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# A Study On Glimpse Of Economic Effects Of Demonetization In India

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## ABSTRACT

The Indian Economy which was billed as the "fastest growing major economy" in the world and the "only bright spot" among Emerging Markets seems to have slowed down even before the latest "shock therapy" of "demonetization". As per the recent estimates by some economists, nearly 90% of the total cash in circulation has come back into the banking system. On the other hand, with more taxes being collected due to higher deposits in banks that can be taxable as well as increased compliance due to greater scrutiny and oversight by the IT (Income Tax) Department. An attempt has been made to draw the impact of demonetization process and its reflections in India.

**Key words:** Demonetization, cashless transactions, credit, tax evasion, Economic effects, Demonetization,

## 1. INTRODUCTION

"It is dangerously destabilizing to have half the world on the cutting edge of technology while the other half struggles on the bare edge of survival"--Bill Clinton. The government of India announced Demonetisation of all 500 (US$7.80) and 1,000 (US$16) banknotes of the 'Mahatma Gandhi Series' on 8th Nov 2016. This immediate decision of Demonetisation has brought a large impact on the Indian Economy. The main aim of this attempt was to minimize the corruption carried out all over India. The sudden nature of the announcement and the prolonged cash shortages in the weeks that followed created significant disruption throughout the economy, threatening economic output.

### What is demonetisation is all about?

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 different way of demonetisation is like payments done using gift cards.

The reasons for the demonetisations are:

- To combat Inflation.
- To combat corruption and crime.
- To discourage the cash dependent economy.
- To facilitate Trade.

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**INDIA'S DEMONETISATION**

In 2016 Indian government made a huge decision in demonetising the two biggest denominations in the Indian currency system (500 & 1000 rupees notes were the demonetized denominations). These notes were estimated for about 86% of the country's circulating cash. With no prior information or warning Indian prime minister Narendra Modi announced to the mob on the late evening of 8th Nov 2016 that those notes were worthless and extended a span of time for the Indian citizens to deposit or exchange those notes for newly introduced 2000 rupee and 500 rupee bills. The reason for the sudden act of demonetisation without any prior warning was broke out by the Indian Prime minister Narendra Modi as it was an act of elimination of corruption, black money and terrorism.

**IMPACT OVER INDIAN ECONOMY**

Demonetisation is the generation's memorable experience and one of the great economic events of our time. The demonetisation has affected the Indian economy through the liquidity state. The effect of it was felt by each and every Indian citizen. As a result of Rs. 500 and Rs. 1000 notes, there occurred huge gap in the currency competition at the time when there was no other denominations except Rs. 100 and Rs. 2000 were used. Absence of Intermediate denominations like Rs. 500 and Rs. 1000 has totally reduced the utility of Rs. 2000. This phenomena has reduced the worth of Rs. 2000 amongst the huge mob.

**SOME REFLECTIONS ON DEMONETIZATION**

| | |
|---|---|
| Very big mistake | Kaushik Basu, former Chief Economic Advisor (CEA) to the Government of India |
| There was a flaw in the analysis and the costs involved in the short term for even a growing economy are significant | The Lalit Doshi Memorial Lecture |
| Demonetisation were not good enough owing to the fact that 86 per cent of the currency notes in the economy were taken out of the system | Basu, Professor of Economics at Cornell University |
| Shock therapy can work, even in India, but not without leaving some burn marks | World bank |
| Demonetization scheme will likely hurt gold demand in the long run, "by dramatically reducing the stock of black money hitherto used in a large chunk of purchases," | The Financial Times |

**TABLE NO 1**

**THE MAIN IMPACTS ARE**

- Demonetisation is not a huge disaster when compared to the global banking sector crisis of 2007. But at the same time it was a liquidity shock in the economy that disturbed the economic activities.
- Indian government risked the position of the nation of being the fastest growing largest economy. By the reduction of consumption, Income, Investment etc. The GDP growth of the nation was also reduced due to the chaos that lasted for upto six months.
- Most active segments of the population who were considered as the base of pyramid do their regular transactions using currencies. For eg: Daily wage Earners, other

 

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labourers, small traders etc. who reside out of formal economy uses cash regularly these sections had no income in the absence of cash.

