Demonetization: A Comprehensive Study

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ABSTRACT

Demonetization is a generations’ memorable experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. Demonetization affects the economy through the liquidity side. On 8 November 2016 midnight, the Government of India announced the demonetisation of all 500 and 1,000 banknotes of the Mahatma Gandhi Series. This scheme has a great impact on the businesses, common people, and financial institutions. The government claimed that the action would curtail the shadow economy and crack down on the use of illicit and counterfeit cash to fund illegal activity and terrorism. Demonetization represents much more than destabilization; it has struck a body blow on the economic activity in India. While the proponents of demonetization may have had good intentions, the suffering it has caused to millions of Indians is unwarranted. Demonetization can be said as a “Surgical Strike” on Black Money, Terrorism, Fake Currency, Unorganized trading, Real Estate, Share market etc. Demonetization is not a big disaster like global banking sector crisis of 2007; but at the same time, it will act as a liquidity shock that disturbs economic activities. The rush to surrender old notes and the limited release of new money created a huge monetary imbalance in the system. Obviously, it will take some time for the system to self-adjust and for normalcy to be restored. But during this period, there has been a phenomenal increase in the deposits with the banking system. Demonetization, coupled with Digital India and Jan Dhan Yojana, is aimed at strengthening transparency in money transactions. In addition, a few immediate negative implications of demonetization are also seen in terms of minimum growth in GDP, losing job by wage earners in some industries and real estate sector which have affected the Indian economy to some extent. Demonetization is followed by remonetization to replace the old discontinued currency with a new currency in the economy. Remonetization after demonetization is an uphill task initiated by Government to make India Digital.

Keywords: Demonetization, Remonetization, Digital/Cashless Economy, Black Money, Tax Evasion

INTRODUCTION

Indian economy is said to be a fast growing and also considered to be bright spot among other emerging markets in the world. In the global environment, India has multiple strengths of larger youth population, growing middle class people, increasing literacy level and improving technical knowledge among the work force which would address favorably any proactive change in the present setup. India is basically a cash transaction oriented economy in almost all business activities. It is true that any country which has a strong banking and financial system would have got the capacity to withstand any crisis arising out of financial dealings. In that order, Indian financial system is inherently strong and our banking system is also well structured to meet any financial endeavor.

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 demonetization exercise which was suddenly introduced in India during the quarter (October – December, 2016) had affected the performance of many industries in the immediate next quarter (January-March, 2017) and on the other hand some other industries have positive implications. Moreover, demonetization, coupled with Digital India and Jan Dhan Yojana, is aimed at strengthening transparency in money transactions by curbing black money, corruption and financial crimes. Therefore, this paper will take up the issues relating to demonetization and its linkage to the implications of various sectors in Indian economy.

Objectives of the study

a. To analyze the impact of Demonetization on GDP.
b. To understand the implications of demonetization on various sectors of economy.
c. To analyze the future impact of Demonetization on Indian economy.
d. To analyze the measures needed to retain the benefits of demonetization.

**METHODOLOGY**

This is a thoughtfully arranged investigation and thusly, theory and testing can't be connected. In that capacity, the opinions communicated in this paper are the author's own particular conclusion and the opinions of some presumed authors.

**History of Demonetization**

This is not for the first time Government Demonetizing the currency. Earlier to this India has witnessed demonetization twice. For the first time demonetization took place in pre independence period. In January 1946, for the first time demonetization took place in India. During this demonetization currency notes of Rs. 1000 and Rs. 10000 rupees were withdrawn from the circulation and new currency notes of 1000, 5000 and 10000 denomination rupees were introduced in the year 1954. On 16th January 1978, Government of India Demonetized the currency notes of 1000, 500 and 10000 rupee notes 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 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.

