

## DEMONETISATION: CAUSES AND IMPACT

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### ABSTRACT

*As the news of demonetization rushed round the country, it was received with surprise and followed by huge lines in front of ATMs, shops, and petrol pumps. People seeking to exchange their old notes had to stand in huge queues, and many people lost their lives. At the same time many people supposed that government's move may turn out beneficial for the common man. The recent step of demonetisation of the high denomination currency notes is, argue its supporters, a master stroke to flush out black money, dismantle terror funding, and crack down on money laundry and counterfeit currency. However, the real motive behind this unprecedented move seems to be undisclosed so far. The economists, intelligentsia, social scientists, politicians and the common man are in confusion regarding the size of its impact on black money and corruption and finally on economic growth and development. This step will affect Indian economy comprehensively. This paper will evaluate causes and impact of recent demonetisation.*

**KEY WORDS:** *Demonetization, Black Money, Cashless Economy, Corruption, Counterfeit Currency*

### OBJECTIVE

The objective of this paper is to study the reason behind demonetisation on 8<sup>th</sup> November, 2016 and its impacts on Indian economy.

### METHODOLOGY

The paper is based on the secondary data, viz. various published sources like, newspapers, magazines, journals and the like etc.

### INTRODUCTION

When the Prime Minister announced demonetisation of 500 and 1000 rupee notes on the evening of 8<sup>th</sup> November 2016, he took the whole country by surprise. Prime Minister Narendra Modi in his address to the Nation announced that note of Rs. 500 and Rs. 1000 'will not be legal tender from mid night and this will be just worthless piece of paper'. Whatever else supporters and critics of Indian government's demonetization exercise may agree or disagree about the outcome, but most of us will agree that the decision by the Prime Minister, on November 8, 2016 to remove from legal tender of high denomination notes accounting for 86% of the currency stock in value terms was an unprecedented step.

Demonetisation can be a topic of discussion in Economics, but it becomes a huge challenge when a country implements demonetization. Dimensions of

demonetization are much vast therefore; it is a matter of evaluation to know the real effect and veracity of the decision. Demonetisation of high denominational notes announced by the Prime Minister in his address to the Nation after a high level meeting with bankers and the Cabinet and with Chiefs of the three Armed Forces separately. Demonetization is an extraordinary major taken by the government to push out counterfeit currency from market. Although government of India has given several reasons like to root out black money concentration, corruption, disrupting terror funding and money laundering. Later, in a changed narrative government said that it wants to turn Indian Economy into a cashless economy, but experts have speculated about the real motive behind this surprise move by the government. In fact, Government of India claimed that demonetization of high denomination notes was a well calculated move to achieve certain goals. Although, Government of India claimed that it was a well thought decision; in an interview to the NDTV, Nobel Laureate and eminent economist Amartya Sen said, "The demonetisation of currency was a despotic act as the government broke the promise of compensation goes against trust. It undermines the trust of entire economy". According to Kaushik Basu, "Demonetisation was ostensibly implemented to combat terrorism financing and inflation. But it was poorly designed with scant attention paid to the laws of the market and it is likely to fail. So far its effects have been

disastrous for the middle and lower middle classes as well as the poor. And the worst may be yet to come". Former Prime Minister Dr. Man Mohan Singh called demonetization of Rs.500 and Rs. 1000 notes as a "monumental mismanagement" that might bring GDP down by 2 percent. Arvind Virvani said demonetisation is a useful method of flushing out black money. Surjit Bhalla found demonetisation bold step and bigger than GST.

In India demonetisation was undertaken twice in the past, once in 1946 and the second time in the 1978. However, during both those times, the Indian economy was not so vibrant. Since, the 500 and 1000 rupee notes were the most widely circulated denominations; demonetization left people with no cash in hand even to purchase daily perishables like milk, vegetables and fruits. How fee to be paid, salaries to be given became daily concerns for the common man.

More than seven months have passed since the Prime Minister announced the decision that high denominational currency notes would cease to be a legal tender. Subsequently, those notes have been demonetized. When 86 percent of a country's currency constituting 12.2 percent of its GDP, is squeezed out of the market and sought to be replaced by a new currency, there would obviously be significant consequences of that decision.

### **INCONVENIENCES**

Although people with black money obviously stands the most affected, there are several implications that have to be faced by average middle class person, farmers, labor class and the economy as a whole. Although there would be an apparent inconvenience to the common man initially, given the short span of time to get these currency notes exchanged or deposited in banks and post offices, but he/she was expected to adapt to the new currency systems.

### **EXCHANGE OF MONEY**

In rural area farmers have faced more inconvenience due to the Rabi crop harvest season, where the farmer could have earned cash for their harvest. Similarly, in the rural areas the exchange and deposit system took long time because most of the villages do not have banking facilities, due to this reason people suffered inconveniences in terms of transportation, additional expenses and people have to go to the nearby cities for this purpose.

### **LACK OF BANKING**

When decision of demonetization came in to effect, the common man rush to the banking system for exchange and deposit of money, during this period people faced inconveniences a lot. On the other hand, system faced a lot difficulty in responding people timely and efficiently. But common man one thing had in their mind that system would recalibrate soon despite kinds of rumors.

