

# A Study on Demonetization and Its Implications on Indian Economy

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**Abstract:** A year ago, on 8<sup>th</sup> November 2016, the honorable Prime Minister of India, Shri Narendra Modi announced that the currency notes of ₹500 and ₹1000 would no longer be legal and their ban would come into effect immediately. The Demonetization of 2016 meant the removal of ₹ 500 and ₹ 1000 from usage as a currency. The government had also barricaded all the known passages through which hoarders may channelize unrecorded money without paying penalty under tax laws. The citizens had the 'deadline' of giving up their old notes and the citizens were restricted to withdraw only upto ₹ 2000 for the entire day per transaction. This limit was increased to ₹ 4000 per day on for the day. The cash withdrawal was from the bank ₹ 10000 per transactions and for the week it was set to ₹ 20000.

In the paper, the authors discuss about the implications that this demonetization had at the time of its implementation, what problems were faced by the citizens before the new currency came.

**Keywords:** Demonetization; Black Money; Parallel Economy; Counterfeit Currency

## 1. Introduction:

Demonetization is the act of stripping a currency unit of its status as legal tender. Legal tender it is anything which when offered in payment clears the debt. It is nothing new to the world. Many countries like North Korea, Russia, Zaire, Myanmar, have already implemented it and had failures due to flaw in the regulations. In India too it is no concept. It has already been implemented twice earlier in the year 1938 and 1954. It was introduced mainly counter Fake Indian Currency Notes (FICN) and Black Money. There is a parallel economy running in the economics of the country which has all the unaccounted, unreported, unrecorded cash and hinders the growth of the economy as these are away from the eyes of the government. A parallel economy corrodes and eats into the vitals of the country's economy.

According to a study conducted by Sukanta Sarkar (2010), on the parallel economy in India: Causes, impacts & Government Initiatives, she focused on the existence of causes and impacts of black money in India. As per her, the main reason behind the generation of black money is the Indian Political System which includes the Indian government which is just focused on making committees rather than to implement it. It concludes that laws should be implemented properly to control black money in our economy.

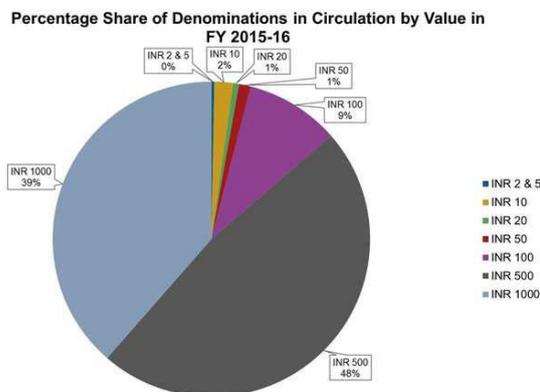
## 2. Previous Versions of Demonetization:

India is no new to the concept of Demonetization as it has experienced it twice earlier on the 12th January, 1946 and 16th January, 1978.

In the year 1934 ₹ 500 and ₹ 1000 notes were introduced and subsequently followed the ₹ 10000 notes in the year 1938. In the year 1946, ₹1000 and ₹10000 were removed from circulation but it did not cause a great impact because the higher denomination notes were not accessible to the commoners. According to the data available, only notes worth ₹ 9.07 crores were demonetized out of ₹ 143.97. There was no fool-proof administrative method by which a particular note brought by an individual could be proved as the life-savings of the hard-working man who presented it or established as the sordid gains of a black-marketer. Exempting the princely states from questioning when they presented the notes was another short coming.

In the year 1954, there was reintroduction of notes of ₹1000 and ₹10000 and in addition, ₹5000 notes were also introduced. In the early 1970's Wanchoo Committee was set up by the Planning Commission of India. It suggested the demonetization as a measure for unearthing as well as counter spreading of demonetization. The then Prime Minister, Moraji Desai in the year 1978 announced that notes of denomination ₹1000, ₹5000 and ₹10000 would go out of circulation with an

immediate effect. The main aim to introduce demonetization was to curb black money spread in the country. The total amount was in circulation amounted to ₹145.42 crores and out of which 89% or ₹129.4 crore came for exchange.



**Fig 1: Denomination Wise Currency Note Distribution**

### 3. Demonetization 2016

The government introduced the new currency of denomination ₹2000 and a new note for the ₹500. It had taken country to a sudden shock as it was confidential and there was not even a single hint given. There was a chaos all over as to how to get the new notes and where the old notes were still valid. Government tried to curb every way out through which they can channelize the money. According to a report published by RBI, the ₹500 and ₹1000 notes are approximately 86% of the circulated currency. So the government decided to remove these currencies as a legal tender. Also the maximum Fake Indian Currency Notes are in the form of these currencies, which provides growth to terrorist activities. The usage of high denomination notes for storage of unaccounted wealth has been evident. It must be noted that the total number of bank notes that were in the circulation increased by 40% between the years 2011 and 2016 and the and for the 500 currency notes in the circulation, the value in shot-up to 76% and for 1000 currency notes, it was increased to 109% during the period. According to a report published by Swiss Bank in 2011, it showed that India had \$1500 billion as the total black money and on the second rank was Russia with \$470 billion cash as black money.



**Fig 2: Banned Notes of ₹500 and ₹1000**

### 4. Similarities Between Both Demonetization:

#### 5.

The major similarity between them is that both the events were kept confidential and was unknown to the majority. Only a few government officials knew about it. The note ban by Morarji Desai and Narendra Modi aimed to drive away black money out of circulation in the economy. One was directed completely for opposition and the other shook the whole of the country. Narendra Modi announced about demonetization in an address that was broadcasted across all news channels. Similarly, Morarji Desai announced the ban over the radio after which the banks were closed the following day.