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Step Taken</th>
<th>Status</th>
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<tbody>
<tr>
<td>USA</td>
<td>1969</td>
<td>Due to existence of black money in the nation, the country was losing its sheen built on Silicon Valley. In 1969 the U.S. President Richard Nixon announced all bills above $100 as null and void.</td>
<td>Success Even today $100 bill is the maximum available for circulation.</td>
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<tr>
<td>Nigeria</td>
<td>1984</td>
<td>The government run by Muhammadu Buhari has announced demonetization of all existing currencies to improve the high-inflation-debt economy.</td>
<td>Failed He was thrown out of power in 1985-86.</td>
</tr>
<tr>
<td>Zaire</td>
<td>1990</td>
<td>The Dictator Mobutu ran the demonetization drive which led to economic instability in the country which won freedom in 1970 making it more vulnerable to foreign funding at that time.</td>
<td>Failed</td>
</tr>
<tr>
<td>Soviet Union</td>
<td>Jan 1991</td>
<td>Mikhail Gorbachev, withdrew 50 and 100 ruble notes, in order to eliminate black money and increase the currency value. The notes accounted for a third of the total money in circulation.</td>
<td>Gorbachev faced a coup within eight months in August as the move was not a success. The 1991 attempt led to a successful re-denomination of the ruble in 1998. This was followed by another currency switch in 2010. The 2010 attempt was not as successful.</td>
</tr>
<tr>
<td>Australia</td>
<td>1996</td>
<td>The government to the curb black money crisis and improve security features on the notes, they withdrew all paper-based notes and replaced them with long life polymer-based notes of the same denomination.</td>
<td>Success This improved the life of the bills and helped in making Australia a business friendly country, despite the initial costs incurred to manufacture polymer-based notes.</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>2010</td>
<td>Due to chronic inflation in Zimbabwe, the government started printing notes with a face value of 1 hundred trillion Zimbabwean Dollars’ worth just 40 cents.</td>
<td>Failed The country replaced their currency with US Dollars later</td>
</tr>
<tr>
<td>North Korea</td>
<td>2010</td>
<td>The then dictator of North Korea Kim Jong-IL has decided to remove two zeroes from the currency denominations to curb black money menace and tightly control the economy.</td>
<td>Misereably Failed Due to bad harvest and high inflation, this move was highly criticized by the International Media, making the dictator to apologize in the public.</td>
</tr>
<tr>
<td>Pakistan</td>
<td>June 2015</td>
<td>The Government of Pakistan has announced the demonetization of Rs.5 and Rs.500 in June 2015 with immediate effect and phase out of all other denominations. The people of Pakistan had one-and-half year time to exchange these notes, after which (December 1, 2016) the notes will be declared null and void.</td>
<td>Messed Up One and Half Years for demonetization. To exchange notes. Can’t curb black money neither counterfeit notes.</td>
</tr>
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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. Selected sectors have been covered for the study which, according to me, can have major effects of demonetization.

- **Agriculture**
  This sector typically sees high cash transactions. Agricultural growth in India was expected at 4% in the year 2016-17 as per CRISIL Report, but due to Demonetization farmers ran out of cash to buy Seeds, Fertilizer, equipment and Wages payment to workers and Commission to Agents etc. Most of the farmers are not educated and aware about how to work on E-Payment System. In most of the Villages Proper Banking system is not Developed yet and Villagers are needed to go to the cities for the same because of which Farmer’s most of the time was engaged in exchanging the old notes in Banks.

- **Impact on counterfeit currency**
  The real impact was expected on counterfeit/fake currency as its circulation would be checked after this exercise. It was previously estimated that 250 out of every million Indian bank notes were fakes. The new 500 and 2,000 rupee notes are less vulnerable to counterfeiting, having advanced security features with one report claiming that it will be “impossible” to fake them.

- **Terrorism**
  The Demonetization had badly hit Maoist and Naxalites as well. The surrender rate has reached its highest since the demonetization is announced. The move also reportedly crippled Communist guerrilla groups (Naxalites) financing through money laundering. It is expected that smuggling of arms and dealing with the terrorist will not sustain further as all of the money will be on record now.

