

DEMONETIZATION: A DUAL EDGED SWORD

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Abstract - Demonetization was a concrete step taken by the Central Government on 8th November, 2016, with profound impact on the economy. The objective of the action was fourfold: to forge counterfeit notes, curb corruption, check the usage of high denomination currency for terrorist activities; and predominantly restrict the “black money” accumulation. As per the 2018 report from the RBI, around 99.3% of the demonetized notes, were deposited with the banks and the notes that were not deposited were only worth Rs.10,720 crore. The NIFTY 50 and BSE SENSEX stock indices fell over 6 percent on the day after the move was announced. Demonetization temporarily led to: rise in crime rates, loss in jobs due to the shutdown of unorganized and cash based small sectors, negative impact on the agriculture and the industrial sector productivity, fall in the economic growth for the two consecutive years after demonetization and an adverse effect on income distribution in India. However, demonetization in the long run, will result in better economic development. GDP can be expected to rise, once the nation diligently adapts digital modes of payments. The Government should make sure that every businessman has a swipe machine and proper dissemination of knowledge about its usage should be widely spread. Digitalization must be stimulated with incentives in favor of cash offsetting and the cost should be borne by the RBI/ government; cybersecurity systems should be strengthened further, to enrich trust in the digital transactions. Spreading proper awareness about the e-wallets and Credit/ Debit Cards usage can help people in transition towards the use of digital currency smoothly. The policy makers should focus on maximizing the benefits and minimizing the costs imposed by demonetization.

Keywords - Demonetization, Tax-GDP, Notebandi, Denomination, Rs1000, Rs500, Corruption, Black Money

I. INTRODUCTION

The devaluation of any denomination of currency to nil or zero, reducing it to a piece of paper with absolutely no worth can be termed as “Demonetization”. It means retiring a particular currency from the market and bringing a new currency in its place. Demonetization is required whenever national currency of an economy changes. Demonetization is called “Notebandi” in Hindi. This is not new for India or for other countries of the world. Apart from India, other countries like Zimbabwe, Fiji, Singapore, etc. have also opted for demonetization in past. India ranks 78th out of 180 surveyed countries, revealing a significant amount of corruption. This index's largest supporters are regarded as tax evaders and black money holders. Corruption is

conceptualized in most literature as a psychological aspect that is determined by different factors (Mittal, Singh, & Mittal, 2019a). The reasons for demonetization may be to fight corruption, to eliminate black money from the economy, to fight evasion of tax, or to resist the inflation. November 8, 2016 was the day when demonetization was declared for the third time in India. Prior to demonetization, Government and RBI had made sure that everyone had a bank account and get enough time to disclose their incomes, with the introduction of Income Disclosure Scheme (IDS) and Pradhan Mantri Jan Dhan Yojana (PMJDY). Only the government of a country can take this step to cease the currency value. This decision was taken by the government to remove fake currency, to fight corruption and to discourage cash transactions. Demonetization was considered as the surgical strike against unaccounted cash and was aimed at highlighting the government’s resolution to punish the illegal activities and the corresponding wealth; and in effect, the undisclosed amount was sought to be punitively taxed. Since majority Indians are cash reliant, so this step might help in changing the mindset of people and make them adapt digital modes of payments. The demonetisation debate has raised three major questions. First, the wider aspects of the management, as mirrored in its implementation and design. Second, it’s immediate effect and the long run effect in the economy. And, third, the suggestions underlying the future bearing of the economic policy.

