

A Study on Demonetization and Its Impact to India

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Abstract

The Government of India suddenly announced demonetization of Rs. 500 and Rs. 1000 worth of currency notes on November 8, 2016 night. The government was hopeful that this move will curb black money and crack down the foreign funding with counterfeit and illegal notes for terrorism, human trafficking and other illegal acts. Despite having good intentions behind demonetization, it caused millions of Indians to suffer for a long time. It happened when India was being considered as a big democracy and was on the verge to become a global leader. India has a lot of strengths such as rising literacy levels, improved technical knowledge among the workers, growing middle class income, and larger youth population. This article is aimed to discuss the impacts of demonetization on various sectors like real estate, stock market, employment rate, taxpayers, economy, etc. This paper also explores the positive and negative effects of demonetization in different ways and whether it was successful in its efforts to curb black money and promote digital transactions.

Keyword – demonetization, Indian economy, government of India, black money, Indian currency

Introduction

On November 8, 2016, Prime Minister of India Mr.NarendraModi demonetized all the high-denomination currency notes of Rs. 500 and Rs. 1000 with the issuance of new banknotes of Rs. 500 and Rs. 2000 in exchange. According to the PM, that decision would curb the use of counterfeit and illegal cash for funding terrorism and other illegal activities in India. This historic decision resulted in long-term cash shortages in the following weeks, which led to a huge disruption in the economy. People had to stand in long queues for exchange of their demonetized banknotes and several deaths had been reported in rush for exchanging cash.

More than 99.3% of demonetized currency notes, i.e. Rs. 15.30 Lakh Crore of Rs. 15.41 lakh crore were deposited in the banking system, according to an RBI report in 2018. But the banknotes of Rs. 10,720 Cr. were still not deposited and analysts were reported that as a failure of government to eliminate black money completely from the economy. The NIFTY and BSE SENSEX stocks also crashed up to 6% just after announcement. The move affected the GDP growth rate and industrial production of the country. Initially some international experts and several bankers were in support for the move. But the move also faced criticism for being unfair and poor planning, and also resulted in strikes, litigation,

and protests against the government in several states across the nation. Both houses of Parliament also had debates about the decision.

However, demonetization is not a new term for India. The Indian banknotes were demonetized two times in the history, i.e. in 1946 and 1978. The government took this decision to deal with tax evasion and black money which is deposited outside the country in both cases (Shirley MA, 2017). The Janata Party demonetized currency notes of Rs. 1000, Rs. 5000 and Rs. 10,000 to curb black money and counterfeit notes (Dash, A., 2017).



Fig. 1 – Rs. 1000 Note (Source: RBI)



Figure 2 – Rs. 5000 Note (Source: RBI)



Figure 3 – Rs. 10,000 Note (Source: RBI)

The Central Board of Direct Taxes opinionated against demonetization in 2012. It added that demonetization may not be helpful to curb shadow economy or black money, which is

mostly held as jewelry, bullion, and benami properties. Black money holders held only 6% of cash as their wealth or even less. Hence, targeting that amount of cash would be an utter failure.

The main reason behind demonetization was controlling black economy, including untaxed and unreported income, corruption money, counterfeit currency, and money gained through smuggling of restricted goods, and illegal acts like human trafficking. Other objectives of this move were expanding the number of taxpayers and tax base, cutting down the funding for radical aggressive groups like Naxalites and Maoists, and terrorists, reducing the number of cash transactions, and integrating informal and formal economies.

India is not the only country which faced demonetizations over the years since independence. Several countries have attempted this move in the past for different reasons.

- **United States** – The Coinage Act of 1873 in the United States was the first incident of demonetization in which silver was mandatorily removed for gold standard in legal tender. It contracted the cash flow and also economic depression for five years in the country. The tough situation and peer pressure from farmers and silver miners led to the re-monetization of silver in the form of legal tender by implementing Bland-Allison Act in the year 1878.

Under President Richard Nixon, the US announced all bills null and void above \$100 in 1969 to control black money and restore the reputation of the country. It was truly a landmark decision for the growth of the banking system in the US. The \$100 bill is still the most widely-used denomination.

