can use their accounts and became familiar with banking practice.
- ix) Tax Collected due to demonetization policy will be used for financing developmental activities in the economy,
- x) Demonetization will promote a cashless society as transaction of banking channels increase significantly.
- xi) Inflationary conditions are steadily reducing which may contribute towards improving standard of living of low income group.

## **Negative Impact**

- i) Demonetization resulted in severe cash shortage and people had to wait in long queues for exchanging their bank notes due to inconvenience and heavy rush.
- ii) GDP growth was adversely affected as the rate of Growth of GDP decreased by 2-3%
- iii) Farmers majority had to suffer shortage of cash and credit facilities and inflatimary conditions.
- iv) Real sectors of Indian economy as also adversely affected to the shortage of credit and buyers.
- v) As there was delay in the circulation of new currency, situation become more and more chaotic.
- vi) Even public expenditure had to be substantially reduced leading to widespread unemployment and making standard of living of the masses making very poor.

## **Operation Clean Money:**

As the non-inclusion of undisclosed wealth in the national economic activities has far reaching negative effects on the economy, so that Government had to take necessary steps to contract such economic evil. In this context the tax administration also has decided to take steps to control black money as directed by the Government agenda. Some main steps include Demonetisation, Constitution of the Special Investigation Team (SIT) on Black Money, enactment of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015 detailed amendments of Benami Transaction (Prohibition) Act 1988. Information Exchange Agreements with Switzerland, Changes in tax treaties with Mauritius, Cyprus and Singapore and also Income Disclosure Scheme (2016). In addition recently the scheme of “ Operation Clean Money(OCM), launched by the Income Tax Department for e-verification of large cash deposits made during 9<sup>th</sup> November to 30<sup>th</sup> December 2016. The OCM aimed at verifying cash transactions do not match with the tax

enforcement action if the transactions do not match with the tax status. According to Press Information Bureau, The CBDT had identified 17.92 lakh persons for E- verification of large cash deposits. Later on 6.6 Lakh people also have been identified. It has been well realized that the Black Money is menace not only for nation economy but also for global economy. The OECD and G20 Countries have considered this issue so as to rationalize that every country gets its due share of tax and the OECD has formulated 15 Action Plans to provide tools to the established to encounter BEPS, where India has also participated in the process. Although the task of controlling black money is difficult, still it can be achieved with the help of Indian CA fraternity along with recent measures taken by the Government that will help to contribute towards double digit growth of Indian economy.”<sup>7</sup>

The OCM includes

- i) Creating awareness about OCM, by the Chartered Accounts and
- ii) Pledging their support on the clean Money Web Portal by using the “I Support” link on OCM Portal or ICAI web Portal and
- iii) Supporting voluntary compliance by encouraging tax payers to file Income Tax Returns showing income correctly and
- iv) Providing suggestion and feedback to Department. Thus, this collaborative approach will help in achieving the mission of OCM i.e. “to create a tax compliant society through a fair, transparent and non-intrusive tax administration, where every Indian takes pride in paying taxes” as an ideal citizen of India.

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7. Editorial of The Chartered Accountant (2018): “Operation Clean Money and Role of The CAs The Chartered Account” Vol. 66, No.7, p 3.

### **Conclusion:**

As the Finance Minister on 7<sup>th</sup> November 2017 made spirited defense of demonetisation calling it as “Watershed movement for the Indian economy.” Thus, demonetisation has not only changed the usual agenda but also make corruption difficult. Thus, it was morally, ethically, economically and politically a correct step. If all the authorities and individuals make sincere efforts than the desired goal of controlling corruption and black money can be achieved, although it is time consuming but essential job.

Under cashless economy corruption, black money and any other illegal financial transactions cannot flourish. The cashless transactions can promote not only saving but also tax revenues which can be used to achieve the goals of our economic development.