



## DEMONETIZATION-IMPACT ON INDIAN ECONOMY

**Dr. S. K. Khatik**

*Professor and Head, Department of Commerce, Ex-Dean faculty of Commerce, Chairman, Board of Studies Commerce, Barkatullah University, Bhopal.*

### **Abstract**

*Demonetization of currency means when face value of a coin or paper currency loses its legal tender status in the economy. It is an act of replacing old unit of currency with a new currency unit or withdrawal of a specific currency from the market. In the history of Indian currency, India has experienced three times the demonetization of currency, in the year 1946 Rs1000 and Rs10000 banknotes were withdrawn. The second demonetization has taken place in the year 1978 to withdraw Rs1000, Rs5000 and Rs10000 and the third demonetization has happened recently on 8<sup>th</sup> November 2016, to withdraw Rs500 and Rs1000 banknotes from the circulation of the currency. The objects behind towards all these demonetization were to abolish black money, corruption and fake money. This paper analysis the causes and effect of demonetization on Indian economy and also includes the government initiatives before the demonetization such as Jan Dhan Yojana, Digitalization and Income Declaration Scheme(IDS). While analyzing the effect of demonetization on Indian economy it has been observed that online transaction has increased significantly which make the system more accountable and efficient.*

**Keywords:** *Demonetization, Caseless transaction, GDP, Corruption, Black Money, Fake Money.*

*JEL Classification Code: E00, E20, E23, E26.*

### **Intoduction**

The Indian rupee (INR) is the official currency of the Republic of India. The rupee is subdivided into different denomination like Rs 1, 2, 5,10,20,50,100,500 and 2000 which is controlled, managed and issued by the Reserve Bank of India (RBI).The Reserve Bank of India was established in the year of 1934.The circulation of the currency and demonetization has been done by RBI with the guideline of government of india.The demonetization had been done three times in India. The first time it happened in the year of 1946 the denomination of Rs.1,000 and Rs10,000 notes, in the year 1938 the RBI introduced first time the largest currency denomination notes of Rs10,000, the reason behind to control over black money and inflation. The second time it happened in the year of 1978 when Rs1000, Rs5, 000 and Rs10, 000 denominated notes were demonetized. In the year 1954, these notes were re-introduced in the Indian economy as a result it gives momentum to inflation and black money. On account of high inflation and pilling up of black money in the economy the Janata party coalition Government(BJP),in the year of 1978,the Finance Minister H.M Patel gave instruction to RBI Governor I.G Patel to withdraw high denomination notes of Rs1000, Rs5000 and Rs10000 from the circulation of money. In the month of October, 1987 and November, 2000 the RBI re-issued Rs500 and Rs1000 notes respectively. The move was then justified to control the volume of banknotes in circulation due to inflation. The third time on 8<sup>th</sup> November 2016, the old denominated notes of Rs500 and Rs1000 were demonetized and re-issued new denominated notes of Rs500 and Rs2000 under the leadership of Honorable Prime Minister Shri Narendra Modi.This demonetization has been done to control over corruption, black money and fake currency.

- Bank notes in Ashoka Pillar watermark series in Rs 10 denomination were issued between 1967 and 1992, Rs 20 in 1972 and 1975, Rs 50 in 1975 and 1981 and Rs 100 between 1967-1979.
- The banknotes issued during this period contained the symbols representing science and technology, progress and orientation to Indian art forms.
- In the year 1980, the legend Satyameva Jayate — ‘truth alone shall prevail’ — was incorporated under the national emblem for the first time.
- In October 1987, Rs 500 banknote was introduced with the portrait of Mahatma Gandhi and Ashoka Pillar watermark. Mahatma Gandhi (MG) series banknotes – 1996 were issued in the denominations of Rs 5, (introduced in November 2001), Rs 10 (June 1996), Rs 20 (August 2001), Rs 50 (March 1997), Rs 100 (June 1996), Rs 500 (October 1997) and Rs 1,000 (November 2000).
- The Mahatma Gandhi Series – 2005 bank notes were issued in the denomination of Rs 10, Rs 20, Rs 50, Rs 100, Rs 500 and Rs 1,000 and contained some additional/new security features as compared to the 1996 MG series.
- The Rs 50 and Rs 100 banknotes were issued in August 2005, followed by Rs 500 and Rs 1,000 denominations in October 2005 and Rs 10 and Rs 20 in April 2006 and August 2006, respectively.

