



Demonetization: A milestone towards redefining Indian economy

Dr. Ranjana Sharma

Associate Professor, Department of Management, Sri Guru Ram Rai University (SGRRU), Dehradun, Uttarakhand, India

Abstract

Finance plays pivotal role for the success of economic development at large. The recent announcement of demonetization made tremendous impact in society. In this parlance, Demonetization refers to withdrawal of a specific form of currency from circulation. It considered as necessary whenever there is a change of national currency. The old unit of currency to be removed and substituted with a new currency unit. This move will help the government to track the black money. The currency was demonetized first time in 1946 and second time in 1978. The currency is demonetized as third time by the current Narendra Modi government on Nov. 2016. This is the bold step taken by the government for the betterment of the economy and country. The objective of this study is to discuss the impact of recent demonetization on the Indian system and also challenges of implementing monetization in the country. In the wake of demonetization, there have been multiple debates on whether the “radical” and “bold” step taken by the Central government was a judicious, well-thought out and well-implemented step. Besides this paper also focuses on pros and cons of recent announcement pertaining to the concept of demonetization.

Keywords: demonetization, Indian economy, black money, parallel economy, tax evasion, Swiss bank, counterfeit currency, national currency

Introduction

Demonetization is the act of stripping a currency unit of its status as legal tender. It is a process of removing a currency from general usage or circulation of money in a country. Demonetization is an act where the old unit of currency gets retired and replaced with a new currency unit. It can also be considered as withdrawal of a specific currency from market.

The birth of a paper currency in India

Before we start with the discussion of demonetization which took place on 8th November, 2016 we will look into history of birth of paper currency as how use of paper currency had been started in India.

Until the 18th century, people in India used to use silver and gold coins to carry out their day to day transactions. But then some European companies established their own banks in the region to carry out their business transactions, like the Bank of Hindustan in Calcutta. They introduced the very first versions of Indian paper notes which then boosted the further popularised the use of paper notes. The Bank of Bengal went on to release notes that featured a small image of a female figure meant to represent the idea of “commerce,” as well as the bank’s name and the denomination in three scripts: Urdu, Bengali, and Nagri.

However, it was only after the Paper Currency Act of 1861 that the British colonial government really got involved in producing money, establishing the paper currency as we know it today. Money was now to be issued by the state alone, not banks.

Demonetization in India before November, 2016.

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. In January 1946, Rs1,000 and Rs10,000 banknotes were withdrawn but the same Rs1,000, Rs5,000 and Rs10,000 notes were reintroduced in 1954, and were again demonetized in January 1978.

The second demonetization has taken place in the year of 1978 by the Janata Party government. It had decided to withdraw Rs1,000, Rs5,000 and Rs10,000 notes by issuing an ordinance on the morning of 16 January that year.

The objective behind the all the acts of demonetization happened in past and happened recently is common reduction of black money, corruption and removal of fake currency.

Demonetization- November, 2016

On Tuesday, 8th of November, 2016 Prime Minister of India Narendra Modi announced the demonetization of Rs. 500 and Rs. 1000 notes with effect from midnight, making these notes invalid. The major reasons behind this move were controlling black money, controlling fake currency and controlling corruption.

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. “The fake notes are being used for illegal activities by anti-nationalists like terrorists and India being a nation of a cash-based economy, the circulation of fake currency continues to be a threat. 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.

Prospects and Constrains of demonetization in India

1) Prospects of demonetization

- i) **Corruption free India:** The demonetization policy will help India to become corruption-free. Those indulging in taking bribe will refrain from corrupt practices as it will be hard for them to keep their unaccounted cash. Corruption will also be automatically reduced by eliminating black money from economy.
- ii) **It helps to create Digital India:** It is a giant step towards the dream of making a Digital India. It helps to ensure that government services are made available to citizens electronically by improved online infrastructure and by increasing internet connectivity or by making the country digitally empowered in the field of technology. With the increasing adoption of digital currency, it will create a treasure trove of data in every industry. This kind of approach in future will see startups and big companies alike take advantage of these technologies to re-invent and innovate.
- iii) **It makes cashless society:** The ultimate objective is to make India a cashless society. A cashless society describes an economic state whereby financial transactions are not conducted with money in the form of physical banknotes or coins, but rather through the transfer of digital information (usually an electronic representation of money) between the transacting parties. The proportion of hard cash in the economy will decrease and our economy will get more digitized which will result in greater transparency.
- iv) **It curbs black money:** This move will help the government to track the black money. This move will help the government to track the black money. Those individuals who have unaccounted cash are now required to show income and submit PAN for any valid financial transactions. The government can get income tax return for the income on which tax has not been paid.
- v) **It controls escalating price raise:** Implementation of demonetization immensely supports in controlling the escalation of price. By this the consumer can clearly get to know about the fair price of the product. It helps in better allocation of economic resources by the government.
- vi) **It stops flowing of funds to illegal activity:** Moving towards demonetization will stop the circulation of fake currency. Most of the fake currency put in circulation is of the high value notes and the banning of 500 and 1000 notes will eliminate the circulation of fake currency. Most Hawala transactions used to be carried out in the denominations of Rs. 500 and Rs. 1000. This led to fatal blow to the unethical Hawala traders at large.
- vii) **It makes people accountable for every rupee & proper filing of income tax return:** The demonetization policy will force people to pay income tax returns. Most of the people who have been hiding their income are now forced to come forward to declare their income and pay tax on the same. All the monetary transaction has to be through the banking methods and individuals have to be accountable for each penny they possess. Despite deposits up to Rs 2.5 lakh will not come under Income tax scrutiny, individuals are required to submit PAN for any