II. LITERATURE REVIEW

Various experts, intellectual economists and politicians have examined the impact of demonetization. Rani Geeta (2016) in her study on demonetization concludes that initially the demonetization impact on the market were agonizing, but this move instigated the consumers and shopkeepers to adapt cashless means of payment such as debit/credit cards, paytm, internet banking etc. Abhani Dhara K. (2017) claims that the recent demonetization in India is going to be more fruitful than the previous two and concluded that demonetization was a much-needed step to deal with the issue of corruption, black money and terrorist activities etc. Vaidyanathan (2017) gave an authentic outlook on the black money calculation and analysis of unaccounted money. Singh and Roy (2017) found an increasing trend of the bank deposits as a result of demonetization and if these deposits are well sustained, they could be beneficial for the financial savings. A survey was conducted on retail sector in the city of Ghaziabad by Vij. Dimple and Arora (2017), who found that demonetization

has hit the retail sector very badly as they are largely dependent on cash. Dr. Mittal Arun (2017) in his research survey found that people faced a shortage of cash initially immediately after demonetisation, but they helped one another with small currency notes and also changed their expenditure pattern. People started cutting their expenses and started saving cash. Shukla, Hariom, Bal Govind and Gupta (2018) in their study used basic data and stated that the people are actively motivating any step taken by the government to remove corruption, black money, naxalism and call over the country.

Across country analysis depict that on an average the use of cash decline with development. Also, there is a linkage between wicked activities and cash: the larger the amount of cash in the economy, the larger the amount of corruption, as measured by Transparency International (Economic Survey 2017-18)

III. OBJECTIVES

- To understand the history of demonetization in India and the need for it.
- To comprehend the positive and negative impacts of demonetization.
- To understand the sector wise effect of demonetisation.
- To find out the possible future outcomes of demonetization and make suitable recommendations.

IV. RESEARCH METHODOLOGY

Different studies have been considered in this paper to analyze them. Furthermore, the required secondary data is collected from various websites, research papers, publications, newspapers, journals and magazines etc. and compiled to study and analyze for conclusions and suggestions.

V. FACTS AND ANALYSIS

Indian History of Demonetization:

Demonetization occurred three times in India. The first demonetization was announced on 12th January 1946, second on 16th January 1978 and the third and the most recent was on the 8th November 2016.

1.1 Demonetization of 1946:

The World War II had just finished and first demonetization was announced in India. The 10,000 and 1,000 rupee note were demonetized and new notes of 10,000, 5000 and 1,000 were introduced and circulated in 1954. Common masses of that time didn't have access to higher currency which were banned, so the demonetization in 1946 did not have much impact on commoners.

1.2 Demonetization of 1978:

Congress was defeated by the coalition government Janata Party in 1978. Shri Morarji Desai became the new prime

minister of India, demonetized Rs. 1000, 5000, and 10,000 currency notes on 16th January 1978. Rupees 1.46 billion worth currency notes were banned. 1.7% of the total notes were demonetized and 68% of this amount, i.e. 1 billion was reverted, however the demonetization value was only 0.1% of the GDP then. Demonetisation aimed to phase out black money out of the nation and it showed some positive results.

1.3 Demonetization of 2016:

On 8th November 2016, the government demonetized 1,000 and 500 rupee notes. The 1,000 and 500 currency notes were considered worthless after the midnight of the 8th November, 2016. The new 500 and 2,000 currency notes were introduced in exchange. The 2000 rupee note denomination was newly introduced currency for the first time in India. 80% of the total cash were in 1,000 and 500 rupee notes and suddenly they were only pieces of paper, worthless. The citizens were given the option to convert or exchange their cash for the new currency notes by 31st of December 2016. The government was of the view that this 50-day time was sufficient to convert the nation's cash. It affected almost all Indians whether owning a large or small enterprise. All the ATMs and banks went under severe pressure because of scarcity of cash which eventually affected the agriculture sector, transportation, small and medium business sectors. People had to stand in long queues and wait for hours to get their cash converted into a valid currency, leading to reporting of several deaths, even hospitals were not accepting cash and medical facilities were adversely affected. The table below depicts the quantity of currency demonetized and detained in India in all three periods of demonetization in India.

