

India's Demonetization Exercise – 2016: An overview

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Abstract

The demonetization move by the Government and its rationale and impact are being debated by all concerned, in homes and newsrooms. In the dark night of Tuesday, 8th November 2016, a bold initiative taken by the Government to ban Rs. 500 and Rs.1,000 currency notes from circulation from the midnight of that day was announced by the Prime Minister. The ultimate aim of this scheme was said to be eradication of the deep roots of shadow economy from India and to make the nation free from the clutches of huge forces holding unaccounted money. The scheme has evinced a mixed reaction from Indian subjects all over the country. The main aim behind the demonetization of high value notes was the eradication of black money. In a surprise announcement on November 8, the Government withdrew notes of denominations of Rs.500 and Rs.1,000 as legal tender, rendering 86 percent of the currency circulating in the country worthless. In taking such an important economic decision affecting almost all people in the country, "the Government did not find it necessary to promulgate an ordinance, which is the tried, tested and constitutionally valid way to bypass the legislature. The Government used "a gazette notification to bypass the legislature and implement a decision that affected the entire population and caused significant collateral casualties". So, the decision of the Government to demonetize the high value currency notes simply by using a gazette notification to bypass the legislature (parliament) has made all of us to ask a question: is there a democratic deficit in India?

Keywords: Currency, Demonitization, Black Money, Fake Notes, Cashless Economy, Bank

1. Introduction

The demonetization move by the Government and its rationale and impact are being debated by all concerned, in homes and newsrooms. In the dark night of Tuesday, 8th November 2016, a bold initiative taken by the Government to ban Rs. 500 and Rs.1,000 currency notes from circulation from the midnight of that day was announced by the Prime Minister. The two demonized currency notes accounted for approximately 24 percent by volume and about 86 percent by value of the currency in circulation. This bold decision was considered as a historic move in the Economic History of India. The ultimate aim of this scheme was said to be eradication of the deep roots of shadow economy from India and to make the nation free from the clutches of huge forces holding unaccounted money. The scheme has evinced a mixed reaction from Indian subjects all over the country. The main aim behind the demonetization of high value notes was the eradication of black money. The next grave malady was the fake currency in circulation. Over the past few years fake notes were in circulation in the Indian economy, which mainly consisted of Rs.500 and Rs. 1,000 currency notes.

1.1 Pats for the scheme

Microsoft founder Bill Gates has applauded the Prime Minister Narendra Modi for the bold decision taken to demonetize Rs. 500 and Rs.1,000 rupee notes. Mr. Bill Gates has commended, "It is a bold move and will deflate India's shadow economy". While delivering the second transforming India lecture organized by NITI Aayog on Wednesday the 16th November 2016, Gates said "The shift of digital transaction will enhance transparency and reduce leakages". Gates stated further, "The Prime Minister's bold move to demonetize high value denominations and replace with new notes with high security

features is an important step to deflate India's shadow economy". He added further that "Has all the pieces in place for a compelling vision for digital financial inclusion. Aadhaar will convert a cumbersome, paper – based account opening process into a 30 second, all digital system". "The impending rollout of payment banks and the ambiguity of mobile phones can enable access for all Indians to digital accounts connected to a fraud- resistant interoperable payment system" Bill gates added.

Mr. Muhammad Yunus, founder of Grameen Bank and winner of Nobel Peace Prize in 2006, told "the Hindu" on 5th January 2017 "cashless economy is a boon and demonetization had to come someday". French Economist and winner of the 2014 Nobel Prize in Economics, Jean Tirole when delivering the Dipak Banerjee lecture at Presidency University in Kolkata on 5th January 2017 said, "you cannot get the corrupt money right away because the money has already been invested in real estate, gold and other things". Such a move, however "will make future corruption more difficult".

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made all of us to ask a question: is there a democratic deficit in India?

1.2 Brickbat against the Demonetization Decision by the Government

Former Prime Minister Dr. Manmohansingh calls the demonetization scheme announced by Prime Minister Mr. Modi, “a monumental disaster” and terms its implementation a case of “organized looting and legalized plunder”. He says that the demonetization decision could lead to the GDP declining by two percentage points.