deposit of above Rs 50,000 in cash. This will help the income tax department to track individuals with high denominations currency. This move will help the government to track the black money. Through this method, the government was able to mop up a huge amount of undeclared income.

- viii) **Myriad number of opening bank accounts:** Government had urged people to create bank accounts under Jan Dhan Yojana. They were asked to deposit all the money in their Jan Dhan accounts and do their future transaction through banking methods only. This move has generated interest among those people who had opened Jan Dhan accounts under the Prime Minister's Jan Dhan Yojana. They can now deposit their cash under this scheme and this money can be used for the developmental activity of the country.

2) Constrains of demonetization

- i) **Inconvenience to society:** The announcement of the demonization of the currency has caused huge inconvenience to the people. They are running to the banks to exchange, deposit or withdraw notes. The sudden announcement has made the situation become chaotic. Tempers are running high among the masses as there is a delay in the circulation of new currency. Many poor daily wage workers are left with no jobs and their daily income has stopped because employers are unable to pay their daily wage.
- ii) **Mad Rush at the Banks:** Banks will be extremely overcrowded by people. People will forget everything else and throng to the places where the banned notes are being officially exchanged leading to a tremendous chaos.
- iii) **Short-term Inflation:** Due to shortage of money in the market, short-term cost push inflation will occur. The price of gold has already become sky high. Prices of vegetables and fruits have also soared burdening the common man.
- iv) **Difficulty to Government:** The government is finding it hard to implement this policy. It has to bear the cost of printing of the new currency notes. It is also finding it difficult to put new currency into circulation. The 2000 rupees note is a burden on the people as no one likes to do transaction with such high value currency. Some critics think it will only help people to use black money more easily in future. Further, many people have clandestinely discarded the demonetized currency notes and this is a loss to the country's economy.
- v) **Loss of Tax Payers Money:** Rs 500 printing costs Rs 2.5 and Rs.1000 costs Rs 3, (approx). Multiply it by number of notes present in India now. Government has to pay this money from taxpayers
- vi) **Powerful Politician are converting black into white easily:** In many areas they are distributing/giving loan of amount few lacs to each farmer/labour and later they will take their money back as poor man can't fight to those powerful peoples.

Effects of demonetization

Demonetization created effect on different sectors in different manners resulting into boom for some sectors like E-Wallet

businesses and somewhere resulting into temporary slowdown like micro businesses like vegetable vendors or some small seasonal businesses, where most of the transactions are on cash basis. Selected sectors have been covered for the study which, according to me, can have major effects of demonetization.

a) Online retail stores temporarily stopped cash on delivery facility

Successful online retail stores in India like Flipkart, Amazon, Snapdeal and other online retailers have either temporarily stopped offering cash on delivery services. According to a research firm named Redseer Management, about 70% of the e-commerce orders are still paid for in cash. Such a move may temporarily impact the volume of business because cash on delivery is the most popular mode of payment for shoppers in India, industry experts said. Flipkart Ltd, Snapdeal and International Journal of Commerce and Management Research Shopclues have put a cap on the maximum value of cash-on-delivery transactions, while Amazon India has temporarily stopped cash on delivery, the companies said in statements.

The companies are instead encouraging consumers to resort to payments through debit and credit cards enabled by the point of sales devices carried by delivery personnel. According to industry experts, the absence or an upper limit on cash on delivery may lead to cancellations or clog logistics networks. There are many orders which are in the pipeline to be delivered and for which mode of payment is cash on delivery. But unless a new model where wallet transaction replaces cash on delivery, many of them may not executed, or clog the logistics network with significant delays in delivery.

b) Disbursement Rate Microfinance Institutes' slow down

Micro finance institutions (MFIs) are important institutes which provide financial assistance to micro businesses. Such MFIs have saw their disbursement rate slowing after the government's decision demonetization of the notes of Rs 500 and Rs 1,000. The MFIs have acknowledged that the move may result in a delay in collection of instalments from the clients in the near future. Demonetization and unavailability of cash can also have an impact on disbursement especially cash disbursement.

c) Effect on Micro Businesses

Indian Micro Small and Medium Enterprises (MSME) sector contributes considerable share in India's GDP. But amongst all the three, medium sized enterprises have share of around one per cent and they generally use online mode for their payment and receipts. But Small and Micro, especially micro businesses faced lot of problems as most of the transactions take place on cash basis, because many people are not that educated and tech-savvy. So the move demonetization has hampered micro businesses in a bad manner resulting into slowdown in micro enterprise sector.

d) E-wallet firms could gain good business

A digital wallet is an electronic device which allows an individual to make electronic commerce transactions like payment of bills or online bookings etc. An individual's bank account can also be linked to the digital wallet. The examples of wallet in India are- Paytm, PayU India, MobiKwik, and

Freecharge and so on. Such E-wallets are expected to be the biggest beneficiaries of the decision of demonetization taken by central government.