Table 1: The Quantity of Currency Demonetized and Detained in India

Year of Demonetization	Total Money Demonetized in Rupees	Detained Currency in Rupees
1946	143 crores	134 crores
1978	146 crores	100 crores
2016	15.44 lacs crores	14.97 lacs crores

Source: News

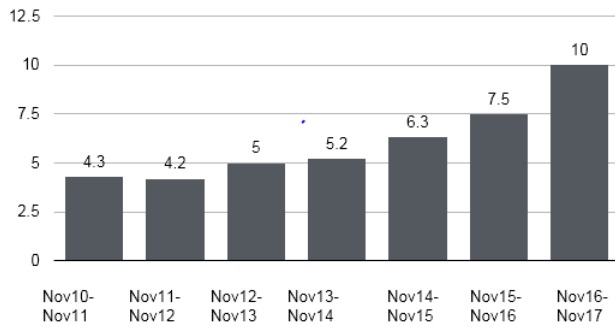
Effects of Demonetization:

2.1 Positive Effects of Demonetization:

Increase in the Number of Income Tax Returns: There has been a rise in the number of income tax returns filed in 2016-17 by 25% after demonetization. It is expected that the tax-GDP ratio would rise, which was around 12% lately, amounting to less than half of the ratio that existed in developed countries. A higher Tax-GDP ratio reflects a developed economy with low tax evasion; India had a ratio of 10% in 2014, which rose to 12% in 2017 (Mittal, Singh, & Mittal, 2019b). The figure below reflects the picture of New

Tax Filers in India overtime.

Figure 1: New Tax Filers (In Millions)



Source: Department of Revenue (CBDT)

The above figure depicts that there has been a substantial rise in the New Tax Filers in India overtime, especially after demonetisation. (ii) Awareness about Digital Payments: Masses have been enlightened about the merits of demonetization. Camps have been organized to educate the masses about the plastic money. Since approximately 86% of the total cash circulation was banned in the country during demonetization, the cash scarcity as a result, induced many people to switch their behavioral pattern of spending towards the plastic money. (iii) Control of Fake Currency: Demonetization has been called a masterstroke, with the terrorist activities been ceased as a sudden ban of notes led to the squeeze of purchasing power, as a result, fake currency was under control.(iv) Benefits to the Middle Class: The high inflated prices of buildings, houses, and real estate crashed and came under the reach of the middle class people. (v) Check on Black Money: High denomination currency notes were of no use during demonetisation and elite class with huge amount of black money were forced to reveal their holdings and were given a chance to convert it into white money by paying taxes on it. As a result, black money was traced, removed and large amount of tax was collected. (vi) Credit Creation: Demonetization led to an increase in the liquidity of commercial banks, which increased the credit creation capacity of the banks and led to larger funding of many new business ventures and industries. (vii) Over Kashmir Unrest: Demonetization has reflected its positive effect in Kashmir much sooner than any other area as the long disturbance in Kashmir, had come to a standstill because of the paucity of money. As per an intelligence report, the separatists used to get huge chunk of money every year from neighboring countries to cause social unrest in Kashmir and the money used to get transferred through hawala avenue. However, demonetization ruined hawala route completely and Kashmir is more peaceful now with terrorist activities checked. (viii) Naxalism: Naxalites are funded by those who rely on black money for their operations. They were severely hit by demonetization as they use black money for obtaining

arms, food, shelter, etc. and had no money for weapons and terror activities. This led to a reduction of naxalism activities in the country.

2.2 Detrimental Effects of Demonetization

(i) Rise in Cyber Crime: According to the report by ASSOCHAM, cyber crimes in India have increased three times. The challenge is, that the new digital users are not aware of the internet security, and even the police is not well skilled to deal with these kinds of crimes. The table below depicts a substantial rise in cybercrimes after 2016.