- **Hawala**
  The brightest spot is the end of Hawala racket and rising property prices. Hawala is the way of transferring money from a different country to India in Indian denominations. Although illegal, the people in this racket make their money white through this process in different countries. To attract more people to remit through this form, they pay a premium over the existing exchange rates. Come 8th November, 2016, the government scrapped all high denominations making the notes lying with the Hawala traders null and void.

- **Tax Collection and Tax Compliance**
  It was executed with the goal of taxing the bulk possessions of black money. Numerous hoarders and pawns of the dark currency market were brought under the tax net. Black money hoarders have endured generous misfortune either in form of tax penalties or in transformation expenses to tax criminals. Bank accounts are as yet being screened for suspicious exchanges.

  Tax avoidance now has two particular sanctions— financial penalty and social judgment. In such a situation, the dodgers may choose that in the years to come, it would be a doable alternative to pay a direct customary tax as opposed to undertaking the danger of paying a sudden punitive duty. This would round up the advantages of formalized economy and assist the tax administration with furthering the tax consistence objective.

- **Liquidity crux**
  Reduced liquidity has caused a sharp decrease in the accessibility of discretionary and disposable income, influencing spending and consumption in the economy for the time being. Cash stringency will induce producer firms to diminish the work cost, along these lines lessening the wages of the poor common laborers. With time, the general population in the higher level of pay would in all likelihood confront the stream up impact of the liquidity crux.

- **Development and GDP**
  GDP is hurt due to the demonetizationwhich resulted in constriction of consumption, pay, and investment. It lost its momentum of financial growth.Cash escalated sectors, for example, agribusiness, real estate, FMCG, automobile, and so on were influenced more when contrasted with different sectors, because of decreased liquidity, working capital and supply chain. The extent of fall was very less and it existed only for a short duration of time.

- **Black Money**
  The entire bulk of the black money is not stored by the general population as cash yet out the type of physical and profitable resources like gold, land, buildings and so on. Just an irrelevant bit of black money which is held as cash is relied
upon to be countered by the demonetization. But it might have served as a stringent strategy encouraging reduction in the stream of unaccounted income, consequently checking the generation of black money.

- **Disbursement Rate Microfinance Institutes’ slow down**
  Micro finance institutions (MFIs) are the institutes which provide financial assistance to micro businesses. The MFIs have acknowledged that the move may result in a delay in collection of installments from the clients in the near future which will have an impact on disbursement.

- **Effect on Micro Businesses**
  Indian Micro Small and Medium Enterprises (MSME) sector contributes considerable share in India’s GDP. But Small and Micro, especially micro businesses faced lot of problems as most of the transactions take place on cash basis. So the move demonetization had hampered micro businesses resulting into slowdown in micro enterprise sector.

- **FMCG Products**
  Consumer expenditures also affected by that decision as only those products were purchased which were necessary for daily consumption and mostly the small traders like ‘kiranastore’, ‘small bodies’, ‘thelawala’ etc. were affected. It was also a short term impact.

- **Service Sector**
  Service sector is hit very hard by Demonetization decision. The Nikkei India Services Purchasing Managers' Index (PMI), which tracks services sector companies on a monthly basis, stood at 46.7 in November, down from 54.5 in October.

- **Effect on Anti-Social Activities**
  Demonetization is a mighty blow on the anti-social activities. Due to the demonetization funding of anti-social activities were curbed.

- **Drop in industrial output**
  There was a reduction in industrial output as industries were hit by the cash crisis. The growth in eight core sectors such as cement, steel and refinery products, which constitute 38% of the Index of Industrial Production (IIP), decreased. The construction industry has been badly hit with significant wage implications for its casual workforce.