- Public were not able to get the sufficient denominations like newly introduced Rs. 500 note. It constituted to nearly 49% of the previous currency supply in terms of value. It took a long time to resupply the newly introduced Rs. 500 denomination until then there was a huge collapse in the economic activities all over the country.
- When the cash shortage stroked the Indian economy. Consumption was adversely affected.

## IMPACT ON GDP GROWTH OF INDIA

Bank deposits on the short term may rise in case of exchange but whereas in the long term its effects will come down. It was very difficult for the normal people to assume that the ready cash stored in their hands were put into savings for the long term. And this was done just for an exchange of old notes to new notes and there were no interest paid for such savings as they were just considered as exchange money. It also had an impact on the Interest rate as the demonetisation was announced most of the banks reduced their rate of Interest which affected the people who make their regular saving in such banks. Only the small portion of black money was stored in the form of cash whereas the majority of the black income are in the form of physical assets like gold, land buildings etc. therefore their impacts on reduction of corruption, Black Money and Terrorism was less.

## GOVERNMENT ORDINANCE

The Specified Bank Notes (Cessation of Liabilities) Ordinance, 2016 was issued by the Government of India on 28 December 2016 ceasing the liability of the government for the banned bank notes, and also imposing a fine up to ▪ 10,000 or five times the amount of the face value of the bank notes, whichever is higher, for people transacting with them after 8 November 2016; or holding more than ten of them after 30 December 2016. The ordinance also provided for the exchange of the bank notes after December 30 for non-resident citizens and others on a case by case basis. However, Petrol, CNG and gas stations, government hospitals, railway and airline booking counters, state-government recognized dairies and ration stores, and crematoriums were allowed to accept the banned 500 and 1,000 bank notes until December 2, 2016.

## EXCHANGE OF NOTES

The Reserve Bank of India stipulated a window of fifty days until 30 December 2016 to deposit the demonetized banknotes as credit in bank accounts. The banknotes could also be exchanged over the counter of bank branches up to a limit that varied over the days:

- Initially, the limit was fixed at 4,000 per person from 8 to 13 November.
- This limit was increased to 4,500 per person from 14 to 17 November.
- The limit was reduced to 2,000 per person from 18 November.

All exchange of banknotes was abruptly stopped from 25 November 2016. International airports were also instructed to facilitate an exchange of notes amounting to a total value of 5,000 for foreign tourists and out-bound passengers.

 

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**CURRENCY CIRCULATION**

Up to 97% of the demonetised bank notes have been deposited into banks which have received a total of 14.97 trillion ($220 billion) as of December 30 out of the 15.4 trillion that was demonetised. This is against the government's initial estimate that 3 trillion would not return to the banking system. Of the 15.4 trillion demonetised in the form of 500 and 1000 bank notes of the Mahatma Gandhi Series, 9.2 trillion in the form of 500 and 2000 bank notes of the Mahatma Gandhi New Series has been recirculated as of 10 January 2017, two months after the demonetisation. Cash withdrawals from bank accounts were restricted to 10,000 per day and 20,000 per week per account from 10 to 13 November. This limit was increased to 24,000 per week from 14 November 2016. A daily limit on withdrawals from ATMs was also imposed varying from 2,000 per day till 14 November, and 2,500 per day till 31 December. This limit was increased to 4,500 per day from January 1, and again to 10,000 from January 16, 2017. Limits placed vide the circulars cited above on cash withdrawals from Current accounts/ Cash credit accounts/ Overdraft accounts stand withdrawn with immediate effect. RBI increased the withdrawal limit from Savings Bank account to Rs 50,000 from the earlier Rs 24,000 on February 20, 2017 and then on March 13, 2017, it removed all withdrawal limits from Savings Bank Accounts.

**2. REJOINDERS**

**SUPPORT**

The decision met with mixed initial reactions. Several bankers like Arundhati Bhattacharya (Chairperson of State Bank of India) and Chanda Kochhar (MD & CEO of ICICI Bank) appreciated the move in the sense that it would help to demolish the count of black money. Finance Minister Arun Jaitley said that demonetisation would clean the complete economic system, increase the size of economy and revenue base. He mentioned the demonetisation along with the upcoming Goods and Services Tax (GST) as "an attempt to change the spending habit and lifestyle. By and large, international response was positive which saw the move as a bold crackdown on corruption. International Monetary Fund (IMF) issued a statement supporting Modi's efforts to fight corruption by the demonetisation policy.