The opening attack on the Government for its demonetization decision Dr. Manmohansingh made the above observations in the Rajya Sabha on Thursday the 24th November 2016, in the presence of Prime Minister Mr. Narendra Modi and the Finance Minister Mr. Arun Jaitley. Quoting the eminent British Economist of the 20th century, John Maynard Keynes, Dr. Singh said of Mr. Modi’s call to wait for 50 days, “ I am reminded of John Keynes, who once said, “ In the long run, we are all dead”. Dr. Manmohan singh, who led the opposition attack on the Government’s demonetization exercise in the Rajya Sabha asked the prime Minister to name “any country, he may think of where people have deposited their money in the bank, but they are not allowed to withdraw their money” which alone is “enough to condemn” what has been done in the name of the greater good of the people. Another criticism put forth by Dr. Singh is that the banking system comes with the modification of the rules, the conditions under which people can withdraw money. Such frequent modifications in the rules, Dr. Singh said, reflect very poorly on the Prime Minister’s office, on the Finance Minister’s Office, and on the Reserve Bank of India. He concluded that the monumental mismanagement of implementation of the demonetization scheme was the main reason for the difficulties and hardships that people are undergoing as a result of demonetization exercise undertaken by the Government.

Some writers and critics opine that the banks when they are paying only a small fixed amount of money (say Rs. 2,000 or Rs.24,000 as the case may be per week) in compliance with the directive of the Government or RBI they are committing a Breach of contract entered into between the banker and customer at the time of opening the account with the bank. As per the contract the relationship between the banker and customer is that of a debtor and creditor and the banker as per the contract cannot deny the payment of money demanded by the customer as long as there are enough funds in the account. However, this legal lacuna in the way of implementation of the demonetization scheme is to be decided by courts of law.

1.3 Implementation Hurdles

Our economy, which has more than 125 crore people, with more than 25 crore households, 90 percent of transactions are in cash, 50 percent population is under banked and only 10 percent household is having the facilities of card and mobile wallets. In India there are 6.5 lakh villages, of which many do not have banks and full-fledged banking services; moreover rural people are not aware of ATM and its mechanism to operate it for the deposit and withdrawal of money. The average per capita income of Rs. 96,000 per annum, could be translated into earning of Rs.1,000 for 4 days of work. The household saving is nearly one third, which is about 30 thousand per year of which a lot is in cash. The recent study

says that, India’s black money economy is above Rs. 30 lakh crore, which is about 20 percent of our total GDP; this is even bigger than the GDP of the countries like Thailand and Argentina. The present condition for successfully implementing the scheme is not conducive.

1.4 Monumental Mismanagement

The scheme is resorted to with the aim of bringing out the unaccounted money in the country and to eradicate corruption at all levels and to put an end to fake currency notes in circulation in the country. The confidence with which the Government took initiative steps to implement the scheme has now been shaken because of “monumental mismanagement” of the scheme by the Government. When the Government’s intention was to close the window of black money, its haphazard way of implementation of the scheme opened the door of difficulties for the common people across the country. As the Government and other connected agencies were not prepared for the new exercise, the demonetization scheme, in course of time since its announcement on 8th November 2016, put the common people and small traders and daily wage earners into great hardships. The crowd that gathers in front of banks and ATMs is mainly of laborers, small traders, marginal farmers and service personnel whose earning is below taxable limits. This, combined with poor re-monetization, has led to a cash crunch across the country. Out of two lakh ATM centers, only seventy five thousand ATMs are being operated in the country during these difficult days after demonetization of currency. This created a more difficult situation for the public in withdrawing and depositing the cash and 47 people died in ATM queues. Moreover, in a country like India where there are eighty crore people whose earning capacity per month is less than ten thousand per month, fourteen lakhs crore notes made invalid overnight caused havoc to the people.