- **Jewelry and Real Estate Business**
  The liquidity squeeze caused by demonetization will be negative across sectors with high level of cash transactions. Real estate, jewellery, retailing, restaurants, logistics, consumer durables and luxury brands, cement and some segments in retail/SME lending space faced short term instability.

- **Effect on Money Supply**
  Money supply reduced in the market due to withdrawal of currency notes from circulation. This had a short run impact as the problem of less money supply was solved by introducing new currency notes in the market.

- **Online retail stores temporarily stopped cash on delivery facility**
  Successful online retail stores in India like Flipkart, Snapdeal and Shopclues had put a cap on the maximum value of cash-on-delivery transactions, while Amazon India had temporarily stopped cash on delivery. 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.

**POSITIVE IMPACTS**

- **Digitalization and E-wallet firms**
  With cash exchanges affected bydiminishing liquidity, alternative and digital payment modes, for example, e-wallets, online transaction utilizing ebanking, debit and credit card usage has expanded fundamentally. 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. Digitalization brings individuals into the formal economy, subsequently expanding money saving, diminishing taxavoidance, and making everything fair between tax compliant and tax evading companies.

- **Reduce Government Liability**
  It will reduce the risk and cost of cash handling as soft money is safer than hard money. It will also reduce government liability. Since every note is a liability for the government, the old currency will become worthless for those people, who
choose not to disclose their income. Thus, this will extinguish government's liability to that extent. It is expected approximately Rs 5 lakh crore may come to the government in the form of extinguished RBI liability, taxes and penalties.

- **Effect on Banks**
  As directed by the Government, the 500 and 1000 Rupee notes which now cease to be legal tender are to be deposited or exchanged in banks (subject to certain limits). This in turn will enhance the liquidity position of the banks, which can be utilized further for lending purposes. This move pulled a large chunk of first time users to banks. According to a study conducted by Moody's, people tend to continue using banking services once they have crossed the 'first-time user' mark.

- **E-Business**
  E-commerce companies saw a decline in cash on delivery (COD) orders. Several e-commerce companies hailed the demonetization decision as an impetus to an increase in digital payments. They believe that it would lead to a decline in COD returns which is expected to cut down their costs. The demand for point of sales (POS) or card swipe machines has increased.

- **Impact on IT Industry**
  New-age payments like PayTM, Instamojo Payment Gateway, PayUMoney and Mobikwik, online banking and e-commerce platforms saw increased demand in the near future as people are showing willingness to move away from cash. This particularly will benefit IT startups and Fintech domains that work on online payments that enable technology processes for such companies. This also could create key requirements for technology processes for tracing financial information. Government initiatives such as Aadhar, Jandhan will nudge a lot of Fintech companies to enable financial institutions and banks to adopt these facilities.

**Demonetization to Digital Remonetization**

Demonetization is followed by remonetization to replace the old discontinued currency with a new currency in the economy. Remonetization after demonetization is an uphill task initiated by Government to make India Digital. The Digital India programme is a leading programme of the Government of India with a vision to transform India into a digitally empowered society and knowledge economy. “Faceless, Paperless, Cashless” is one of stated role of Digital India. As a part of promoting cashless transactions and converting India into less-cash society, various modes of digital payments are available such as Banking cards, USSD (the Unstructured Supplementary Service Data), AEPS (Aadhaar Enabled Payment System), Mobile wallets, Banks Pre-paid Cards, Points of Sale, Internet Banking, Mobile Banking and Micro ATMs.

**Measures Taken By the Government**

Some of the incentives/measures taken by the Government are –

1. The Central Government Petroleum PSUs has initiated to give incentive by offering a discount at the rate of 0.75% of the sale price to consumers on purchase of petrol/diesel if payment is made through digital means.
2. The Central Government through NABARD will also support Rural Regional Banks and Coopertative Banks to issue “Rupay Kisan Cards” to 4.32 crore Kisan Credit card holders to enable them to make digital transactions at POS machines/Micro ATMs/ATMs.
3. Railway through its sub urban railway network shall provide incentive by way of discount upto 0.5% to customers for monthly or seasonal tickets from January 2017, if payment is made through digital means. All railway passengers buying online ticket shall be given free accidental insurance cover of upto INR 10 Lakh.
4. Public sector insurance companies will provide incentive, by way of discount or credit, upto 10% of the premium in general insurance policies and 8% in new life policies of Life Insurance Corporation sold through the customer portals, in case payment is made through digital means.
5. The Central Government Departments and Central Public Sector Undertakings will ensure that transaction fee associated with payment through digital means shall not be passed on to the consumers and all such expenses shall be borne by them. State Governments are being advised the same.
6. Public sector banks are advised that merchant should not be required to pay more than INR 100 per month as monthly rental for PoS terminals/Micro ATMs/mobile POS from the merchants to bring small merchant on board the digital payment eco system.
7. For the payment of toll at Toll Plazas on National Highways using Radio-frequency Identification (RFID) card/FastTags, a discount of 10% will be available to users in the year 2016-17.

Further to above incentives provided, Government also announced new Yojanas post demonetization. As Indiamove towards a digital and cashless economy, the Government announced two schemes- Lucky Grahak Yojana and Digi-Dhan
Vyapar Yojana to give cash awards to consumers and merchants who utilize digital payment instruments for personal consumption expenditures. The prizes range from INR 1000 to INR 1 crore and the transactions permitted are from INR 50 to INR 3000 to keep the focus on the common man. The schemes will not only give a boost to cashless transactions, but will particularly bring the poor, lower middle class and small businesses into the digital payment fold, and new way of life.

**Pros and Cons of Demonetization**

Black money is nothing but money generated in transactions which are hidden from Government in order to avoid tax. This is usually done in cash because cash transactions do not reveal the identity of the person who is doing it. So, in the cycle of financial system somewhere black money gets converted into white money. For e.g. a person who holds black money uses it for purchasing luxurious products such as car, gold, precious metal etc, for which he pays in cash. Here, for the one who receives cash against his proper sales bill became white money. Another example, a person with black money donates to various temples or institutions, the recipient of black money gets it as white money. So, it creates a vicious cycle of black and white money. Earlier demonetization was said to be the failure due to lack of financial infrastructure to trace black money holders. But the present action has logically better chance of success. Because people across India were given an Identity (Aadhaar) and bank accounts were opened under Jan Dhan Yojana. Now, people can transfer money using various methods such as mobile transfer, internet banking, NEFT, RTGS and even pay through Debit / Credit cards also.

However, existing system of demonetization too have certain loopholes. As per the Central Board of Direct Taxation (CBDT) notification quoting of PAN is mandatory for transactions exceeding Rs. 50,000 during any one day or an aggregate amount of exceeding Rs. 2,50,000 during 09.11.2016 to 30.12.2016. Means a person with bank account without PAN can deposit up to Rs. 2,50,000 in multiple deposits of less than Rs. 50,000 on various days. Hypothetically a person knowing around 10 people with their bank account having few transaction, to deposit Rs. 2,50,000 per person without PAN can convert his black money into white money. Even a person who does not have bank account can exchange their old currency by providing ID proof up to Rs. 4,000 per day. So a person who has black money (in cash form) through paid agents gets converted his black money into white.

Looking into the misuse of this exchange, Government reduced the ceiling limit to Rs. 2,000 and use of indelible ink mark on the right index finger of the customer so as to identify that he/she has exchanged the old currency notes. However, this cannot be overcome with cash based economy meaning thereby we must move towards cashless economy to completely eradicate the menace of parallel economy.

All of us know that black money is not kept as hard currency in home for long time but rather used to buy gold, precious stone, luxurious goods or it is invested in real estate. This sort of black-money driven consumption is out of purview of the legitimate formal economy. The effect of demonetization on such consumption will be positive.

Agriculture sector is considered to be backbone of Indian economy, which contributes 15% to Indian total output. Here, cash is the primary and prevalent mode of transactions. So, agriculture which is primarily cash based economy has negative striking effect of demonetization. Agriculture is impacted through the input-output channels as well as price and output feedback effects. Sale, transport, marketing and distribution of ready produce to wholesale centres, is dominantly cash dependent. Disruptions, breaks in the supply chains feedback to farmers as sales fall, increased wastage of perishables, lower revenues etc that show up as trade dues instead of cash in hand and when credited into bank accounts with limited access affect the sector. Looking at these disruptions, Government relaxed some of its demonetization norms in agriculture sector. So again it cracks down the motive of demonetization.

**Measures needed to sustain demonetization benefits**

After a lot of efforts to erase the parallel economy, the efforts should not go waste. Following are a few measures which will help sustain the dividends of demonetization:

1. **Implementation:** The problem is not the existence of parallel economy or finding the measures to curb it, but it is implementation of all those measures to overcome menace of parallel economy. If Government takes initiation in implementing at least majority of the measures available before Government, then this problem finds solution on its own.

2. **Linking of Aadhaar:** All multiple bank accounts must be linked with Aadhaar. Even not only bank accounts but also various departments such as Income Tax, sales tax, VAT, Excise, Customs, Service Tax, Licensing department etc. so that, various transactions can be traced easily. This not only creates awareness among the people but also as controlling mechanism.
3. **Reduced tax rates:** One of the main motives behind tax evasion is high tax rates. Tax rates are to be brought down to such extent that cost of compliances must be lower than the cost of tax evasion.

4. **Mechanized System:** Due to corruption, we find that there are leakages in generating revenue to Government. If we plug those leakages, Government can reduce its tax rates. Reduced human interference in the system will reduce corruption.

5. **Declaration of assets:** Like wealth tax which was in force earlier, it must be made mandatory to declare every person’s asset to Government. Undeclared assets if found by Government, then the same can be seized by Government. This prevents mobilization of black money in the form of gold, land, house property etc.

6. **Simplified tax structure:** Many people are finding it difficult to understand various taxes and its calculation. So a movement of GST may bring transparent and clear picture of indirect taxes. At the same time removal of various tax mechanism in direct tax such as surcharge, education cess, short term capital gain u/s 111A etc will simplify the tax calculation mechanism.

7. **Uniform Property Registration Software:** Developing a uniform software network like stock exchange to register properties throughout the country is necessary to overcome holding of benami property.

**CONCLUSION**

From the above analysis, it can be easily concluded that the year 2017 is an important milestone for India and would mark transition from a largely cash economy to a less cash and a more digital economy. But the buzzwords like “less cash”, “cashless” and “digital” do not really convey the range and diversity of the transition.

Demonetization was broadly acknowledged and upheld by the masses because of its apparent advantages. The apparent advantages of having a more formalized and transparent economy, and decrease in black money exercises may trump the expenses to the economy, making demonetization a fruitful strategy activity over the long haul. The demonetisation undertaken by the government was a large shock to the economy. The impact of the shock in the medium term was a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency in circulation is extinguished. While it has been argued that the cash that would be extinguished would be “black money” and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy, this argument is based on impressions rather than on facts. The idea of demonetization is good but it has to be taken into consideration that most of the black money is kept in the form of land, buildings or gold or kept abroad. A surge in non-cash transactions through digital options such as mobile wallets and debit cards is a clear sign that India is gradually embracing the cashless economy, but it remains to be seen if this will continue when new currency notes come into circulation. However, one of the major concerns would be digital security. It may be noted that to have a smooth transition to adigital economy, the government needs to have a policy of digital security. A strong digital security and low risk will enhance the spread of digital/cashless economy. “When you expect an honest Government with no corruption and malpractices, you also have to be honest. Honesty is not one way road” – Prime Minister Shri Narendra Modi

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