**CRITICISM**

The Indian Supreme Court while hearing one among a slew of cases filed against the sudden demonetisation decision in various courts, observed that it "appears to be carpet bombing and not surgical strike" which government repeatedly claims it to be. Former Senior Vice-President and Chief Economist of the World Bank, Kaushik Basu, called it a 'major mistake' and said that the 'damage' is likely to be much greater than any possible benefits. Chief Ministers of several Indian states like Mamata Banerjee, Arvind Kejriwal[134] and Pinarayi Vijayan have criticised and led major protests against the decision in their states and in parliament. Initially, the move to demonetise and try to hinder black money was appreciated, but the manner in which it was carried out by causing hardships to common people was criticised. A Public Interest Litigation (PIL) was filed in Madras High Court by M Seeni Ahamed, General Secretary of the Indian National League, to scrap the decision. The High Court dismissed the PIL stating that it could not interfere in monetary policies of the government. Similar PILs were also filed in the Supreme Court of India Supreme Court of India is yet to decide on the matter. It is listed for hearing on 2 December 2016. Several government ministers had declared before the

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demonetisation that they were holding large amounts of cash, including Arun Jaitley, who had more than 65 lakh rupees in cash. This led to speculation about whether and when the ministers had deposited the cash they held.

## OPPOSITION

Many Political parties opposed the BJP government on the demonetisation issue. The chief minister of west Bengal Mamata Banerjee met the former Indian president Pranab Mukherjee in case of opposition in terms for demonetisation. On 17th Nov 2016 there was rally held against demonetisation led by the chief ministers of Delhi and West Bengal at Azadpur Mandi. Delhi chief minister Aravind Kejriwal demanded for the withdrawal of the act of demonetisation in 3 days whereas the west Bengal chief minister also demanded the same to fix things or withdraw the demonetisation scheme in the time duration of 3 days. On 24 November 2016, in the demonetisation debate, the former prime minister of India Manmohan Singh said "this scheme will hurt small industries, the farming sector. The GDP may decline by about 3% due to the move, while he also questioned Prime Minister examples of countries where people have deposited their money in the banks and not allowed to withdraw their own money." and later also mentioned that "It was not good that on each day banks bring out new notifications. It doesn't reflect properly on Prime Minister's Office, Finance Minister and the Reserve Bank of India. Cooperative banking system has been prevented from handling cash". Singh at last termed the demonetisation move as an "organised loot, legalised plunder of the common people".

## STRIKES

Due to the great opposition for the act of demonetisation in the both the houses of parliament. It lead to the organisation of national wide strikes all over the nation. All the opposition parties of BJP started to protest against the act on the campaign day 28 Nov 2016. There were huge protest in front of the banks by the people demanding to return back their money.

**IMMEDIATE EFFECTS OF DEMONETIZATION**

| | | | |
|---|---|---|---|
| Stopping fake currency | Mobile ATM Started functioning | Aadhar based ATM | Jandhan account filled with cash |
| People declared money | Small vendors go cash less economy | Banks received lot of cash deposits | Salaried people declared money |

Source: Adopted from Indian money.com

**TABLE NO 2**

## 3. CLOSING THOUGHT

"Learn from the mistakes of others, you can't live long enough to make them all yourselves"

*–Chanaka*

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. The policy measures require lot of depth debate. Any change is hard at first, messy in the middle and gorgeous at the end. The advantages are much dominating and it will be in the long term interest of our country comfortably outweighing the disadvantages.

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Government need to take all the necessary steps so as to ensure that there will be a smooth flow of currency exchanges. It will make a massive change in our economy. We congratulate the entire government and those hidden brains of our democracy that brought this decision. Increased financial inclusion and transparency are of course fantastic goals, and if achieved, would alleviate poverty and increase productivity, but the question is whether demonetisation is worth the price Indians have had to pay.

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