

IMPACT OF DEMONETIZATION IN INDIA

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With the announcement of PM Narendra Modi that the denomination of Rs. 500 and 1000 would cease to be the legal tender from 9th of Nov, 2016, the whole country was taken aback. This decision generated unprecedented excitement and sensation in the whole country in particular and the world in general. The government's decision to demonetize paper currency notes of Rs. 500 (US\$7.40) and Rs. 1,000 (US\$15) denomination of the Mahatma Gandhi series rendered the legal tender ineffective in the whole country. It is worth taking into consideration that such notes accounted for 86% of the total currency in the system. When this news was broken by the P.M. over the television, social media got inundated with messages and information of all sorts ranging from welcoming the decision to predictions of doomsday. Some affected people began counting the trash they had heaped for years legally or illegally.

The whole country was rife with rumors. Some who considered themselves smart enough attempted to invest their dying currency in gold. Such people also tried to contact their close friends and relatives in this hour of crisis. The government had announced that people could get only Rs. 4000 of old denomination exchanged with the new one. Consequently, there were massive queues before the banks and ATMs and such queues were conspicuous with their presence in every city, small and big. With every passing day, these queues were getting longer and serpentine. The government had set 30th December, 2016 as the last date for the whole process. The clients were

authorized to deposit the old cash worth Rs. 2.5 lakh till 30th December.

The thrust of this initiative was to curb the menace of black money, corruption and fake money. Except the black money hoarders, the common men welcomed the move. The whole opposition got united against this initiative citing one reason or the other. They termed this decision a draconian law and asked the government to roll back it. Tirades were hurled against the government for such a decision. However, the Modi government was also prepared to carry out counter attacks.

OFFICIAL STAND

Addressing the press conference, Mr. Urjit Patel, the Governor of the Reserve Bank of India, and Mr. Shaktikanta Das, Economic Affairs secretary explained the reason behind such a move. They told the media that during the period between 2011 and 2016, the supply of notes of all denominations increased by 40%, while that of Rs. 500 and Rs. 1,000 increased by 76% and 109% respectively. They drew the attention of the journalists to this fact that it was due to forgery and such fake currency being used to fund terrorism in India. The decision, Mr. Patel said, was taken six months ago and the printing of new currency notes had already begun.

OBJECTIVES

The government of India asserted that it was constrained to take the decision of demonetization in view of the following:

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1. To put a stop to counterfeiting of the current banknotes.
2. To choke the funding of terrorist activities.
3. To crack down on black money.
4. To prevent corruption, use of drugs, and smuggling.

PRECEDENTS

During the British rule, the government introduced the demonetization of the banknotes of Rs. 1,000 and Rs. 10,000 denominations in January 1946. In 1954, the Government of India led by Mr. Nehru introduced new notes of Rs. 1,000, Rs. 5,000 and Rs. 10,000 denominations. On 16 January 1978, the coalition government of India under Mr. Morarji Desai demonetized the currency notes of Rs. 1,000, Rs. 5,000 and Rs. 10,000 so as to curb counterfeit currency and black money. According to an estimate, India has got one of the highest levels of currencies in circulation at over 12% of gross domestic product and of this cash, 87% is in the form of Rs. 500 and Rs. 1000 notes. This is a global practice. Central banks of several countries keep on pumping huge amounts of cash into the economy, and it is largely done in very large denominations only. To cite some instances, \$100 bills account for 80% of the cash supply in America and in Japan, ¥10,000 note (about \$100) accounts for 90% of total cash holdings. Most of this cash keeps underground black economies vibrant.

As is obvious that Indian government is not the first to demonetize large currency bills. The European Central Bank has made the announcement to this effect that it will phase out the €500 mega-note, much against the preferences of cash-loving Germans. The benefits of phasing out large paper currency are very crucial for an economy and even more to a society such as India where corruption has become a part and parcel of life. The government has assured the honest Indians for

a joyride ahead. Some world renowned economists such as Ken Rogoff and Richard Thaler have been pleading for a less-cash economy. The reason being that it is safer and fairer to have a less-cash economy.