1.5 Sudden Impact on Indian economy

The Government is saying that the ultimate aim of demonetization will be the establishment of cashless economy in the country. The value of real goods in the country remains the same, but the value of money to purchase those goods has been reduced over a night. This leads to reduce the prices of goods till the purchasing power of consumers comes back to earlier levels. The purchase power of consumers has been reduced to a greater extent, which directly makes a negative impact on various goods and services. The reduction would be felt in the cases of assets which are used for long term investment and consumption, which mainly includes real estate, cars, steel, cements, etc. There will be a limited impact on the stocks of defense sectors like FMCG and Pharmaceuticals. “Demonetization is a bold move, but could hurt market for 6 months,” said Christopher wood, Chief Equity Strategist and managing director of CLSA. Furthermore, he said “The Government’s move to withdraw high demonization bank notes to curb black money is a bold one and even though it is a long term positive, it can hurt equity markets for around six months”. As Dr. Manmohan singh, has predicted the GDP of the country may go down by 2 per cent. When demonetization was announced by the Government, the jewellery industry was in favour of it and welcomed the Government decision and said that there could be an increase in demand for gold as people will have more faith in the precious metal than in the currency notes. Gitanjali Gems

Chairman and managing director Mehul Choksi said that “It will create havoc for a little while and the economy will also destabilize. But overall, it is going to be good for the country. In fact, the jewellery industry will thrive as people will have more trust on jewellery than in currency notes”. In a context of this it could be a short term impact when PC Jewellers managing director Balram Garg said “This is a very good decision for long term especially for the organized sector. This could have an impact on pure gold demand, which is good for jewellers”.

The unorganized builders and secondary (resale) property market are adversely impacted by the demonetization. DLF CEO Rajeev Talwar said “we are moving toward the cashless economy, which is a sign of maturing economy. It’s a step in the right direction”. Furthermore, he added that “The black money was mostly in the land purchases. But in last 6-7 years, there has been no major land buying in this sector. Big builders and organized players are already using bank channel and they would gain from this decision. Unorganized players and the secondary market would be impacted”.

1.6 Does Demonetization Re-monetize India

Demonetization and poor management of re-monetization process by the Government have led to big cash crunch in the country. To overcome the problem and to make India cashless country, the Government and the people in information technology field are advocating the e-transactions in all economic activities in future. Cashless methods of payments through digital transactions such as e-wallet and apps, online transactions using e-banking and usage of debit and credit cards are now being used by some people in marketing payments. Had the Government taken the necessary preliminary steps before demonetization announcement, most of the problems faced by the people would have been averted. The successful implementation of the demonetization scheme is expected to change to considerable extent, the economic life and its healthiest in the country. The new trend and shift toward the electronic mode of money transaction could be useful for tracking the financial transaction, and it could be helpful to attain more effective and efficient mechanism to collect the service tax and income tax across the country. This could lead to obtain more sustainable fiscal and monetary benefits and could be able to significantly track the movement of black money and fake notes. Additionally, this will lead to more liquidity in the banks, where the public can easily get loans for the requirements. All these achievements will lead to more transparency in all sectors and achievement of a new age of cashless economy, which means a shift from cash transactions to online payments.

No doubt, eradication of corruption and illegal money transaction is the need of the hour, but it is questionable that how far the demonetization practices are very much coping-up with the present condition of the nation. Because, the imbalanced socioeconomic status divides the people in their understanding level and fiscal maneuver. The present demonetization practices are bringing only the puzzling money, which are amassed so far and are never a solution for regulating monetary practices hereafter in a sustainable manner. Still, numerous people have satisfaction only with dealing of physical money rather than e-dealing. When a major part of the country was facing difficulties, an Akodara village in Gujarat, which is about 90 kms from Ahmedabad was

enjoying an atmosphere of an oasis in the midst of a panic situation in the country. This village is known for its digitization and is called “Digital Village”, where the households or families do everything on e-banking whether it is for buying milk or biscuits and all transactions are done by their mobile. A cashless economy could be possible in the country if the example of Akodara Village is followed.

In conclusion, it may be said that, in spite of the “monumental mismanagement” of the demonetization scheme by the Government leading to “monumental disaster” in the economic life of the people, the general public is having the same confidence and trust in the Government headed by the Prime Minister Mr. Modi, which they had at the time of the Parliament election in May 2014. As predicted by some eminent economists we have to wait for another six or more months for a result at the end of the demonetization exercise. The demonetization decision taken by the Government has become a great challenge to both the rulers and the ruled and the success of the scheme depends not only on proper implementation practices of demonetization but also on the changes in the mentality of the public to accept a cashless society.

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