**Fig 3: New Notes of ₹500 and ₹2000**

### Differences between Demonetization of 1978 and 2016:

The differences are tabulated below:

Point of Difference	Demonetization of 1978	Demonetization of 2016
Prime Minister	Morarji Desai	Narendra Modi
RBI Governor	I.G. Patel	Urjit Patel
Notes	₹ 1000, ₹ 5000	₹ 500 and ₹

<b>Banned</b>	and ₹. 10000	1000
<b>Motive</b>	Ban was implemented simply to immobilize the funds of the opposition party	Immobilization of fake Indian currency notes and curbing black money
<b>Inflation Rate</b>	2.54%	4.94%

**Table 1: Differences between Demonetization of 1978 and 2016**

### 6. Impacts of Demonetization:

Demonetization post its implementation had impacts on the Indian Economy in both optimistic as well as pessimistic way. Considering the short term effects, the economy suffered a liquidity crunch. Also, there was a welfare loss of the currency that could be utilized by the population of India. This hit the daily wage earners, casual labourers and small traders, who tend to reside out of the formal economy using the cash frequently. This earning section of the society would be losing their economy in absence of the liquid cash. Also, the firms would be forced towards cash stringency and reduce the labour cost, leading to reduced economy of the poor working class. This would also lead to trickling up of the liquidity chaos to the higher income section of the society with advancement of time. Indian economy is an emerging economy, but with the introduction of demonetization, there was a high probability of reduced consumption, income and investments which could result in reducing the GDP growth of the country. This is due to the fact that the impact of liquidity would last for three-four months. One of the severe impacts of demonetization could be seen on the counterfeit or fake currency. With the introduction of demonetization, there would be a regular check on the circulation of counterfeit currency. Also, there was chaos and frenziness during its beginning days. Another impact that demonetization had was that the destruction of old currency notes and printing of the newer currency notes would incur costs, that needs to be borne by the government and if the above stated costs are higher than the employed benefits, then there's no use of demonetization being implemented. The recent demonetization was implemented with the purpose of curbing the problem of black money and if the citizens had kept their cash as black money and used the money in other classes of assets such as real estate, gold etc. then this step of introducing demonetization would have definitely helped in catching the corrupt. It also reduced the consumption activity of the Indian economy as the money in the banks was increasing. During demonetization the consumption slipped and

market growth slowed down, and parallel there was an increase in the deposition in the bank which was intended for better economy in coming future. As discussed, the demonetization had increased in the banks and according to a report by the Reserve Bank of India with the deposits crossing to 5 trillion rupees from 10<sup>th</sup> November to 18<sup>th</sup> November. Many leading banks such as SBI, ICICI, and HDFC reduced their deposit rates. Post demonetization, the national markets, BSE and NSE fell to 6.3% and 5.9% respectively for the duration 8 November to 22 November.

### 7. Sources of Black Money:

Black Money is the money generated in legal way in the transactions which are hidden from the government so as to avoid paying tax. It is done by means of using cash as a medium of transaction. Not all cash transactions are black money transactions. They become black if hidden from the government to show reduced income thus leading to low tax payment. Many a times the Black Money is plugged into the working economy of a country, because there exist a person for whom the black money is legal cash income and used for his consumption. In the chain of creation it depends completely on the receiver of how he determines it in his book of accounts. It is mostly the poor people who provide some service and their income being under government radar causes the money to add up to the country's economy. The major flaw lies with the tax department who are not able to successfully remove the systematic procedure to create black money.

Another major source are the gold and other precious stone traders who illegally give rise to asset buying and formulate a way to convert the black money to white money (the part of the economy which is under the government radar). Even bribing in cash is done in black money which facilitates smoother working of their business but not having idea of the generation of the wealth which they lead to in the parallel economy.

Also NGOs give rise to growth of black money by raising funds from the citizens for good cause but create a fraud by misrepresenting the numbers and the promoters gaining benefit from the privileges the NGO provides to them. They misuse the NGO for their personal benefit and thus creating a root for generation of black money. The trusts are both receptacles and users of black money. They are not creators.

### 8. Eroding Black Money:

The government has already introduced several measures to counter black money by personal identification through PAN card and Aadhar Card. It has also set cash transaction limits on purchase and sales of ₹2 Lakh.

The government should also help in providing low cost direct bank transfer method such as NEFT, RTGS. Reforming the tax system so that the cost of compliance is lower than cost of tax evasion. This will promote people in doing legal transactions at a higher scale.

The Government has taken many steps already including enactment of a new law 'The Black Money and Imposition of Tax Act, 2015' to deal with black money stashed abroad.

The government is also taking proactive measures internationally by signing pacts which would enhance the sharing and exchange of information with foreign countries and combat tax evasion/black money.

### 9. A Year After Demonetization:

It has been a year since demonetization and it had great impact on the Indian Economy. After the implementation of demonetization, India lost its status of the "best emerging economy" and suffered a major setback in terms of GDP growth. We can say that the currency is best re-utilized. It is being used for different purposes intended for the betterment of a country like South Africa. Also according to the latest reports, the central government has tied up with a Kerala based company, Western Indian Plywood Ltd. For recycling and converting the notes into hardboards which would be used in South Africa 2019 polls.

### 10. Conclusion:

The demonetization was a success for the government as it has created a sense of anxiety among the people of what the government is capable of doing as its next move. The government has also introduced new currencies of denomination ₹50 and ₹200 for the people for more ease of transaction.

The fright of government's next move has led the people to believe as well as fear the government for its new policies. This will lead to a better and a cleaner economy which would not directly or indirectly lead to betterment of the people at large. So, it is better to be on the safe side by adding up to the economy by helping government curb the parallel economy then promoting it because the

government is working on ways to track the black money generators and would stop the menace and punish the guilty.

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