TIMING OF ANNOUNCEMENT

The timing of the demonetization was meticulously planned. Prior to the announcement, it was ensured that the Pradhan Mantri Jan-Dhan Yojana (PMJDY) in India, citizens' access to bank accounts is nearly complete. A demonetization move would have been impossible if low-income households were unbanked. PMJDY has provided them with free bank accounts, which can also be used to transfer government payments. The need for scrupulous people to stash cash in mattresses, therefore, has decreased. This initiative by the Prime Minister has also followed the income disclosure scheme where people are provided an opportunity to declare their wealth accumulated through various means. It was the proper time, therefore, to send the right signal of a crackdown on black money and corruption within India.

It goes without saying that it is not an easy task and as such the next few months are expected to be traumatic. Then this has to be viewed as teething troubles for an economy trying hard to reform its corrupt system. This move has underlined an urgent need for debit cards, electronic transfers and mobile payment platforms to be widely adopted. Behaviors take time to change, especially for those set in their ways. Institutional support from financial institutions, telecom platforms, and payment interfaces also have to rise to the occasion and fill the supply gap. They have to adapt to the ways of all, particularly those that are new to formal financial transactions. But there is more hope than ever before. Using a Paytm card is becoming the reality of the day!

Economists are of the opinion that we should aim at going less-cash, and not cash-less. Cash is an easy option for transactions and that is why the government has introduced new Rs. 2000 bills because there are legitimate high value transactions in every economy. The fundamental idea behind this unprecedented shock is to raise the cost of illegal transactions. It is a fact that the lure of lucre gives rise to crime. Normally they are anonymous. This is why it is suggested that less-cash helps in maintaining a balance between fine financial transactions and curbing malpractices. This fact should not be lost sight of that the new Rs. 2,000 bills have been designed with enhanced security features, and as such this measure is not just new money replacing old money in the system.

Now the million dollar question being raised by experts and common men is whether such an unprecedented move has eradicated black money and corruption in India. Some people are of the opinion that Indians are highly creative and they can devise numerous ways and means to circumvent this demonetization. There is little doubt that this apprehension has got the grain of truth. There are numerous ways to grease the palms of government officials. Criminal transactions are also possible. Taxes also can be evaded without Rs. 500 and Rs. 1000 bills. But now the good thing likely to be is that the removal of large bills will make several criminal and illegal activities more costly such as tax evasion, human trafficking, drugs, extortion and terrorism. Scaling back large bills does not amount to ending crime, but one thing is clear that it will make the underground economy employ riskier and less liquid payment methods. All this augers well for a country that is admittedly and notoriously very corrupt because all this may reflect in bringing the graph of corruption down. Such a measure like demonetization can act as

deterrent for criminal transactions in the economy of India.

The present measure is likely to send some strong signals to some sectors having a larger cash component in their transactions, particularly real estate, film production, campaign finance, etc. Such a move will register a correction in these markets. These corrections may be deflationary (reducing prices) or contractionary (reduce business). Only time will tell actually what happens. But one thing can be surely said that after such a radical measure the market may reflect genuine demand and supply in the real economy for the time being.

If substantially implemented, this will send a strong signal about India's anti-corruption drive and is very likely to improve the country's reformist stance. It also provides a boost to the government's financial inclusion drive, pushing more households towards efficient banking and payment infrastructure. In the immediate run, we are likely to witness larger bank deposits, price corrections and better tax collection possibilities in the economy - all good indicators for Indian bonds.

