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Demonetisation- A Way to Re-boost the Economy

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ABSTRACT

Demonetisation, a commendable step taken by Modi government which is withdrawal of a particular currency from its circulation so as to curb the black money and to create the cashless transactions across the country. Terrorist funding, money laundering, counterfeit currency notes and black money being the specific most reasons behind the move of demonetisation. For the first time, demonetisation came into picture in 1946, and in 1978 for the second time and this is the third time in India. Demonetisation lead to various identifiable challenges faced by the general public. This paper elucidates the impact of demonetisation on the availability of the finances by the government and throwing light on the pros and cons of demonetisation.

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Introduction

Objectives

The paper will be dealing with the various objectives of demonetisation.

1. The first most being the meaning and purpose of demonetisation.
2. Secondly, the focus will be on advantages and disadvantages of demonetisation.
3. Lastly, the impact of demonetisation which took place on 8th November 2016.

Research Methodology

This is a purely descriptive study and the sources for the same are journals, books, newspaper articles and various well known sites.

Demonetisation means when a legal currency loses its legal tender. Basically it can be termed as process of replacing the old currency of the country by a new currency whereas Remonetization means bringing back the legal tender of the currency.

In other words it can be explained as banning the old currency and bringing up of the new currency. Cancelling the legal tender of old currency.

The process involves either introducing the new coins or notes which completely replaces the old currency or same as the old currency

For e.g. In India on 8/Nov/2016 PRIME MINISTER in his speech talked about legal tender of Rs.500 AND Rs 1000 notes. He said the from 00:00 of 8/11/2016 Rs.500 and Rs.1000 notes loses there legal tender and introduces new currency in a form of new RS.2000 notes and RS.500.

Demonetization is done by the person or group of persons who have supreme authority of doing so. Recently in India, Government of India vide their Notification no. 2652 dated November 8, 2016 have withdrawn the Legal Tender status of Rs 500 and Rs 1,000 denominations of banknotes of the Mahatma Gandhi Series issued by the Reserve Bank of

problems and dealing with black market, money and terrorism with fake notes.

During this process people were allowed to deposit their money in Reserve Bank of India or in their respective banks from Nov/10/2016 to Dec/30/2016 and new notes of 2,000 and 500 will come in action. Citizens of India can get their cash exchanged amount Rs 4,000 per person from the counter of bank¹.

In 2016, the Indian government decided to demonetize the 500- and 1000- rupee notes, the two biggest denomination notes. These notes accounted for 86% of the country's cash supply. The government's goal was to eradicate counterfeit currency, fight tax evasion, eliminate black money gotten from money laundering and terrorist financing activities, and promote a cashless economy. By making the larger denomination notes worthless, individuals and entities with huge sums of black money gotten from parallel cash systems were forced to convert the money at a bank which is by law required to acquire tax information from the entity. If the entity could not provide proof of making any tax payments on the cash, a tax penalty of 200% of the tax owed was imposed.

Black Money and Demonetisation

Black Money is regarded as one of the most important and main reason behind demonetisation.

Black money is a sin which is harming our economy and instead of achieving the economic growth at the rate of 8 percent per annum, we have achieved only 5 percent. Black money is the major restraining factor in the process of national economic development. The richer is getting richer and the poor is getting poorer due to menace of black money.

¹ www.rbi.org.in

Black money could be eradicated from our economy only through the strict efforts of the government. In order to achieve a country free from black money, people should disclose their real income and must pay taxes regularly. People should avoid unhealthy means of making currency.

There are various sources² of black money:

- Import licences.
- Transactions in heavy industries.
- Release of industrial license.
- Transaction in public sector.
- Forged and fake currency.

Sometime, it can be said that the government itself is responsible for the creation of black money as the burden of multiple taxes on income, sales, revenue leads to tax evasion. Due to such high and multiple rates of taxes, the honest person will be left with the little money after he pays the taxes. Black money is considered as an evil for economy.