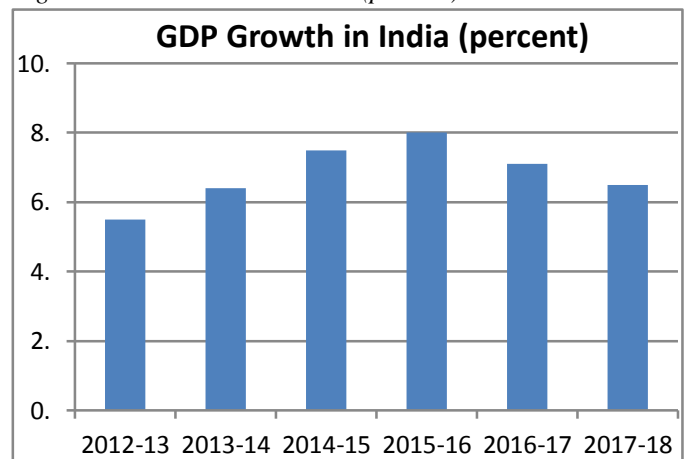
Table 2: Cyber Crimes in India

Year	Number of Cyber Crimes	Debit/Credit Card Related Crimes
2015	560	378
2016	639	139
2017	1803	659

Source: Cyber Investigation Bureau

(ii) Fall in GDP: The fall in GDP numbers was one of the key reasons which demoralized the merits of demonetization. It was projected to rise by nearly two percentage points in 2016-17, but it fell almost by one percent. This was mainly a result of less cash availability in the cash-intensive industries like construction and manufacturing and fall in economic activity in the unorganized sector. The figure below shows the GDP growth in India overtime.

Figure 2: GDP Growth in India (percent)



Source: CSO

The above graph clearly shows the rising trend in growth of GDP of India was checked and it slowed down from 2016-17 onwards after demonetisation. (iii) Unemployment: Many industries were closed, due to cash scarcity during demonetisation leading to a rise in unemployment. According to the Labor Bureau (Sixth Annual Employment-Unemployment Survey), in 2016-17, the unemployment rate rose to a four-year high at 3.9 per cent, compared to 3.4 per cent in 2013-14 and 3.7 per cent in 2015-16. (iv) Deaths: Almost over 100 deaths had been reported by the end of the year 2016 due to demonetization, as hospitals were also not accepting old currency and they refused medical help to the needy. People died of standing in long queues outside banks and ATMs for long hours to replace their old currency notes. (v) Agricultural Sector Problems: Majority of the rural citizens in the country are not friendly with digital payment mode of transaction and are cash reliant. Cash scarcity during demonetization had made difficult for them to purchase seeds, fertilizers etc. In fact, farmers had organized protest rallies in Amritsar, Gujarat etc. against demonetization. (vi) Transportation Halts: Around 8,00,000 truck drivers faced the problem of lack of cash just after the demonetization was announced and around 4,00,000 trucks were stranded at highways across the country. Toll plaza operators did not accept old currency notes. Mr. Nitin Gadkari, the Transport Minister then, announced that no toll collections will be done on national highways till 2nd December 2016.

Sector-Wise Impact of Demonetisation:

(i) Entertainment and Media Industry: Note ban adversely affected the entertainment and media industry as it led to a smaller number of viewers (especially among lower middle class) and the film industry (where the films production came to a standstill). (ii) Hospitality and Tourism: Indian tourism industry got severely affected due to demonetisation as most of the spending is in cash. Most of the luxury foreign trips that are financed by black money came to a halt. Local tourism was also affected, due to the crunch of cash. Further, the slowdown had affected restaurants, and hotels too. (iii) Real Estate and Property: This sector was the most affected sector by the note ban. Since major part of the business of builders depend on cash rather than cheque or banks transfer, demonetisation almost vanished their business. Unorganized builders were worst affected, as most of the unaccounted cash had been pulled out by demonetisation from the system. (iv) Gems & Jewellery: For purchasing jewellery, major part of the customers payment requires cash, so the demonetisation effect in this area was quite high. Demonetisation led to scarce cash availability to people for satisfying their day-to-day needs. Small retailers in the unorganized sector were adversely affected as there was a reduced demand for jewelers. (v) Luxury Items: Mostly people spend their unaccounted money on luxuries. Luxury segments and allied business such as luxury cars, clothing, electronics got a huge setback after the note ban. (vi) Automobiles: Demonetisation