BLACK MONEY DEPOSITED

The demonetization initiative aimed at ending the black money which was believed to be a parallel economy. It was expected by the government that the honest persons would deposit their money and the black money would remain with dishonest persons. Some detractors are of the view that demonetization has completely failed and their plea is that over 90% of black money has turned out to be white as it has been deposited in the banks. Black money has converted itself into new currency notes. It is estimated that out of total Rs 14.18 lakh crore or 14.18 trillion (US\$210 billion)) of demonetized currency in circulation till March

2016, consisting of 15,707 million of Rs, 500 notes and 6,326 million of Rs. 1,000 notes; more than 12.6 lakh crores have found themselves deposited in different banks by 3rd December. This massive deposit, according to such section of society, goes contrary to the success of demonetization.

Now the most critical question arises, 'Where is the Black Money? Such critics assert that only few thousand crores have been seized by the authorities, and for which over 100 people died. This price is too high for such a petty amount. They believe that this is going to be the most devastating decision of the Indian Government.

They cite the data that black money is not an Indian malady only. It is a global concern which could not be eradicated by even developed countries. Due to the non-application of authorities' mind, the initiative turned out to be more a currency conversion or currency swap than demonetization. It became an exercise to convert black money into white.

UNPREPAREDNESS OF RBI

At the time of announcement of demonetization in India, the RBI was not prepared to face the situation. The new notes are smaller in size than the previous notes and as such they could not fit into the ATMs. There are estimated to be 2, 20,000 ATMs in India and they have 4 cassettes of different sizes in which the notes of different denominations can be loaded. The new notes of Rs. 500 and Rs. 2000 denominations are not of the normal size as banned notes of Rs. 500 and Rs. 1000 denominations, while they should rather have been similar. Consequently the immediate need of replacing 4, 40,000 cassettes of ATMs arose. This aggravated the situation and the new currency became less available. Still some ATMs have to be re-calibrated. It would have been far better to have planned the replacement

beforehand. The people would have got their money.

DETRACTORS' STAND AGAINST DEMONETIZATION

INCREASE IN TOTAL BANK DEPOSIT

It is a fact that the Scheduled Commercial Banks of India surpassed the previous records of deposits of last two years in September 2016. According to RBI details, Rs. 102, 08,290 crore Or 102 lakh crore arrived in the banks and this amount was 5.89 lakh crore more than that received in August 2016, amounting to an increase of 13.5%. This smacks of a leakage of the decision of demonetization as is being alleged by some politicians.

INCREASED FOREIGN REMITTANCE

During the tenure of Congress government, the maximum limit in Liberalized Remittance Scheme (LRS) i.e., to send money overseas was fixed at US \$ 75,000. However, the Modi government enhanced this limit in the very first week of coming into power to US \$125,000. Then the government again enhanced to US\$ 250,000 on 26th May 2015, thereby increasing the remittance of Indian money to foreign countries.

MAURITIUS ROUTE TREATY

Every sensible person is aware that the black money is deposited in the accounts of Swiss and Panama. But more than 33% of FDI in India is made from Mauritius Route as a participatory note for the last five years. It is done in the form of benami or pseudonym Shares of Companies, where the black money of Indians returns after travelling overseas. Thus it gets legalized. It was essential to stop this route but it was not done as required. Surprisingly, 3 days before demonetization, this Mauritius Route Treaty was extended.

PRIOR LEAKAGE OF DEMONETIZATION

The RBI Governor told the media that only the top government officials, security agencies and RBI were aware of the demonetization. But the media had already reported about the introduction of Rs.2,000 denominations way back in October 2016, well before the RBI announcement, giving rise to unsavory controversy. It is significant to note that prior to six months, the RBI Governor was Mr. Raghuram Rajan, not Mr. Urjit Patel and the new banknotes have the signature of the newly appointed Governor. Now the question arises how Mr. Urjit Patel had started signing new notes when he was not even the Governor of the RBI.

A fortnight prior to the official announcement, the Hindi newspaper quoting RBI sources reported about the release of new Rs. 2000 note alongside withdrawal of old Rs. 500 and Rs.1000 notes and this came true. Likewise, the Chairman of the State Bank of India publicly stated about the coming demonetization way back in April 2016.