- **Ghana** – It demonetized its currency of 50 cedi in 1982 to clear excess liquidity and curb tax evasion. Public started moving for physical assets and foreign currency and this move failed miserably. As a result, the public also lost their faith in the banking system and the currency cropped up in a fresh black market.
- **Nigeria** – In 1984, Muhammadu Buhari led the military government to use new colors and issue new currency notes in order to replace old currency notes for fixing the inflated and debt-ridden economy but it also failed miserably.
- **Soviet Union** – In 1991, Mikhail Gorbachev removed currency notes of 50 and 100 rubles under his leadership from circulation to deal with a parallel economy. Around one third of total circulated money was removed. Various Soviet republics like Ukraine and Kazakhstan were badly affected and it caused economic dislocations. People started losing trust in the government and there was a huge downturn in economic activities. Gorbachev suffered a coup due to a failed demonetization attempt.

- **Myanmar** – In 1987, around 80% of circulated money was demonetized by the military to control the black money. It caused a government crackdown and student protest next year.
- **Australia** – In 1996, the Australian Government replaced all paper-based currency notes with polymer-based ones as part of demonetization to control black money and improve security features. At the end, this step was successful as it improved the overall lifespan of the bills. With this move, Australia became a business-friendly economy, even though it faced initial manufacturing costs.
- **Zaire** – In 1993, Mobutu SeseSeko, under his dictatorship, rolled out some currency reforms. He withdrew obsolete currency. But this move failed as it brought economic instability and made the country more susceptible to foreign funding.
- **Pakistan** – In June 2015, the Pakistan government demonetized its currency notes of Rs. 5 and Rs. 500 immediately and phased out other denominations. It gave the time-frame for one and a half years for exchanging old currency notes. On December 1, 2016, obsolete currency notes were announced null and void. Since it took a long time for exchanging notes, the government failed to curb counterfeit notes and black money (Shirley, 2017).

Demonetization of Rs. 500 and Rs. 1000 currency notes was such a huge decision from the Indian government which affected almost all sections of the society. Demonetization has several advantages and disadvantages while changing the way people were doing financial transactions over the years.

- The best part of demonetization was that it was helpful for the government to curb black money. Tax evaders kept a huge sum of black money hidden. Government has recovered a huge sum of cash which had no record. According to the RBI, over Rs. 3 Lakh Crores were deposited as black money in bank accounts and it played a vital role to slow down the epidemic of parallel economy.
- A huge sum of black money was going for terrorism funding, inflating the price of gold, real assets, and other asset classes, and gambling. Demonetization served as the best counterattack against such acts. Since most of the activities have been curbed, people would take several years to recover that sum of black money. It was a great move to finish this endless loop of engaging in illegal acts for black money and using the same for more illegal acts.
- Government has also ensured a decent amount of revenue from taxes that can be used for development activities and infrastructure development, such as schools, colleges, hospitals, roads, and other facilities for the underprivileged and poor sections of the society because people were forced to disclose their income when it came to deposit their money in their accounts.

Just like another side of the coin, so is the demonetization –

- This sudden move caused the rush and chaos among the common people. In order to exchange demonetized notes, everyone was rushing to the banks and poor supply of new notes also affected the daily budgets of people. There were long queues outside the ATMs and banks and financial losses also affected small businesses in the short

term. In rural areas, the situation was way too harsh because of lack of proper ATMs and banking facilities in villages. People had to travel a lot to withdraw and exchange cash.

- Government also had to bear higher costs for printing new currency notes and destroying old currency units. The costs were even higher that it seemed to overshadow the pros of demonetization.
- This step was targeted for controlling black money. But there were people who used or rotated their black money in different asset classes like gold and real estate. So, they had no major effect of demonetization.

As demonetization has both positive and negative effects on the economy, it alone is not enough to curb parallel economies and deal with black money. Government has to implement various other measures to make changes to the economy.

Literature Reviews

Dr. Partap Singh and Virender Singh (2016) discuss the possible impact of current demonetization on several economic entities and variables because a huge part of household cash is generated without reporting to tax authorities from economic transactions that may or may not be generated with corruption. Demonetizing such a high amount of denominations would either get money just banishing or bring 87% of the amount of total cash in India, i.e. around Rs. 14 lakh crore as Rs. 500 and Rs. 1000 currency notes back to the system. This paper attempts to explore the impact of demonetization over the years in various countries and analyzes the immediate impact on Indian economy.

