

Impact of demonetization on Indian economy

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Abstract

Demonetization has offered both challenges and opportunities in the digitization of the Indian economy. The government has implemented a major change in the economic environment by demonetizing the high value currency notes – of Rs 500 and Rs 1000 denomination on 8th Nov.2016. Demonetization refers to Withdrawal of a particular form of currency from circulation. Demonetization is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency. The main objective of this paper is to study the impact of demonetization on Indian economy and system. The paper is based on the secondary data. The secondary data was collected from various published sources like reports, magazines, journals, newspapers and websites etc. This paper concludes the impact of recent demonetization on the Indian system. The currency is demonetized third time by the present Modi government. This is the bold step taken by the govt. for the betterment of the economy and country. Demonetization works as a cleaning agent and can produce many good things for society.

Keywords: demonetization, economy, economic environment

Introduction

Demonetizing is Progressive shift to a cashless economy with a greater focus on electronic transactions is being envisaged. Demonetization is a radical monetary step in which a currency unit's status as a legal tender is declared invalid. This is usually done whenever there is a change of national currency, replacing the old unit with a new one. Demonetization is the act of stripping a currency unit of its status as legal tender. The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency.

Legal tender is any official medium of payment recognized by law that can be used to extinguish a public or private debt, or meet a financial obligation. The national currency is legal tender in practically every country. The opposite of demonetization is demonetization, in which a form of payment is restored as legal tender.

Demonetization in India

The act of demonetization 2016 is not happening for the first time in India, but before it, has happened twice, first in the year of 1946 and then in the year of 1978.

The Indian rupee (INR) is the official currency of India. The recent sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. It is also interesting to note that this was not the first time the Government of India has gone for the demonetization of high-value currency. Rs 1,000 and higher denomination notes were first demonetized in January 1946 and again in 1978.

Demonetization across the World

Such a step, for example, was taken when the European Monetary Union nations decided to adopt Euro as their currency. However, the old currencies were allowed to convert

into Euros for a period of time in order to ensure a smooth transition through demonetization. Zimbabwe, Fiji, Singapore and Philippines were other countries to have opted for currency demonetization.

In India's case, the move has been taken to eliminate the black money and fake notes by reducing the amount of cash available in the system.

Objectives

The main objective of this paper is to study the impact of demonetization on 8th November 2016 by the present government on Indian economy and system.

Methodology

The paper is based on the secondary data. The secondary data was collected from various published sources like reports, magazines, journals, newspapers and websites etc.

History of demonization

Demonetization before Independence

In January 1946, Rs 1,000 and Rs 10,000 banknotes were withdrawn but the same Rs 1,000, Rs 5,000 and Rs 10,000 notes were reintroduced in 1954.

Demonetization after Independence

The government's move to demonetize, even then, was to tackle the issue of black money economy, which was quite substantial at that point of time. In January 1978, the Janta Party government demonetized Rs 1,000, Rs 5,000 and Rs 10,000 notes which was quite substantial at that point of time. The move was enacted under the High Denomination Bank Note (Demonetization) Act, 1978. Under the law all "high denomination bank notes" ceased to be legal tender after January 16, 1978. People who possessed these notes were given till January 24 the same year — a week's time — to

exchange any high denomination bank notes. The main difference between then and now is that currency of higher denomination was barely in circulation, unlike the Rs 500 and Rs 1000 note today.

Demonetization in India by PM Narendra Modi

On November 8, 2016 evening, Prime Minister Modi, in his televised address to the nation, made Rs 500 and Rs 1000 notes of Mahatma Gandhi Series invalid, saying that it was aimed at curbing the “disease” of corruption and black money which have taken deep root. People holding notes of Rs 500 and Rs 1,000 can deposit the same in their bank and post office accounts from November 10 till December 30. All notes in lower denomination of Rs 100, Rs 50, Rs 20, Rs 10, Rs 5, Rs 2 and Re 1 and all coins continued to be valid, and new notes of Rs 2,000 and Rs 500 were introduced. There was no change in any other form of currency exchange be it cheque, DD, payment via credit or debit cards etc.

Reasons of Demonetization

According to The Reserve Bank of India, the most important reason for the demonetization of 500 and 1000 rupees note was the rise of fake currencies of the same notes, and also the higher occurrence of black money in the economy. Prime Minister of India, Mr Narendra Modi, took the entire country by surprise when he declared demonetization of INR 500/- (USD 7.69) and INR 1,000/- (USD 15.4) currency on 8th November, 2016. As per Modi Government, the agenda of this move was 3 fold:

To eliminate counterfeit currency

To shrink the size of the parallel economy and black money in India and to reduce corruption

To create room for further monetary accommodation

To Positive impacts from bond market perspective

To rise in GDP growth potential

Impact of demonization

In a country where 68% of the transaction are cash based (as per CLSA data), a move like this is definitely going to have several long- as well as short-term impacts.