EXCHANGE OF CURRENCY AT COMMISSION

The people in Mumbai exchanged old notes at 40% commission while in Bangalore it was 10%. Some bank managers were doing the same at 10%. The government offered an option of 50% tax and penalty plus surrendering interest on another 25% of the deposit for 5 years. This amounts to 12% at prevalent rates. The people would not like to pay 62% to convert their black money. The black money was being exchanged on commission basis at 10% to 40%. The game of black money that was confined to a few corrupt people became a cottage industry throughout India. Then the Government of India also jumped into the fray and tried to earn something in the process. The PM again announced the 50-50 scheme for black money.

LOANS WRITTEN OFF

After the declaration of demonetization, the Indian Banks wrote off 1.14 lakh crore Rupees of Big Business Houses. For example, the SBI wrote off about 8000 crores of Vijay Malaya. The bad debt of Rs. 8 lakh crore is still pending and would be dealt after demonetization.

ADVERSE EFFECTS OF DEMONETIZATION

The immediate effect of demonetization was liquidity crisis, as 86% of the currency had been withdrawn. The situation was akin to the draining of 86% of blood. Thus the death was imminent. The cash contributes to working capital, but the cash was removed, causing a great scarcity of cash needed for the growth of economy. Consequently, the consumer demand dropped. The people became suspicious to spend as they did not know when the cash would arrive and they did not want to do away with the cash in hand. The petty traders, hawkers or vendors who purchase raw material on a daily basis and sell it on streets did not have working capital. They lost it first due to the lack of consumers and second due to the loss of working days in queues to withdraw money. The business men of perishable items were worst hit.

The detractors allege that demonetization has turned out to be a great fiasco as it has hardly achieved any objective for which it was targeted. Rather it has dealt a severe blow to small scale industries, businesses, agriculture, transportation, trading etc. The public was constrained to queue up outside the ATMs for hours together in an inadvertent atmosphere. About 50% of the ATMs in the country were non-functional and there was a great scarcity of cash for several months. The present demonetization move has reduced the number of jobs. The people such as Nepali workers who did not have any bank account or proper identity proof were forced to exchange the

money on commission basis. The common men had to pay a huge price of demonetization as over 120 people died due to the inconveniences caused in queues. The refusal to accept old banknotes by hospitals also added insult to injury and that too resulted in some deaths. The daily wage earners and laborers became the victim of retrenchment due to less cash to pay them. There has been a loss of several men's working days. The organized sector has experienced a fall in production. For example, the top two Auto companies worked for three days a week only. There was a shortage of money for the workers and suppliers and no cash was coming back from the retailers. The whole country was queued up. The age old Indian culture was affected as festivals and family occasions like marriages could not be celebrated at the traditional scale. A father of a daughter could not get money from the banks after standing in the queue for three days despite facing an emergency as his daughter was to undergo emergency surgery. At last the girl died. There are other examples of such nature. The basic principle of law and justice is that no innocent person should be penalized. Gold and jewelry were sold at double the prices creating more black money, defeating the very purpose of demonetization. Agriculture sector is heavily dependent on cash and farmers had no cash to purchase seeds, fertilizers and pesticides. The demand of card swipe machines increased. The sale of e-commerce companies declined by 30% in cash on delivery orders, but they welcomed digital payments. The demonetization dealt a severe blow to the small scale industries (SSI), most of which were either closed down or were at the verge of closure.

POSITIVE EFFECTS OF DEMONETIZATION

1. It is well said that it is not important that justice is done but it is equally important that it looks that justice is done. Since

independence, the graph of corruption is ascendant only and the Congress government was never serious about the issue of corruption. Modi government has at least showed its commitment to eradicate corruption.