Dr. G Ganesan and B Gajendranayagam (2017) explore the issues on demonetization and its association with the implications on various economic sectors in India before and after demonetization and also the impact and experience of demonetization in Indian context. With initiatives like Jan Dhan Yojana and Digital India, demonetization was aimed to improve transparency in financial transactions and to curb corruption, black money, and financial offenses. According to the authors, it is the right time to strike the chord between new banking operations and second financial reforms with a digital framework to achieve significant economic growth. It takes sound infrastructure and good governance to ensure a trained workforce with positive impact and start business.

K. Veerakumar (2017) conducted a survey on the randomly selected samples of 100 participants in Coimbatore District to understand the impact and significant impact of demonetization on the common public on the ground level. It was found that demonetization has significantly affected four variables – annual income, gender, age, and occupation. It was found that the respondents gave first rank to destroying black money as the impact of demonetization, followed by terrorism, corruption, etc. **M. Angel Jasmine Shirley (2017)** explores the impact of demonetization on Indian and global economy. The author sheds light on the major impacts on households, counterfeit money, black economy, industrial output, bank deposits, real estate, jewelry, and other segments. They also discuss the history of demonetization and other countries that demonetized their currencies in the past and their success and failure.

A Dash (2017) studies the socio-economic impact of demonetization in Indian context. According to him, India has one of the highest currency levels at 12.1% of GDP in circulation. In addition, there are around 3.2% of cash on hand as household assets, i.e. around \$220 billion or higher than investment in equities. According to him, the social sector faced more impact of demonetization and the common and poor people were the worst hit by this move.

Research Question

Q. What are the impacts of Demonetization to India?

Q. Should a country demonetize currency every 50 years?

Objectives

- To Study impacts of Demonetization to India
- To describe the concept of demonetization

Methodology

This is an analytical study on the impact of demonetization on various industries and segments of society and to determine whether it is a good move for a country. In order to serve the purpose of this study, secondary data was used. Major sources of data were the official news portals, media sites, facts released by the RBI, government websites, and various other websites and related sources.

Q. What are the impacts of Demonetization to India?

There were strong indicators behind the extraordinary move of demonetization or 'note ban' both in favor and against it. Some praised it as a bold move against black money while others saw it as a disaster for the economy. There were several impacts of demonetization faced by India -

Impact on economy

India, which was once a booming economy, had suddenly grounded to a halt due to demonetization. All the indicators, be it traders' incomes, sales, employment, or production, were down. Small producers were already shutting down due to lack of capital. There was a huge population of daily wage workers who did not get cash because their employers were also out of cash for their payment. Lack of money also led local industries to suspend their work. Stringency of cash also forced companies to save labor costs and it affected income of the poor workers.

It also slowed down industrial production and the country's GDP. Some economic sectors also struggled due to lack of cash flow. Due to this reason, a lot of businesses started seeking opportunities with digital payments and the masses also started moving towards a cashless economy for basic services and goods. The banks were also out of new currency notes on hand for the distribution in lieu of banned notes. It suddenly led to the breakdown of the commercial ecosystem in India and disrupted trade in all aspects of the economy. It disrupted economic activities due to liquidity shocks when people were unable to have sufficient numbers of cash, especially of denomination of Rs. 500 (Shirley, 2017).

Impact on jobs

Unemployment rate crossed its four-year highest in FY 2016-17 thanks to the demonetization of old currency notes, as reported by the Sixth Annual Employment-

Unemployment Survey by the Labour Bureau. The unemployment rate was 6.1% higher than that of 45 years in 2017-18, according to the periodic labour force survey conducted by the National Sample Survey Office. In addition, there was 2% to 3% point reduction in national economic activity and jobs due to demonetization in November and December 2016. Over 5 million people already lost their jobs from 2016 to 2018 with declined labour force participation from September to December 2016 for both rural and urban India.

Impact on taxpayers

In FY 2016-17, over 8.8 million taxpayers skipped filing annual tax returns when high-value notes were banned by the government. According to The Indian Express, there was a massive rise in “stop filers” and it reversed a trend of four years. There was a 10-fold rise in the number of “stop filers”, i.e. 8.8 million from 856,000 in FY 2015-16. It was the highest since 2000-01.