There are various reasons³ for the same:

i) Illegal Activities, one of the major cause of black money: There are certain activities like gambling, production of liquor, drugs, smuggling which are considered as crime under the Indian law. When the private individual wish to indulge in these activities, the income generated will obviously be the black money. Public expenditure: The government itself lives in the glass house as the rapid growth of its spending over the last two decades has been a major factor in generation of black money⁴.

ii) Political funding: Political parties are the major party for political funding. In today's scenario, contesting of elections only has become a very costly affair. The so elected person has to spend a lot of money for getting the ticket which can only be arranged with the help of black money.

iii) Inflation: Inflation is also one of the cause of black money. According to one of the economist⁵, inflation leads to the growth of parallel markets and strengthen propensities to hide incomes and to evade taxes.

iv) Faulty taxation⁶: Due to effects in taxation structure, black money has generated at a large extent because tax rates on income and on wealth are very high which ultimately causes evasion. Though there are various tax laws, but the enforcement of the same is weak due to corruption.

v) Inadequacy of Powers: The inadequacy of power which has been given to the tax enforcing authority is also one of the major cause for black money.

vi) Lack of publicity: The secret provision of the direct tax laws, is one of the major responsible factor for creation of black money. When any person is caught or penalised for keeping the black money, he is kept secret from everyone because the department prohibits the disclosure of any information relating to assessment of person.

History of Demonetisation

This is not the first time, the step of demonetisation has been taken in India. Earlier also, there were times when this step was taken like in:

12th January 1946 Demonetisation:

In year 1946, government took a major step to deal with the black marketing in the country by issuing the demonetisation ordinance. By taking in consideration the action in several foreign countries including France, U.K and Belgium. Under this ordinance the government notified that the currency note of value of rupees 500, 1000 and 10,000 cease to be the legal tender.

The penalty for the contravention of the ordinance or any false declaration was imprisonment up to three years or fine or both. The move was called a "death -blow" to black marketers.

Impact of 1946 Demonetisation:

The demonetisation ordinance was a complete surprise to the speculators because the demonetisation came out as an unexpected move taken by the government. It was reported that people were unofficially buying and selling rupees 100 currency notes at anything between 95 to 97. Currency notes sold for 60 or 70 percent of their value. Gold which shot up from rupees 73 to 96 earlier was quoted at rupees 82 after demonetisation ordinance.

The outcome of 1946 demon was almost a failure as most of the notes were exchanged and hardly anything get demoned. The measures did not succeed because as by the end of 1947, out of the total issuance of rupees 143.97 Crores of high demonetisation notes, rupees 134.9 crores were exchanged. Thus, notes worth only rupees 9.07 crores were demonetised and not have been presented⁷. Sir chintaman in his lecture⁸ mentioned that, "demonetisation was more of a conversion at varying rates of profits and losses"

16th January 1978 Demonetisation:

The second demonetisation step was taken in 1978 when Janata party government proclaimed an ordinance about the same. Janata party government took an initiative to attack the assets that were being used for fraudulent purposes. This demonetisation ordinance was announced via All India Radio in 1978, the then governor I.G Patel was not in favour of demonetisation ordinance because in his view some people in the government saw demonetisation as a measure specifically being targeting the corrupt government or the government leaders. He in his book⁹ mentioned that such an exercise generally produces:

- The striking results.
- The black money holders do not tend to keep the ill gotten earning in form of the currency for long.
- The corrupt people have the chance to convert their notes through paid agents.

The reason behind the ordinance was that high denomination notes facilitating the illegal transfer of money

² 23rd March, 2015, Reasons for and Problems of black money,

<https://www.ukessays.com/essays/economics/reasons-for-and-problems-of-black-money-economics-essay.php>

³ Taxation, Causes of black money in India, <http://accountlearning.com/causes-black-money-india/>

⁴ NIPFP Report, Taxation, Causes of black money in India, <http://accountlearning.com/causes-black-money-india/>

⁵ Dr.Brahmananda, , Taxation, Causes of black money in India, <http://accountlearning.com/causes-black-money-india/>

⁶ Smritichand, The Causes of black money, <http://www.yourarticlelibrary.com/economics/what-are-the-causes-and-remedies-of-black-money-in-india/3016/>

⁷ Digging through India demonetization history, <https://mostlyeconomics.wordpress.com/2016/11/11/digging-through-india-demonetization-history-12-jan-1946-saturday-and-16-jan-1978-monday/>

⁸ Dadabhai naraji memorial prize fund, <https://mostlyeconomics.wordpress.com/2016/11/11/digging-through-india-demonetization-history-12-jan-1946-saturday-and-16-jan-1978-monday/>

⁹ I.G Patel, Glimpse of Indian Economic Policy

for the financial transaction which were adversely affecting the national economy as it was favouring the illegal purposes.

