

Impact of Demonetization in the Indian Economy: A Review

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*People who change after change will survive, People who change with
the change will succeed, People who cause change will lead.*

-- Prime Minister Narendra Modi

Abstract

Having a wallet full of highest denomination currency is like being at the top of world, but one can't even imagine what will happen if the same currency converts at once in normal blank papers. The boldest move of Prime Minister Modi came up on 8th November in the form of demonetization since he came into power in 2014. Demonetization is tightening the regulatory system in the Indian economy, it is expected change the odds of the game. The move seems to be an appreciable step by the Modi government, as the intention is to stop tax evasion and to uproot corruption. But the side effects in the form of public inconvenience, scams of crores, slump in real estate and other sectors, security issues, effects on GDP can't be overlooked. In the initial days of demonetization majority of the people were supporting the drive, but as the new currency scams were coming up and the length of queues in the banks was not reducing, people were getting frustrated. It seems that demonetization has demoralized Indians. The various scams involving nearly 300-400 crores of new currency have made normal citizen depressed who standing in the long queues was looking at the government with the eyes of hope. Whether demonetization will take the country to new heights or it will snatch the tag of developing country from India, it is still a question. The common man is thinking whether the nation is demonetized or demoralized. The paper discusses the bright as well as dull sides of demonetization drive. It tries to identify the effects of this move on the Indian economy as a whole. The paper is based on descriptive research design and tries to explore the hidden realities.

Keywords: India, Demonetization, Economy, Impact, Government

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I. Introduction

Having a wallet full of highest denomination currency is like being at the top of world, but one can't even imagine what will happen if the same currency converts at once in normal blank papers. One such jerk was given to Indian citizens by Prime minister of the country recently. Narendra Modi in a daring voice announced on 8th November 2016 the abolition of old high denomination currency as a bolt from the blue. This move of Prime Minister Modi is known as the boldest move since he came into power in 2014. He differentiated his government from others with many new steps like Swatch Bharat campaign, Adhaar card, opening of bank accounts, yoga day and many more, but change of currency was really a shocking move for entire India. It changed the perception of many overnight and made the currency valueless. The entire process was kept a complete secret. A young team of researchers were involved in this mission and the entire move was finalized at Modi's residence at New Delhi.

II. Methodology and Objectives of Study

The study focuses on extensive study of secondary data collected from various books, publications from various websites, which focused on various aspects of Demonetization. The study has been made with the following objectives:-

- a) To know the meaning of Demonetization.
- b) To study the position of India in the advent of Demonetization.
- c) To assess whether Demonetization was actually required in Indian economy.
- d) To discuss the detrimental effects of Demonetization.

III. Literature Review

Annamalai and Iiakkuvan (2008) discussed about the acceptability on electronic payments in the retail transactions. The authors discussed in detail the problems a country faces during the acceptability phase along with the bright future of using plastic money. Das and Agarwal (2010) put forth his views on the idea of being cashless. They described the benefits in the form of cutting down of costs and saving of tax and reduction in fraudulent transactions. Roy et al. (2016) assessed the short run and long term impacts of demonetization on the economies. The success of step depends upon the intention of government, circulation of black money, availability of credit and many other considerations. Kaur (2017) discussed the role and economic status of electronic payments system. She added that with increasing adoption of electronic payments, particularly those driving e-commerce and m-commerce, there is a growing demand for faster payment services which, in turn, facilitate ease in doing financial

transactions. Kumar (2017) Collected data from 100 respondents from Coimbatore district and researched the variables which affect significantly the outcomes of demonetization.