2. The sleuths of Income Tax departments have confiscated new currency at different places throughout India. Illegal money is reportedly seized. For example, cash worth of Rs. 4.4 million (US\$65,000) was seized in Chhattisgarh.
3. There were frequent reports that new Rs. 2000 notes were seized throughout the country despite a weekly and daily limit on cash withdrawal from banks. Like Rs. 4 crore in Bangalore, Rs. 33 lakh in West Bengal, Rs.1.5 crore in Goa, 18 lakh in Tamil Nadu, Rs. 10 crore in Chennai, and Rs. 242 crore at other places.
4. Media reported that some people made it a routine activity to withdraw money from the bank. In a way, they are beneficiaries to some extent. Some persons reportedly amassed millions of rupees in new notes.
5. As a by-product of such an operation, the activities of insurgent Naxalites also got interrupted. A petrol pump owner who was trying to deposit Rs. 2.5 billion was arrested in Ranchi. This money belonged to banned CPI (M) and more than 300 insurgents staged a surrender due to shortage of cash.
6. Such a move has successfully generated a fear psychosis among the mal-practitioners and criminals and a feel good factor among the common men.

OUTCOME OF GOVERNMENT INITIATIVES

The government has confiscated a large amount of black money across the country and this is not a mean achievement. The Government of India informed the parliament that during the last 31 months the State confiscated 1, 25,000 crore of black money, out

of which, 61,500 crore came from Income Declaration Scheme ending 30th September, 2016. Under Section-132 (4) of Income Tax, about 21,354 crore was recovered from the people and business. Under Section-138 (A) of Income Tax, Rs. 22,475 crore was received during the survey from the tax payers. Rupees 8186 crore of undeclared income arrived from HBC Bank Geneva after the revelations made by the French Government in 2011. Rupees 5000 crore was received through the revelations made by the union of international whistleblowers. This total amount comes out to be 1,22,265 crore.

IMPACT ON ECONOMY

It is reported that more than 15 lakh crore of the demonetized currency had arrived in the banks by 30th December 2016. According to Bloomberg, more than 97% of the banned currency in the form of Rs. 1000 and Rs. 500 notes were deposited in the banks. However, the RBI did not give the official figure.

The Vice Chairman of Policy Commission asserted that the adverse effects of demonetization on economy would be recovered in the first two quarters of the next financial year 2017-18. He opined that the decline in the growth rate in the last quarter 2015-16, i.e., after the demonetization would be recovered in the next financial year. However, the Chief Statistician of Central Statistical Department of Government of India, releasing the first advanced estimates related to the GDP on 6th January 2017, said that the rates of GDP in 2016-17 could go down to 7.1% from that of 7.6% in 2015-16 and that the per capita income too would go down to 5.6% from that of 6.2% in the previous financial year. A former Finance Minister expressed the view that the GDP would go down more than the estimates given by the Indian Government. The decrease in the GDP of just about 1% means

the loss of 1.5 lakh crore. He said that the RBI and Statistical Department too had acknowledged the decrease in GDP due to demonetization. He further said that, "Demonetization was like much ado about nothing. It was like the Mountain in Labor in Aesop's Fables. A mountain had gone into labor and was groaning terribly, but in the end, it gave birth to a mouse."

CONCLUSION

There is a great impact of this move initiated by the Central Government. This move has a great bearing on the Indian society and economy. For example, at the time of the announcement of demonetization, the society had to avoid purchasing luxurious things. There was a decline in ostentatious expenditures on marriages and other ceremonies. The society grew lesser materialistic and people more frugal. With the fake money destroyed, Indian economy would witness a big boom in the time to come. The Indian currency is likely to command respect in the international market. Such a move will act as a great deterrent to the terror-related funding and therefore to criminal activities. Corruption will be discouraged to a great extent as people stop the tendency of accumulating money using foul means. Such a move may turn out to be a step towards bridging the gap between the haves and the have-nots. Initially there were some hardships for a couple of months. But this inconvenience was transitory and for short term. However, it has to be borne in mind that it is against the spirit of natural justice to penalize the innocent in order to bring black money hoarders to books. Good initiatives may not yield the positive result overnight. But they are worth taking. What matters the most, is the motive of the person who has initiated such a move. There is little doubt to say that the motive is to make India a developed country, a super power to reckon within the comity of nations.