Impact of 1978 demonetisation:

No support was given from the then RBI Governor in 1978. Low quantum of higher denomination notes in sufficient secrecy. Very low fraction of black money holders turned up.

In 1978, the notes of higher denomination resulted in only 15% of the total currency. Wanchoo committee's recommendation was also a failure for the 1978 demon as the discussions gave ample time to the black money holders to get rid of their illegal assets which ultimately resulted into non fulfilment of the decisions¹⁰.

Demonetisation in Different Countries Across the Globe:

• Pakistan:

The step for demonetisation was taken in June 2015 with demonetising rupees 5 and 500 currency. People of Pakistan had one and half year time to exchange their notes. The result of this demonetisation was a failure hence it was messed up.

• Zaire:

Demonetisation in Zaire took place in 1990. It led to economic instability in the country and thus making it vulnerable for the foreign funding. Thus failed.

• Zimbabwe:

The demonetisation took place in 2010. It was a failure ultimately leading to replacement of currency by the U.S Dollars.

• U.S.A:

The demonetisation took place in 1969. The country was losing its sheen built on Silicon valley due to which the then U.S President announced all bills above Dollar 100 null and void. Demonetisation in U.S.A. was a great success.

• Australia:

To curb the black money Demonetisation took place in 1996. Australian government improved the security features on notes. They replaced paper based notes with the polymer based notes of the same denomination. Demonetisation in Australia was a great success and thus making Australia a business friendly country.

• North Korea:

In North Korea, the then dictator decided to remove two zeroes from the currency so as to curb black money in 2010. The demonetisation was miserably failed.

• Nigeria:

The step of demonetisation was taken in 1984. The Nigerian government announced the Demonetisation of all existing currencies to improve the high inflation debt economy. The step taken led to a great failure.

Impacts of Demonetisation

• Time bound impacts¹¹

Very short term impacts:

With removal of 86% of currency in circulation, demonetisation has led to a severe contraction in money supply in the economy. With result of this contraction, cash balances have been wiped out, thus eliminating number of transactions for a while as there was not enough means of cash exchange available. Demonetisation has adversely affected the individuals who earn incomes in cash and spend

it in cash. Individuals earning incomes in non cash forms were also affected.

Talking about the various sectors in the economy, all those sectors where demand is backed by the cash are adversely affected. For example; transport services, kirana stores, fruits and vegetables sellers etc. Instead of reduction in prices of commodities, their prices hiked up where people take the recourse to credit. Also, it will lead to compression of the demand for the non-essentials by the agents in the economy at the time of uncertainty. A further impact of demonetisation in the very short run is the real estate space.

Short term impacts:

In the short run, due to fall in consumption, the GDP Growth of the economy has been poorly impacted by 0.5-1%, with low demand pertaining to liquidity issues, the inflation is also likely to fall. Also, the interest rates will come down in the short run. The short term effect on the economy due to demonetisation depends upon the extent to which and speed with which the authorities replace the cash. The shorter the time period of replacement, the little will be the effects, but the agricultural industries, automobiles industries and the construction sector are to be severely affected.

If the authorities wish to replace only a certain portion of the total cash, then the people may suffer some other adverse changes. Until and unless, people get familiar with the functioning of the demonetising authorities, they will have to face certain problems for the same. People have to shift to digital version as the means of exchange of money so as to cope-up with the problems thus fulfilling of the motto "Digital India".

Long term impacts:

In the various discussions on demonetisation, it has been refereed consistently that the credit creation is increasing in the economy like Finance Minister Arun Jaitley says "bank deposits will increase and they will have more capacity to support the economy".

With the restriction on cash economy, the tax net has been broadened, ultimately resulting in paving the way to greater GDP in long run. The reduction in demand can have a lagging impact on inflation due to which the prices may remain either flat or fall in the long run. Taking in concern, the effects of demonetisation, it is likely to increase in the size of formal economy due to which tax collections will also improve.