IV. Demonetization

A couple of days back many Indians did not even know what demonetization stand for. The dictionary meaning of demonetization is 'ending, termination or conclusion of something' which may be gold, silver or currency notes etc as no longer legal tender of a nation. Thus demonetization involves a radical move which makes the old currency relieved, as it is replaced by the new currency unit. In the process of demonetization, either all together new notes or coins of same currency are introduced or the old currency is entirely replaced by new currency. The concept is not a new phenomenon. In the year 2002, European Monetary Union nations demonetized their old currencies and took a step to introduce Euro. Similar step of demonetizing the currency was taken in Zimbabwe in the year 2015 to deal the problem of hyperinflation in the country. It took nearly three months to revamp the Zimbabwean dollar and stabilize the economy. Governments take the decision to demonetize the local units of currency due to variety of reasons:

- To control black money
- To combat corruption and forgery
- To combat inflation
- To discourage a cash system

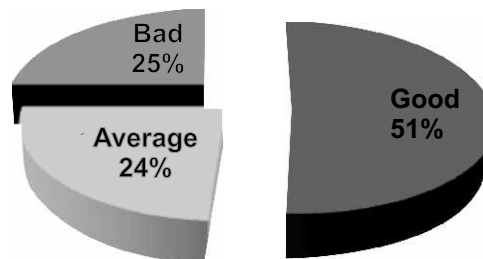
But demonetization is not a threat for all. Those who pay regular tax on the incomes need not worry and hurry. People get full value of their money back in the form of bank deposits. They can buy the things from past taxed income.

V. Indian Scenario

On 8th November 2016 Indian Government decided to demonetize two of the country's highest denomination currency and this decision scraped Rs 500 and 1000 notes. These two denominations account for nearly 86% of the total money supply in circulation with the public of nation (nearly 16.6 lakh crore). Prime Minister Narendra Modi suggested this step to tackle with certain major problems prevalent in the country, such as making the value of fake currency as zero, making the country cashless economy, blocking the terrorist financing programmes, elimination of black money, restricting tax evasion etc. Individuals had to exchange these two denominations from banks, while the bank accounts of customers would provide the real picture of economic status of citizens. Some economists

believe that in India demonetization was need of the hour and was due since long back. But the way demonetization is introduced in the economy, it has resulted in complete unexpected immediate financial chaos and confusion in the country. The nation is still in dilemma about the impact of this move, whether it is going to be a bane or a boon. In the initial days of demonetization nearly 51% people were supporting the demonetization move, but as the new currency scams are coming up and the length of queues in the banks are not reducing, people are getting frustrated. It seems that demonetization has demoralized the Indians. The various scams involving nearly 300-400 crores of new currency have made normal citizen depressed who standing in the long queues was looking at the government with the eyes of hope.

Rating of government's demonetization program conducted by Local circles with 9039 respondents dated 17 November 2016



Source: <http://www.localcircles.com>

VI. Was Demonetization Required?

Prime minister has proposed this move with certain motives. Demonetization may result in tight in regulatory system in the Indian economy, it is expected change the odds of the game. The move may offer the following positives:

1. Cashless economy: In India the fashion of transacting with cash is quite in. People feel comfortable to deal with cash. Many researchers have concluded that more than 50% of the transaction in India are undertaken with cash, thus cash hoarding is inevitable. According to Gurumurthy, till 2001 the growth of cash economy as a percentage of country's GDP was less than 10%. This growth should have gone down as we as a nation are moving towards e-economy with online banking transactions, internet money transfers, automated payment through instruction etc. But currently this percentage has increased to 12%, which is destroying quite alarming and is a sign of insufficient banking efforts. Further this ratio has been given a push by high denomination currency. Thus demonetization would be a strong step for making India Card Economy.

2. Security aspects: The fake currency in circulation is a question mark on the security of Indian economy. Taking the example of the state of Jammu and Kashmir, out of total old currency deposited in banks all over India, 3% are in this state. In spite of disturbance in the state, the citizens have stood up in the long queues for exchanging, withdrawing and depositing money. The instability in the state has declined to certain level, which is really a positive sign in this disturbed state.

3. Terror funding: According to the government one of the basic aims of demonetization is to control the terrorism in the country. It will make the fake currency coming from Pakistan useless. The funds with which terror agencies work are generally cash. Demonetization has made the currency available with these agencies as null and void. Either they have to deposit the funds in banks or the notes will carry no value. Many of these agencies work with counterfeit currency and most of them are of high denomination. Thus this fake currency will go out of the economy.