led to a major decline in the demand for two wheelers as compared to luxury cars/four wheelers, since buyers prefer cash payments for buying a two-wheeler. The used car industry also got affected by demonetisation wherein decrease in sales were reported by various dealers. Payments are not regulated in this industry. (vii) Retail: Products demand suffered due to cash crunch leading to a decline in sales of producers. The effect of demonetisation on unorganized sector and small traders has been higher as compared to the organized sector. (viii) Agriculture: Various sub-sectors under agriculture - marketing, sale, distribution and transport are majorly cash-dependent. The supply chains, small farmers selling their produce on a daily basis got severely affected by demonetization. Further, there was large wastage of perishables, due to which this sector was severely affected. (ix) Labor-Intensive Sectors: There is a huge cash requirement to pay daily wage laborer. A limit on withdrawal of money from the bank affected the weekly payments to contract personnel in leather industries, mining and textiles. This adversely affected the procurement and production in this sector. (x) Banks: Banks have proven to be the biggest beneficiaries and the backbone of this complete process of demonetisation. As per the government's direction, old notes had to be exchanged with the new ones which resulted in increased bank's liquidity position which could be used for lending. Deposit and lending rates were adjusted in downward direction by many banks. The figure below represents the change in composition of deposits overtime.

Figure 3: Composition of Incremental Deposits



After demonetization (2016, November), the composition of deposits has changed as depicted from the figure above. The share of savings account increased substantially after demonetization, indicating large saving deposits with bank. Overtime, the Cash-GDP ratio should fall as more savings are channelized through the financial system. It was projected that the cash-GDP ratio would decline by about 2 percentage points. (Economic Survey 2017-18).

VI. CONCLUSIONS

A lot of antagonism happened regarding the implementation of the demonetization process. With demonetization, the

agriculture and the industrial sector has been greatly affected leading to a rise in unemployment. The loss in jobs happened due to the shutdown of unorganized and cash based small sectors especially across various micro, medium and small enterprises. There has been an adverse effect on income distribution in India. Crime rates had risen, economic growth had fallen for the consecutive two years after demonetization. It seems that only a small portion of black money was in form of cash, the rest in the gold and land holding. RBI faced a huge printing cost of new notes and many other issues affected the economy adversely during demonetization. However, overtime, it is projected that with demonetization, Indian economy will realize an increased tax collection and eventually a rise in GDP. GDP can be expected to rise as the transactions cost reduce, once the nation diligently adapts digital modes of payments. More credit creation capacity of the banks- created as a result of switch in people's preference to park more money with the banks, instead of keeping in the cash form, should eventually lead to higher lending to the private sector for various investment purposes, which can potentially, further contribute to the higher economic activity in the nation. Demonetization is considered as the surgical strike against unaccounted cash. Further, government transfers have high potential to mitigate the impact of demonetisation on poor people's income and hence on income inequality. Digitalization must be stimulated-- and the incentives in favor of cash offsetting- the cost should be borne by the RBI/ government. To enrich trust in the digital transactions, cybersecurity systems should be strengthened greatly. There is a need to make sure inter-operability of the payment system, required for enlarging digitalization in future, which is accrued to the newly developed UPI.

Demonetization surely has long-term benefits while it is quite early to quantify its magnitude. It will take many years to perceive the impact of demonetisation on illegal transactions, on black money and on financial savings. In spite of its long-term potential, demonetisation imposed short term costs on the economy. Assessing the extent of these costs remains tough, as sector wise data has only recently started to filter in. Besides, the overall economy is so diverse and large that assuming from a few indicators is a risky venture. In order to successfully achieve the objectives of demonetization, the Government should make sure that every businessman has a swipe machine, proper dissemination of knowledge about its usage should be widely spread; further banks should be well equipped with this machine so that it can be allotted to the traders. Spreading proper awareness and knowledge about the e-wallets and Credit/Debit Card usage through various camps at the village, city level can help people in transition towards use of digital currency smoothly while avoiding cash usage at the same time. Policy makers should focus on maximizing the benefits and minimizing the costs imposed due to demonetization.

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