International Image of Demonetisation

With the news of demonetisation by Modi Government that 500 and 1000 notes would no longer have a legal tender lead to severe havoc amongst the political circles and media being extensively active on this issue worldwide. Talking about Pakistan only, the reporters thereof were discussing the issue and praising PM Modi's move. This move also managed to seek attention of foreign Media.

Chinese media appreciated the PM Modi's move and also suggested that for a country to be free from corruption, more than banning currency note is required. There shall be proper reformation of the system. They have called this move "a bold and a decisive step".

Singapore government was also in favour of steps taken by the PM Modi in order to curb black money and corruption. They also mentioned that the same move was adopted by the Singapore's first Prime Minister, the Late Lee Kaun Yew.

According to The New York Times "the cash is the King in India". They were not exactly in favour of this move, the editorial read- the change has thrown the economy into the

¹⁰ Quora.com

¹¹ <http://www.businesstoday.in/current/economy-politics/demonetisation-long-term-and-the-short-term-impact/story/241439.html>

turmoil, forcing the millions of people to que up in lines in order to get their money exchanged, moreover, many people do not have Bank accounts and Credit Cards.

According to the former Prime Minister Manmohan Singh, who is a well known economist, former RBI Governor and former Finance Minister of the nation: the move of demonetisation is considered as an 'organised loot and legalised plunder'.

• Industries Specific

The impact of demonetisation on the industrial growth was more severe than it was anticipated. The furniture, office equipment, non-metallic minerals, publishing, papers and tobacco industries were contracted in November. Moreover, the industries like food products, textiles, leather, wood, chemicals, rubber shrunk in December.

The transport equipment industries and rubber industries, being the most stable industries also faced contraction in the production due to demonetisation.

• Impact On General Public

General Public has to suffer a lot due to the process of demonetisation which took place on 8/November/2016. But even after lots of chaos public is still supporting cleaner India.¹² There are various impacts on general Public:

❖Discomfort:

Demonetisation caused discomfort as common people have to stand in long queues and get their money deposited in bank or get their money exchanged with new currency and discomfort caused due to long ATM lines.

❖Corruption:

Due to grubbing down of the old currency it will result in less corruption as it cut down the black money and it will result as positive for common people.

❖Poor public:

People who work on daily wages have to suffer a lot during this time of year as people have no cash in hand to pay people who work on daily wages and due to this category of people are facing a lot of problems.

❖Shortage of cash:

People even after standing in long queues in bank still not getting their money exchanged as banks are short with money. This left people in frustration.

❖Marraiges:

People having wedding had suffered a lot during this process because of low cash and bank is providing with the limited amount of cash and which was creating a chaos in their happiness.

Challenges Faced by the Economy During Demonetisation (8th November 2016)

• **Inadequate Infrastructure:** The biggest challenge faced by the economy was inadequate infrastructure related to ATM as well as point of sale terminals. As rural areas was having no proper concentration of ATM.¹³

• **Atm Short Tray:** While this process ATM tray was found to be short for the new currency. And which was resulting in chaos as ATM were not suitable for the new currencies.

• **Currency Chest:** It was seen that there was no proper availability of currency which left public in a great disappointment. There was lack of money in banks, ATMs,

which resulted in poor growth in market and various losses of people who work on daily wages.

• **Customer Awareness:** Most of people living in backward areas or people living in rural areas were not aware or were not having proper knowledge of digitalization process and there was no awareness drive was also made, which left people in chaos to deal with day to day life for period of time.

• **Fake Bank Accounts:** Fake accounts were made for doing illegal transactions. Banking frauds during this process of demonetisation was increased and made many people suffered a lot. Also, this resulted in Increase in white collar crimes.

• **Frauds:** Frauds like people getting a call saying they are calling from particular bank and asking for their bank details and due to lack of knowledge people shared their personal information which lead to loss of their money. Demonetisation resulted in double frauds.

Advantages and Disadvantages of Demonetisation:

Advantages:

• **Increase In Bank Deposits:** Around 86% of Indian currency was in the form of 500 and 1000 Rupees, due to demonetisation people had to deposit these notes in the banks thus increasing bank deposits. Also, the deposit base has been increased because now the people deposit more and store less physical currency with themselves.