4. Positive Impact on economy: Undisclosed funds are primarily responsible for many evils such as poverty in our country. Finance Minister Arun Jaitley in his speech assured that demonetization will have far reaching positive impacts on the economy especially on GDP. With the huge amounts of deposits and flow of white money in the economy banks will be able to lend more funds to the agriculture sector and social sector at low interest rates. The money which was hidden in various sectors will become a part of banking system and banks will be able to use these funds for the development of economy. As the banks will have more funds at their disposal, the interest rates on loans will also come down. Further the money deposited in banks will be multiplied by the banks many times; this will have far reaching positive impacts on the development of economy.

5. Enhanced Tax collection: Demonetization will offer another hidden benefit of tax revenue to Indian economy. Due to advent of new currency, the entire cash needs to be deposited with banking system. Reserve Bank of India estimated that the total cash in circulation is nearly 12 lakh crores, out of which 3 lakh crores will never come back, as it is tied in many other forms of assets. But the money that will be deposited in the banks will be a great source of revenue (nearly 2 lakh crores) for the government in the form of tax payments. Thus willful tax evaders and defaulters may come on the right track.

6. Lower land prices: It is being expected that the prices of lands will come down by 30-40%. The property is such an investment area where most of the black money used to lie. The prices will come down to a reasonable level. Proper registration records will be maintained, which will make this sector legal. Other initiatives of government such as Goods and Sales tax, Benami transactions Amendment Act etc. will also facilitate the advancement of real estate sector.

Thus the move is being appreciated by many as the idea was to uproot many social evils. But the story has much darker side too. The side effects of demonetization drive can't be overlooked.

VII. Side Effects of Demonetization

According to an article by Ahluwalia (2016), demonetization is doing only half of the job, as it is targeting only the cash part of existing black money. It is not giving any thrust on the core areas which generate black income and the corruption/tax evasion. Thus demonetization has a darker side, part of which is visible and part is still not vivid. Some of the side effects of demonetization are:

1. Public Inconvenience: The nation is facing a major inconvenience by waiting in long queues for hours and days outside banks and ATMs. Even though the government and RBI has assured the countrymen many a times that sufficient currency is printed, but to everyone wonder they all come back homes empty wallets. Prime Minister promised people that the problem of long queues will be resolved very soon, but even after one month of the declaration of demonetization millions of people are still waiting in the queues for withdrawing their hard earned money. The harassment of people standing in queues and coming back empty wallets is really unbearable. Many deaths have also been reported.

2. Scams vs. Limits on withdrawals: Income tax department conducted more than 450 raids in the country and found that even the new currency has been hoarded by the criminals without any intimations and recording. Hundreds of cases are still unreported and crores of new currency has been seized. The IT department recovered nearly 5.7 crores (2000 notes) from Bengaluru, 76 lakh new currency notes from Surat, 10 lakh new currency from Gurugram, 85 lakh new notes in Mumbai, 100 crore new noted in Chennai. Has the country been able to eliminate black money, this is still a doubtful question. The government and RBI have mentioned that required currency is being printed, but the citizens are not getting it. The reason is that again the black marketers have started piling up the new currency. But the question is how this money in bulk quantity is going in the hands of hoarders. Either the banks or the government officials are involved in the scene and the unaccounted new currency is being transferred According to a report more than 30 cases have been referred to CBI for detailed investigation. Many other incidents are directing the attention for some serious issues.

The government has put a limit on the amount of money for general public that can be withdrawn. On the other side the scams of crores of new currency have shed the hopes of public.. It shows the signals of certain conspiracy on the part of banking sector and the government officials. The

living of a normal citizen like farmer, trucker, labourer and informal sector individual is entirely based on cash which has been drastically affected. Many poor citizens have lost their livelihood permanently.

3. Recalibration of ATMs: ATMs are crying without cash. The problem has been further aggravated manifold as the new currency is not of the same size as that of the retired one. Thus all the ATMs in the entire country required recalibration. This creates the doubt whether the government printed the currency without thinking of the recalibration requirements, otherwise at least ATMs must have been updated well in advance or the new currency with same size would have been introduced. Centre stated many times that they have taken all necessary steps to reduce the inconvenience of public, but is it really true. The answer is in the hearts and minds of public only.