Suggestions

In order to absolutely get rid of black money within a country, it is necessary to apply a huge plan to get back the money which is stack in neighbour country. Internet connection should be improved in all parts of the country for effective cashless inflow and outflow for mobile and other type of e-banking. By maintaining both withdrawal and deposit facility in all ATM's may reduce inconvenience among the people. In the way of introducing time intervals for withdrawing money in all banks can able to make people much more cozy for the society. For instance in all branches women and aged people are allowed to withdraw the money from 10.00 a.m to 1.00 p.m whereas the men can withdraw from 1.00 p.m to 4.00 p.m. Every bank need to provide swipe machine also apart from cash counter for deposits and withdrawals on permanent basis. Stringent law and regulations to be formulated and practiced for targeting our country to be corruption free nation. To bring our nation in developed countries list, adopting the demonetization practices is need of the hour. As more number of fraudulent practices invading in real estate sector, government authorities to be cautious in all forms of scrutiny in this regard.

Conclusion

Economists are busy in listing out many more merits and demerit of this policy. The government is saying that there are only advantages of demonetization policy and this will be seen in the long term. Former Prime Minister Manmohan Singh who is a noted economist, former RBI governor and former Finance Minister of the country, dubs the demonetization move as an 'organized loot and legalized plunder'. However, by comparing the merits verses demerits, it will be safe to conclude that the former outweighs the latter. Even though there is suffering and agony among the masses right at the moment but the forecast is that its benefits will be seen in the long run. The government is taking all the necessary steps and actions to meet the currency demand and soon the trial and tribulations of the people will be over with the smooth flow of the new currency.

References

1. Report on aspects of black money, the national institute of public finance and policy, 1985.
2. The Reserve Bank of India's Balance sheet: Analytics and dynamics of evolution, Narendra Jadhav, Partha Ray, Dhritidyuti Bose and Indranil Sen Gupta, Reserve Bank of India Occasional papers, winter. 2003, 24(3).
3. Revenue Administration: Managing the Shadow Economy, Barrie Russell, Fiscal Affairs Department, IMF, 2010.
4. Report on measures to tackle black money in India and abroad, Government of India, Ministry of Finance, 2012 [Report of committee headed by chairman CBDT, I & II.
5. Economy, Forum on Tax Administration: SME compliance sub-group, Information Note, OECD, 2012.
6. A study on Issues and Challenges of Tackling Black

- Money Menace in India, [Prof. Dr. Rahul Goyal, Dr. Parul Saxena, IS] TM. 2016, 5(8).
7. Making it harder for the bad guys: The case for eliminating high denomination notes, Peter Sands, M-RCBG Associate Working Paper Series, 2016, 52.
 8. <http://www.freepressjournal.in/featured-blog/indias-history-with-demonetisation-from-1946-to-2016/988212>.
 9. <http://indianexpress.com/article/india/india-news-india/both-sides-of-the-coin-what-to-economists-think-about-demonetisation>.
 10. https://en.wikipedia.org/wiki/Digital_India.
 11. Read more:<http://www.businessdictionary.com/definition/demonetization.html>
 12. Investopedia
<http://www.investopedia.com/terms/d/demonetization.asp#ixzz4PhFwOAeH>
 13. <http://www.investorguide.com/definition/demonetization.html>
 14. <http://www.careratings.com/upload/NewsFiles/SplAnalysis/Effects%20of%20Demonetization%20of%20500%20and%201000%20notes.pdf>
 15. <http://www.careratings.com/upload/NewsFiles/SplAnalysis/Effects%20of%20Demonetization%20of%20500%20and%201000%20notes.pdf>
 16. <https://www.thequint.com/india/2016/11/09/rs-500-1000-notes-scrapped-narendra-modi-a-look-back-at-1977-when-notes-were-scrapped-demonetization-black-money-rbi>
 17. <http://www.livemint.com/Politics/uzZItqeHdMPHHgFJaq2BnM/A-history-of-demonetization-in-India.html>
 18. <http://blogs.timesofindia.indiatimes.com/paperweight/india-repeatedly-ruled-out-demonetization-in-the-1970s/>
 19. <http://indianexpress.com/article/business/banking-and-finance/rs-500-rs-1000-notes-declared-illegal-rbi-issues-25-point-faq-explaining-move-4365032/>
 20. http://economictimes.indiatimes.com/articleshow/55367370.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst