

# Demonetization: The Economic Wave

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**Abstract-** *Demonetization is the act of stripping a currency unit of its status as a 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. Remonetization is restoration of payment in legal tender by issuing new currency.*

*In this paper, the researcher aims to study the advantages and disadvantages of demonetization and its impact on Indian banking sector. Despite major developments in paperless currency over the past decade, physical cash remains widely used throughout the world. It shows that its initial impact is on the unorganized sector of the economy. The paper argues that demonetization is a harsh measure. It is particularly harsh on the poor and the weak. However, it is likely to leave most of the accumulated black wealth unaffected. To the extent it encourages digitization, it will hurt the lower middle class by destroying low skilled jobs.*

**Keywords-** money, cash, cash crunch, cashless, e-money, Demonetization, Unorganized Sector, Organized Sector, Digital transaction platforms

## I. INTRODUCTION

On 8th December 2016, by causing an untold suffering to the common people, The Indian Government dramatically demonetized 500 rupee and 1000 rupee notes, which constituted about 85 percent of the total currency notes in circulation. The reason was to stop generation of black money and fake currency notes, instead of strengthening the administrative apparatus to stop tax evasion, corruption and illegal activity, the government went in for demonetization. With little warning, India's Prime Minister Narendra Modi announced to the citizenry on Nov. 8 that those notes were worthless, effective immediately – and they had until the end of the year to deposit or exchange them for newly introduced 2000 rupee and 500 rupee bills.

(some 78% of all Indian customer transactions are in cash), as long, snaking lines formed outside ATM's and banks which had to shut down for a day. The new rupee notes have different specifications, including size and thickness, requiring

re-calibration of ATMs: only 60% of the country's 200,000 ATMs were operational. Even those dispensing bills of lower denominations faced shortages. The government's restriction on daily withdrawal amounts added to the misery, though a waiver on transaction fees did help a bit.

## II. CHRONICLE OF DEMONETIZATION

Prior to announcement by Prime Minister Narendra Modi that high denomination notes would stop being legal tender from 9th November, there were two similar instances in India. The first instance was in 1946 and the second in 1978 when an ordinance was promulgated to phase out notes with denomination of Rs 1,000, Rs 5,000 and Rs 10,000.

The media in terms of numbers was limited in 1946 and 1978 when compared to 2016. Demonetization was first attempted by Janata Party Government under leadership of Moraraji Desai in the year 1978. The higher denomination currency notes were cancelled. However, the aggregate value of all the cancelled currency notes was Rs. 55,00,00,000 as against the recent value of Rs. 14,00,000 crore. India in 1978, 1990 and 2016 are just not comparable.

Demonetization is also tried in other countries, however, there no examples that such an exercise having helped avoiding 100% of black money, since, most of the money is kept in form of real estate, gold and alike assets

## III.NEED FOR DEMONETIZATION

The RBI annual report has led to a fierce attack on the government from critics over the purpose of demonetisation. Demonetisation was done to crack down on black money, which was significantly affecting India's GDP growth, but with almost all of the money now being accounted for there are doubts if the government's action was effective.

Demonetisation's long-term impact on the Indian economy is still debated. The government, meanwhile, has defended itself with the Finance Minister Arun Jaitley suggesting that just because the money is back with the RBI does not mean that black money hoarders have not been held accountable. RBI data states that out of Rs 15.44 lakh crore

worth of currency notes that were taken out of circulation, Rs 15.28 lakh crore have returned to the system and around Rs 16,000 crore is yet to be deposited back to banks. RBI report also says that about 8.9 crore units of the demonetised Rs 1,000 notes worth Rs 8,900 crore, had not come back into the system. There were 632.6 crore pieces of Rs 1,000 currency notes in circulation on the day of demonetisation. This reveals that just 1.4 per cent of Rs 1000 notes did not return after demonetisation.

The real objective of demonetisation was less-cash economy, digitisation, increased tax base and crackdown on black money. In the long run, there will be more formalisation of the economy due to demonetisation.

The total cost incurred on printing notes stood at Rs 7,965 crore for the current year as against Rs 3,420 crore during 2015-16. The rise in cost of printing was due to introduction of new currency notes after demonetisation, RBI said.

Taking note of RBI's data on demonetisation, former Finance Minister P Chidambaram said "RBI 'gained' Rs. 16000 crore, but 'lost' Rs 21000 crore in printing new notes! The economists deserve Nobel Prize."

According to a CNBC TV report, Parliament Standing Committee on demonetisation has accused RBI for not sharing demonetisation data with the committee earlier. The committee severely indicts government's handling of demonetisation while saying people can't be coerced to go digital. It has also raised concern on cyber security.

The share of the newly introduced Rs 2,000 notes in the total value of banknotes in circulation as at March-end was a little more than 50 per cent, it added. On November 8, Prime Minister Narendra Modi had announced demonetisation move to crackdown on black money and to curb cash transactions

#### IV. ASSETS OF DEMONETIZATION

- Putting a complete full-stop to corrupt-practices.
- Witness a sophisticated banking system.
- Reduced liability for the government.
- Reduced instances for tax avoidance.
- Increased GDP levels.

The benefit of demonetization is that it helps the government to track people who are having large sums of unaccounted cash or cash on which no income tax has been paid because many people who earn black money keep that money as cash in their houses or in some secret place which is

very difficult to find and when demonetization happens all that cash is of no value and such people have two options one is to deposit the money in bank accounts and pay taxes on such amount and second option is to let the value of that cash reduced to zero.

Another benefit is that due to people disclosing their income by depositing money in their bank accounts government gets a good amount of tax revenue which can be used by the government towards the betterment of society by providing good infrastructure, hospitals, educational institutions, roads and many facilities for poor and needy sections of society.

Since black money is used for illegal activities like terrorism funding, gambling money laundering and also inflating the price of major assets classes like real estate, gold and due to demonetization all such activities will get reduced for some time and also it will take years for people to generate that amount of black money again and hence in a way it helps in putting an end this circle of people doing illegal activities to earn black money and using that black money to do more illegal activities.

#### V. PITFALL OF DEMONITIZATION

Cash crunch is a major disadvantage of demonetization due to the unavailability of small currency denominations, an issue which makes it difficult to make small purchase. Sometimes, demonetization can be very inconvenient. For example, sometimes the government will remove certain denominations of bank notes from circulation but keep others. It can be annoying when smaller coins are removed from circulation and you do not have enough change. Further, queuing up in banks to deposit money or exchange currency can be inconveniencing.

Economic growth will experience a period of lull due to business disruptions, at least in the short term. Not everyone understands the essence of demonetization and, therefore, such an exercise is likely to result in panic among a section of the population. Some people are likely to take advantage of lapses in the financial system to engage in fraud and corruption when exchanging currencies. The normal trading activities may be disrupted by this process since it takes time for consumers and suppliers to adjust to the new monetary policy.

People can feel attached to their old bank notes and coins as they can feel that they constituted part of their tradition. If someone has sent some bank notes in the post in order to pay a bill, or if there is any substantial delay in processing a bill payment, and demonetization hits in the

mean time, the money set aside to pay the bill can become invalid. This is more common than you might think in highly bureaucratic systems.

#### **ATMs have to be re-calibrated:**

ATM machines have to be re-calibrated to accommodate the new currencies. It will result in additional costs for banks and also inconvenience customers.

#### **Short term financial crisis for poor people:**

If people adopt a new currency and this currency is not a successful one, then it can cause a financial crisis for everyone who is involved. Even a small change in the value of everyday items, or even a small amount of confusion about whether a currency is valid can mean a lot of hardship. As such, demonetization can increase and exacerbate inequalities within society, at-least in the short term.

#### **Confusing:**

Demonetization can be confusing and annoying – especially for people who are not able to get rid of their old notes in time.

The worse of demonetization is that once people in the country gets to know about it than initially for few days there is chaos and frenzy among public as everybody wants to get rid of demonetized notes which in turn sometimes can lead to law and order problem and chaotic situation especially in banks and ATM's which are the only medium to change the old currency units to new currency units.

Another disadvantage is that destruction of old currency units and printing of new currency new units involve costs which has to be borne by the government and if the costs are higher than benefits then there is no use of demonetization. Another problem is that majority of times this move is targeted towards black money but if people have not kept cash as their black money and rotated or used that money in other asset classes like real estate, gold and so on then there is no guarantee that demonetization will help in catching corrupt people.

As one can see from the above that demonetization has both advantages and disadvantages and it is up to the government to see and analyze all the pros and cons and then decide whether it is beneficial to go ahead with demonetization or not.

## **VI. PUSH TO DIGITAL BANKING**

A cashless economy is one in the flow of cash within an economy is non-existent and all transactions have to be through electronic channels such as direct debit, credit and debit cards, electronic clearing, payment systems such as Immediate Payment Service (IMPS), National Electronic Funds Transfer and Real Time Gross Settlement in India

#### **Benefits of Cashless Economy:**

Reduced instances of tax avoidance because it is financial institutions based economy where transaction trails are left. Curb generation of black money. IT will reduce real estate prices because of curbs on black money. It will place universal availability of banking services to all as no physical infrastructure is needed other than digital.

There will be greater efficiency in welfare programmes as money is wired directly into the accounts of recipients. It Reduces cost of printing notes, instances of becoming soiled or unusable and counterfeit currency. It also reduces costs of operating ATMs. Speed and satisfaction of operations for customers as no delays and queues, no interactions with bank staff required.

#### **Digital Transaction Platforms:**

**UPI:** Unified Payment Interface (UPI) allows you to make payments using your mobile phone as the primary device for transactions, through the creation of a 'virtual payment address', which is an alias for your bank account. UPI was launched by the National Payment Corporation of India (NPCI).

- **BHIM App:** The Bharat Interface for Money (BHIM) is an initiative by the Government to enable fast, secure and reliable cashless payments through mobile phones. BHIM is Aadhaar-enabled, inter- operable with other Unified Payment Interface (UPI) applications and bank accounts, and has been developed by the National Payments Corporation of India (NPCI). This seals the government's push towards digital payments after the demonetization that resulted in the scrapping of high-value Rs 1,000 and Rs 500 currency notes.

- **Aadhar Pay:** There are lots of payment apps in the market. These are the UPI apps, SBI Pay, Paytm, Phonepe, Freecharge, mobile wallets etc. But, the Aadhaar Payment App is special as you can pay through the Aadhaar Payment App without phone. It is possible because you the customer does not require the app. The merchant or people, who want money, have to arrange a smartphone, app, etc. The payer does not

require anything. This app is made for the merchants and shopkeepers. Customer would only enjoy its benefits. The Aadhaar Payment Apposes your fingerprints for the authentication. On the basis of this authentication, the money is paid from your Aadhaar linked account.

- **IMPS:** Immediate Payment Service (IMPS) is an instant interbank electronic fund transfer service through mobile phones. It is also being extended through other channels such as ATM, Internet Banking, etc.

- **POS Terminals:** A point-of-sale (POS) terminal is a computerized replacement for a cash register. Much more complex than the cash registers of even just a few years ago, the POS system can include the ability to record and track customer orders, process credit and debit cards, connect to other systems in a network, and manage inventory. Generally, a POS terminal has as its core a personal computer, which is provided with application-specific programs and I/O devices for the particular environment in which it will serve.

- **USSD:** USSD (Unstructured Supplementary Service Data) is a Global System for Mobile(GSM) Communication technology that is used to send text between a mobile phone and an application program in the network. Applications may include prepaid roaming or mobile chatting.

## VI. EMPLOYMENT AND DEMONETIZATION

The Centre for Monitoring Indian Economy has estimated that 1.5 million jobs were lost after demonetization. Alongside this loss of jobs, there has been a decline in the labour force participation rate (LPR). For a developing economy like India, a drop in labour participation rate is a sign of an economic slowdown. The All India Manufacturers' Organization (AIMO), which represents traders and small-, medium- and large-scale industries, conducted survey and has found a drop in employment of 60 per cent and loss in revenue of 55 after demonetization last year.

### Effect on Medium and Large Scale Industries:

Medium and large scale industries engaged in infrastructure projects, such as big-ticket road construction, reported a 35% cut in employment and 45% revenue loss. The industries like foreign companies, engaged in export-oriented activities reported 30% job losses and 40% revenue fall. In the manufacturing sector, medium and large scale industries reported the least job-losses are 5% and took a revenue hit of 20%.

It is further found that labour intensive units such as food and beverage, tobacco, textile, leather, wood and

jewellery employ nearly half of the total workers in the organized manufacturing sector of the economy. Given that nearly 84 percent of total factories have employment in the range of 0 to 99 are affected by the recent move of the government.

### Effect on Informal Sector:

The informal sector presently employs more than 80% of India's workforce. It includes workers in small and medium industries, grocers, barbers, maids and others. More than 95% of total transactions in informal sector are in cash form. The decision of sudden 'demonetization' therefore led the labor market dynamics changed significantly by rendering millions of informal workers exposed to increased uncertainty in employment; they resorted to 'reverse migration'.

Within manufacturing, labour intensive sectors such as textiles, leather and gems and jewelry have already reported considerable job losses due to supply chain and market disruptions. Demonetization is considered as a means of increasing formality in informal sector. But a 2009 OECD study on informal economies concluded that enforcing formality can be counterproductive and lead to an increase in poverty.

Many daily wage workers or contract workers were rendered jobless due to paucity of cash in the system. But even after re-monetization the number of new recruits has been reduced considerably as compared to pre demonetization. The 2016-17 economic survey also point out the decrease in demand for MGNREGA work in the aftermath of demonetization.

### Effect on Agriculture:

Agriculture was expected to grow at 4% this year according to, but demonetization is likely to dent that forecast. The impact is visible in different sub-segments. Winter crops such as wheat, mustard, chickpeas are due for sowing in a fortnight. Wheat prices were already up due to low stocks and anticipated shortfall in 2015-16 output and have firmed up further as demonetization.

The vulnerability of the small farmers in agriculture is best exemplified by the predominance of marginal and small holdings in the country. Marginal and small holdings account for 85 per cent of the landholdings. Farmers failed to find buyers or due to dearth of cash ended up getting low prices.

### Effect on Self-Employment:

Most of the self-employed workers lose their employment during the months of cash crunch. They don't able to sell their products because of cash crunch and lack of digital transactions facilities.

## VII. CONCLUSION

Demonetization is a beneficial process even though it has some demerits that may render it unfavourable in various ways. However, before any demonetization program is carried out, it should be carefully thought through and its impact on the poor should be considered. In this way, demonetization can be a chance for a fresh new start, or it can be something that causes unnecessary confusion for a country.

Indian reality is that many trades and areas are still cash-based and cannot be digitized just by willing it. Resulting disruption in the real economy stemming from this move is very significant and potentially fatal for some vulnerable sections of society. If some of the key areas are hampered, there is risk of mob violence and rioting. Since the entire country is at risk, there is no way of anticipating and preparing for this, either. So there is a risk of the situation getting out of hand as well. Apart from that it will not be enough just to do this [demonetization]. It has to be matched with a better; more streamlined and integrated tax system.

Government should focus on ensuring growth, job creation and investment. The urgent need is to get the private sector to start investing. One way to avoid winds of deflation is to kick-start private investments. There is a concerted attempt to improve ease of doing business, and technology is being used to deliver public services without leakages.

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