4. Secrecy of the mission: The Supreme Court has raised questions to the central government about the secrecy of the demonetization mission. Many people filed petitions against Narendra Modi that his demonetization mission was known to some high class people. Some have questioned whether such major decisions be left to the whim of central people.

5. Lack of foresighted steps: The centre ordered to grant a limit for people upto Rs. 24000/- every week for each individual, but the condition has not been complied with. The acceptance of old currency at specified places was permitted till 15th November then shifted to 24th November, then to 30th November, then to 5th December, then to 15th December.....The way entire process is being handled it seems that the government has not done any analytical planning to deal with the challenges that are upcoming due to demonetization. Issue of a currency note of Rs 2000 doesn't seem to achieve the target sought to be achieved by the demonetization. The statements like "chaos will be over in 10 to 15 days" seem to be quite irresponsible.

6. Long term impact on real estate: The real estate sector is going through tough times since last some years. This sector contributes nearly 11% of the GDP to the nation and the maximum percentage of black unaccounted money lies in this sector. If this money comes out of real estate, the GDP of the nation may rise to higher level. The demonetization policy has given another sudden shock to this sector especially to land brokers. People who want to buy properties don't have cash to pay. The sellers are also not ready to accept money, as they will be liable to pay huge taxes to the government. Thus the prices of property are coming down like anything.

7. Effect on labourers: Demonetization has negatively influenced the income of labourers. This class works at lowest level of work hierarchy. They survive on minimum daily wages and generally deal with cash only. They are not being paid for their work. Some of the factors owners have relieved the workers with the promise that they will be called back when the

disturbed business environment will stabilize. The farmers are unable to sell their produce in the market, as cash is not exchanging hands. Another problem this class faced is standing in the bank queues for exchanging a minute amount of cash and losing day's wages.

8. Effect on GDP: The major impact has been seen in the informal sector of Indian economy. This sector contributes nearly 40% to the GDP of nation. Estimates have come up with the dreadful figures that demonetization move will slow down the country's growth by 0.5% in six months till the end of March 2017. It means that the GDP of the full year will come down to 3.5%, while the forecast for the year was 6.8%.

The effect of demonetization seems to be positive in the short run. But some facts are really eye opening. According to Fitch report, the positive impacts of demonetization will not be long term for the banking sector. These benefits in the form of tax revenues would be soon set aside due to lowering of GDP growth rate. This rating agency has also predicted the negative impacts of this move on Indian banking sector. The negative effect on GDP will go along with the disruption period. The longer this period continues, more will be the impact on GDP.

VIII. Conclusion and Recommendations

The move seems to be an appreciable step by the Modi government, as the intention is to stop tax evasion and to uproot corruption. But the smooth transition of this move must have been facilitated. Government has given plea that public may have to suffer short term pains for long term gains. The public is ready to bear short term pains but there is a doubt that what types of gains will accrue and when? Commonly raised question is whether demonetization solely will be able to uproot corruption. The modern black marketers have found new ways to tackle with the situation: the currency is being replaced with 30-40% commission; people are saving tax by showing their income as agricultural income, as it is exempted from tax u/s10 of Income Tax Act. Another heart breaking issue came on the scene when RBI announced that banks will be required to submit CCTV recordings for this transition period. The surveys found that most of the banks don't have CCTV cameras and where the cameras are installed they aren't working. Such issues give birth to some serious questions: whether we were ready for demonetization, some other aspects must have been taken in account before this move.

The country is moving towards card economy, but this swipe and digital system has put forth many security challenges. The crux is that demonetization is not a magic wand, but it can be helpful as a part of comprehensive strategy to deal with corruption and black money. The government and the opposition parties are fighting on the issue of

demonetization, but no one is able to solve the practical problems. This cash crunch may have long term impacts in various sectors and may also prove to be constructive disruption.

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