Demonetization showed its positive side in 2017-18 when the tax base was widened. More than 1.07 Cr new tax payers were added and there was a decline of stop filers, i.e. 25.22 lakh in 2017-18. According to the Central Board of Direct Taxes, FY 2017-18 was a positive year with 6.87 crore income tax returns, while there were only 5.48 crore ITRs recorded in 2016-17, accounting to over 25% growth (Business Standard, 2019).

Impact on real estate

There was a 50% decline in the number of real estate developers by 2017-18 in the top nine cities in India. There was a 76.8% decline in the number of developers in Gurgaon alone in 2017-18 and Noida fell from 41 to 11 with 73.2%. Lack of execution, extra supply of inventory, and financial depression of small developers were the factors responsible for the downturn. Demonetization forced a lot of fly-by-night developers to escape from the market. All major cities like Pune, Mumbai, Kolkata, Thane, Hyderabad, and Bengaluru had a great real estate potential but they witnessed a decline in development activities (Business Standard, 2019).

Impact on share market

The NIFTY 50 and BSE SENSEX touched down to 6% just the next day when demonetization was announced. The nation faced an extreme shortage of cash with severe effects on the economy. BSE SENSEX crashed around 1689 and NIFTY faced down to 541 points due to government’s decision on withdrawing old currency notes of Rs. 500 and Rs. 1000 denominations. Even worse, INR was also weakened by 23 paise to 66.85 Rs. per US dollar.

Digitization

Digital payment was a revolutionary move of the government while focusing on a cashless economy. Since demonetization, digital payments had almost doubled in tier-II and tier-III cities. From the leading mobile wallets in India like PayTM, PhonePe, etc. to global tech firms like WhatsApp and Google have adopted digital payments till date. Over Rs. 1.02 trillion worth of UPI transactions happened by December 2018. There was an uprise of Rs. 9.88 trillion in National Electronic Funds Transfer (NEFT) payments. There was whopping 440% rise in all digital transactions since demonetization (Business Standard, 2019).

Q. Should a country demonetize currency every 50 years?

Cash transactions were the inseparable parts of life of Indian citizens. The government was unable to trap undisclosed income, parallel economy, and corruption in its tax revenue. Hence, PM Narendra Modi had no other option but to impose demonetization on November 2016 in India. People had a deadline for 50 days to retrieve their Rs. 500 and Rs. 1000 currency notes and exchange them with new Rs.2000 and Rs. 500 notes from banks. The reason why Rs. 500 and Rs. 1000 were demonetized because higher denomination notes were supposed to be widely used for illegal acts rather than smaller denominations like Rs. 50, Rs. 100 etc.

Curbing black money was one of the most important goals behind this bold move. Cash was the easy way to conduct illegal activities without getting on the radar of the Income Tax Department or the government. Hence, the government was hopeful to bring cash back to the banking system and keep unreported wealth from being used somewhere else. Improving digitization was another advantage of demonetization. Though there were short term issues like lack of new currency notes for exchange, economic decline, job losses, etc. caused due to demonetization. Since there have been only five years since demonetization was announced, it is too early to say whether it is effective against black money and trapping undisclosed wealth.

It is probably because most of the black money holders used their money in other sources like jewelry, gold, real estate, and other sources. They had only a small amount of cash on hand. In addition, poor and middle class people were the worst hit by this step. Considering other countries that have taken this step, only a few countries were successful after demonetization in history. However, it does not mean that demonetization is completely the worst decision for any country. With proper planning and implementation, it could help the country dealing with corruption, black money, terrorism, and other illegal activities.

Results

The recent demonetization of 2016 by the Government of India is one of the trending topics even after several years. Economic development was one of the main reasons for this sudden move. There were several positive and negative effects of demonetization realized over the years in various sectors. This step was considered as the master stroke for the economic growth of the country to curb corruption and black money and promote digitization.

Conclusion

The present paper discusses how demonetization played its part in various industry domains. The note-ban of the highest denomination was known as the big liquidity shock to the Indian citizens. There were several reasons for taking this measure, such as curbing counterfeit currency, tax evasion, terrorism funding, corruption, etc. When unaccounted income was shown at the time of depositing old currency notes exceeding the given limits, it resulted in higher penalties and taxes. This way, the government has recovered a huge sum of black money and unrecorded cash into the banking system. In addition, it also gave rise to online transactions and digital payment methods like e-wallets, credit and debit cards, e-banking, etc. to move to a smooth cashless economy.

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Notes

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