- 1. Black money:** At one stroke the Prime Minister has choked the supply of black money stacked inside the country. Black money operators run a parallel economy which shakes the very foundation of the Indian economy. With Modi’s demonetization move, all domestic black money will either be deposited into the banks with heavy penalty or be simply destroyed.
- 2. Economy:** Demonetization will have a huge resultant effect on the Indian economy. First, it will bring more borrowings to the exchequer, improve inflation outlook, increase India’s gross domestic product (GDP), revive investment opportunities, give a fillip to infrastructure and the manufacturing sector and reduce interest rates and lower income tax rate.
- 3. Real Estate Cleansing:** It is said that real estate is an industry built on black money. Modi’s demonetization move will curtail the flow of black money into the real estate sector. This will help in making the much needed correction in the sector.
- 4. Hawala transactions:** Hawala is a method of transferring money without any actual money movement. Hawala route is used as a means to facilitate money laundering and

terror financing. Hawala rackets run again on black money. Demonetization has crippled the hawala rackets.

- 5. Counterfeit Currency:** Counterfeit currency seriously devalues the real worth of Indian currency. With Prime Minister Modi’s decision to pull out the old Rs 500 and Rs 1,000 notes and replace them with new Rs 500 and Rs 2,000 series has completely stalled the circulation of counterfeit Indian currency. Experts say the new currency notes have come with advanced security features which are almost impossible to replicate.
- 6. Terror Financing:** With the circulation of counterfeit Indian currency completely stalled and hawala transactions stopped, all windows for terror financing are closed.
- 7. Maoism:** Demonetization has hit the Maoists and their movement hard. No wonder, with Modi’s demonetization drive, all those illegal money are reduced to paper scrap.
- 8. Kashmir Unrest:** The four-month-long unrest in Kashmir valley is on a backburner, thanks to demonetization. No stone pelting on security forces has been reported in Kashmir ever since the demonetization announcement was made. It won’t be wrong to say that “stone pelted” Modi completely shattered the Kashmir unrest with his stone called demonetization.
- 9. North-East Insurgency:** Demonetization has severely affected the multiple militant groups operating in the North-East.

Short Term Effects

While this is the third time in the Indian history that Indian high value currency has been stripped of its status as a legal tender, the first two instances of demonetization did not have an impact like the recent one. This is primarily because, this time, the demonetized currency represents 86% of the total currency in circulation. Despite facing the opposition’s ire, the Prime Minister, in an impassioned plea on Sunday, urged the people to support the move while asking them to bear the “pain for 50 days” to help him deliver the “India of your dreams” and also warned that several other steps were in the offing to curb the menace of corruption. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn’t have the digital transaction culture. Overall economic activities will be dampened in the short term.

The end of the year also saw a high-profile family split. The 149-year-old Tata group, the largest in the country and the most respected, with a global turnover of more than \$100 billion, sent shockwaves through corporate India with the ouster of Chairman Cyrus Misty.

misty took charge four years ago after a search panel was appointed to find a replacement for Ratan Tata, who was turning 75. The 50-year-old misty was a surprise choice. And problems were apparently building for a long time under the surface.

Following the announcement, there were huge crowds outside ATMs across the country as people lined up to withdraw currency of smaller denominations. Banks were advised Sunday to increase the Cash Withdrawal limit at ATMs from the existing Rs 2000 to Rs 2500 per day in the recalibrated ATMs. The weekly limit of Rs. 20,000 for withdrawal from Bank accounts has also been increased to Rs 24,000 and the limit of Rs 10,000 per day has been removed. The exchange

limit over the counter has also been increased from the existing Rs 4000 to Rs 4500.

Conclusion

This is a historical step by the Modi Government and also supported by all. This decision of govt. will definitely fetch results in the long term. But it has been taken care by Government that the public that a person who changed his higher value cash will get exactly the equal amount in lower denominations. While bank employees are working overtime to make Modi's ambitious demonetization drive a success. Demonetization though welcomed by people across the country, has left many in the lurch. This move will lead to improve tax compliance, better fiscal balance, lower inflation, lower corruption, complete elimination of fake currency and another stepping stone for sustained economic growth in the longer term.

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