• **Halt Over Hawala Transactions¹⁴:** Hawala is a process in which there is a transfer of money from one place to another but there is no actual money movement. These methods are commonly used for money laundering and terror financing. Hawala transactions got adversely affected by the demonetisation.

• **Direct Boost in Jan Dhan Yojana:** Before the step of demonetisation, the Jan Dhan Yojana accounts has many dormant and unused accounts but after demonetisation, there was a certain spike in usage of these accounts, thus leading to a boost in Jan Dhan Yojana.

• **Halt Over Terror in Kashmir:** Due to demonetisation, the riots in Kashmir came to a stop as there was lack of money supply to the people who were indulged in the riots.

• **No More Black Money:** Black money is considered as the biggest disease of any economy. It weakens the foundation of any Country. Demonetisation is acting as an efficient countermeasure against black money, step resulting in putting an end to the circle of people doing illegal activities to earn black money and using that black money for more illegal purposes.

• Disadvantages:

• **Small scale industries:**

Small scale industries are in big loss after demonetisation as mostly cash transactions are more as compare to other forms of transactions in these industries.

• **Farmers:**

Farmers are most affected by the process of demonetization as November being the Rabi season, farmers in place of being at their farms are standing in the queues of the bank and having very less knowledge of banking system

¹²ShridhaDugar,Impact,<http://www.quora.com/How-the-currency-demonetisation-affect-the-common-man-in-India>

¹³MD & CEO of National Payments Corporation of India,challenges,<http://www.thehindubusinessline.com/27/nov/2016>.

¹⁴ Shashank kulshreshtha, <http://www.examsthisyear.in/2016/12/advantages-of-demonetisation-in-india.html>

are suffering a lot and it will indirectly affect the crops grown in rabi season.

- **Daily wage earner:**

Daily wage earner are also suffering, for eg: people have less cash in their hand and due to this they are avoiding to buy goods from the market. For some time people are in loss as markets are not working as they were supposed to work before demonetization.

- **New currency:**

New currency worth Rs.2,000 is released in market and that will result to more corruption. As higher the currency more easily the corruption.

- **Banking fraud:**

During the process of exchange of money after demonetisation many banks are seen to be involved in banking frauds i.e. involved in activities which are illegal. Taking corruption to all new level.

Recommendations

Though the step of demonetisation is very beneficial for the nation, but then every system has certain flaws, so the case is with this move. These flaws can be minimised by taking into account various measures.

1. Firstly, there should be proper availability of the new currency to the general public.
2. Secondly, fewer number of ATMs lead people to queue up in the long lines due to which there was wastage in their times and also the size of the ATM tray should get enlarged up in order to minimise the chaos.
3. People should be trained well before in advance to make them aware of digitalisation and electronic media.
4. There should be a proper check and balance on the activities of the bankers while providing people with the new currency notes as bankers by using their positions, tries to play smart by making various profitable deals for themselves and one being: bankers exchanging the old currency

amounting to rupees one lakh with the new currency amounting to rupees Ninety Thousand, thus, making profit of Rupees Ten Thousand and hence, defrauding the government.

Conclusion

The process of demonetisation is like the two faces of a coin. On one hand, it will provide advantages to the nation but on the other hand, it will definitely create some temporary and some permanent problems. But, if comparing advantages with the disadvantages, it can be said that the former prevails over the latter.

In order to bring into picture the transparency and efficiency in the economy, it is preferable to go hand in hand with digitalisation. But, it is impossible to depend completely on digital economy because for daily usage cash is required as well.

To meet the demand of currency, the government has taken all the possible measures and actions and the problems faced by the Public were get over with the smooth flow of new currency. Change is the requirement of every system, certainly there are issues and problems related to demonetisation, but then nothing is easy and the step of demonetisation has been taken solely for the good of the nation. Atleast, the black money will be eradicated out of the nation and people will learn to use and trust banking more than before.

The fake currency now has been trashed out of the system but then a mandatory day to day check is required as there are possibilities that criminals will try to copy the high denomination notes too. Government agencies will have to work really very hard in order to make economy a cashless economy. Though, the beginning is good but then it needs to be taken to the logical conclusion.