### **SEVERAL IMPACTS OF THE DEMONETISATION CAN BE FORESEEN:**

#### **BLACK MONEY**

The question, however, is: Will demonetisation actually put an end to black money, which is not restricted to currency. Actually, those who hold unaccounted assets are very smart and they never use single form of accumulation. This move will curb the black wealth accumulated in the form of cash. The black wealth in the form of gold, shares, foreign currency, and land will be unaffected. Now the main question is that where is black money? Has the government achieved its goal? There are two other forms of black money, the big ones—tax evasion and political funding and bureaucratic corruption. The largest source of black money is tax evasion. As per the government of India estimates only about 3% of Indians pay income taxes. These are recurring activities; this aspect will have to be addressed too. Moreover, demonetisation does not stop the generation of black money. It may postpone it a little bit.

#### **COUNTERFEIT CURRENCY**

It seems that one of the main objectives behind demonetization was to neutralize counterfeit currency. The government is yet to present an estimate of how much of counterfeit currency that had been in circulation had been neutralized by demonetization. However, there is no accurate estimate of the quantum of circulation of counterfeit notes. The Ministry of Finance officials are learnt to have told the Public Accounts Committee (PAC) that RBI is still working out the exact number of Specified Bank Notes (SBN), or scrapped currency deposited in banks. It is possible to minimize such currency for short time.

#### **CORRUPTION**

The government of India is of the view that the large volumes of liquid cash are a big source of corruption and black money. Digital payment and payment by other transparent means will bring down possibility of

corruption. This step was a warning for those who had huge unaccounted cash and they suffered too. But this is not ultimate way to root out corruption. Structural reforms can be instrumental such as simplification of income tax, revoking of stamp duty, etc.

### **INFLATION**

India's retail inflation hit a two-year low in December following the government's cash crackdown. Sudden disappearance of unaccounted money due to demonetisation may bring prices lower down. But inflation is related to demand and supply of essential commodities, if any kind of imbalance occurs then prices will go higher. Demonetisation will not going to help for long term check on inflation.

### **GDP**

The Asian Development Bank reduces India GDP growth forecast to 7% and other rating agencies have estimated a decline of around 40 basis points in GDP for 2016-17. Since injection of liquidity is slow, incomes in both formal and informal sectors have been affected with the intensity of adverse impact being greater for unorganized sector. Demonetization created sudden scarcity of cash which affected demand and supply in short term resulting low production. Real estate and manufacturing sectors are main sufferer in short term therefore; there is a possibility of lowering down of GDP.

### **GOLD, SILVER JEWELRY**

India is the world's largest gold consumer and imports a sizeable chunk. After demonetisation, the rush for gold has come down. Jewelry is a high value purchase and customers are putting their decision on hold as they are focused on essentials items. Unless there is a wedding in the family, people are reluctant to buy jewellery. Jewelry is the worst affected sector after demonetisation. Most of the transaction had been in the form of cash therefore, this sector suffered badly.

### **INTEREST RATE**

After demonetisation cash supply has been surged suddenly in the banks and post offices and as of now banks has sufficient amount of liquidity. Therefore, The Reserve Bank of India has option to cut key policy rates. This will create a hope for low interest rate.

### **DIGITAL PAYMENT**

However, in the country like India where a large proportion of the population is illiterate and rural India have inadequate infrastructure for digital transaction, it is

not possible to create a totally cashless economy overnight. It can be implemented slowly step by step. It is good that the government of India has given some incentives for those who prefer digital payment.

### **CASHLESS ECONOMY**

If all cash is not black and all black money is not in form of cash then, how those cashless transactions prevent black money? After two weeks, the government of India came with new narrative and pushed its motive to create a cashless economy which is an imperfect dream because overnight transformation is impossible. But one can mobilize for less cash transactions. Cashless transactions have the benefit of transparency. In fact, in his 'Mann Ki Baat' address to the nation Prime Minister declared, "Our dream is that there should be cashless society. This is correct that 100 percent cashless is never possible. But we can make a start with less-cash society, and then cashless society will not be a far-off destination.

### **UNEMPLOYMENT**

Last but not the least, unorganized sector which was based on cash payment was heavily affected the moment decision was made. Many people became jobless. It will take two or three quarters to get things back on track. The process of remonetization will take time. Small and medium enterprises have suffered resulting unemployment in unorganized sector. Actually, cyber security is a major concern for common man they are not sure about this and it is difficult to provide adequate cyber protection.

If we accept Government of India version on demonetisation then we will have to accept that the period of pain and inconveniences is getting over. Economic activity is being restored. The banks today have adequate amount of cash in order to lend loan for growth. Lakhs of crores, which were floating in the market as loose currency, have now entered in the banking system. When the size of the banking transaction would get in large consequently the size of economy would expand but it is half-truth.

### **CONCLUSION**

The decision of demonetization of high denomination currency notes was bold and challenging one. It has huge impacts on Indian economy on several sectors and in many areas consequences will be far-reaching. This demonetisation drive has resulted in surplus cash within the banks; thereby allowing major banks across the country to lower their lending rates. Sectors like real estate, consumer, luxury items, jewelry and allied may

suffer for short and medium term. Drop in economic activity on account of the currency squeeze during remonetisation period may have short term impact.

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