### **Concept**

Demonetization refers to an act of stripping a currency unit of its status as a legal tender. Demonetization is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit.

### History of Indian Demonetization Notes The Picture of First Demonetization Notes



RBI RS1000 Note in, 1938



RBI RS10000 Note in, 1938

These Notes were Demonetized in the Year of 1946.  
The Picture of Second Demonetization Notes



RBI Rs. 10000 Note In, 1954



RBI Rs. 5000 Note in 1954



RBI, Rs 1000 Note in 1954

These notes were demonetized in January 1978.  
The picture of third Demonetization note



RBI Rs. 500 Note In Year 1987



RBI Rs. 1000 Note in Year 2000

These notes were demonetized in 8<sup>th</sup> November 2016.

### Justification of the Study

Indian economy is the fastest growing economy in the World. As we have abundant sources of natural resources, pleasant weather, work force, forest and water resources but the growth is sluggish. The size of real GDP as compare to USA, UK and China has not been increasing due inflation, corruption and fake currency. It has been observed that during 2010 to 2016 the average CPI inflation was floating between 12.11% to 4.97% which effected the consumption, production, saving and investment. Corruption is the biggest problem in India because of this fake currency in the economy has increased tremendously. All these issues are responsible for poverty, unemployment, high rate of inflation and low growth rate in GDP. Therefore there is a need of combating corruption, black money and fake money. All these issues are challenges for the government of India to control. So the present government that is Bharatiya Janta Party(BJP) has initiated to demonetize higher value notes of Rs500 and Rs1000. So this encourage me to study and analysis the impact of demonetization on Indian economy .

### Objectives of the Study

- To analyze the concept of demonetization.
- To analyze the causes of demonetization in Indian economy.
- To analyze Impact of demonetization in Indian economy.

### Research Design

In this study I have taken secondary data's. Sources of this data's are RBI bulletin, central statistical organization and NITI aayog.

### Limitation of the Study

- Non- availability of sufficient data and literatures.

### Analysis of Demonetization and there Impact

#### Analysis of Demonetization

The Indian economy is the fastest growing economy in the world. It registered significant growth in consumption, production, saving and investment. For smooth functioning of the economy, RBI issued new currency notes from time to time to fulfill the requirement of the market. As per the RBI till March, 2016 total currency value in circulation was Rs16415 billion, among these circulation the composition of high denomination notes of Rs500 and Rs1000 were 47.85% and 38.54% respectively. It has been noted that the total number of bank notes in circulation rose by 40% between 2010-11 and 2015-16, the increase in number of notes of Rs500 denomination was 76% and for Rs1000 denomination was 109% during this period which leads to hyper inflation in the economy. Table 1 reveals, high denominated notes like Rs500(47.85%) and Rs1000(38.54%) together had accounted 86.38% of the total value of banknotes as compared to other denominations notes like Rs2, Rs5, Rs10, Rs20 and Rs50 together accounted 13.68% of the total value of banknotes in circulation. These shows disappropriation of different denominated notes in the economy. Due to excess circulation of high denomination notes which leads to corruption, black money, fake money and inflation. Thus, the Government of India is bound to cancel the high denomination bank notes of Rs500 and Rs1000.

Currency Value (Rs)	In Rs Billion	In %
2 and 5	45	0.27%
10	320	1.95%
20	98	0.60%
50	194	1.18%
100	1578	9.61%
500	7854	47.85%
1000	6326	38.54%
Total	16415	

Source: RBI

### Causes of Demonetization

**Bribery & Corruption:** In India Bribery and corruption are the significant challenges. The 2015 Transparency International Corruption Perceptions index ranked India 76 out of 176 compared to its neighbors Bhutan 27<sup>th</sup> rank, Bangladesh 139<sup>th</sup> rank, Myanmar 156<sup>th</sup> rank, Nepal 130<sup>th</sup> rank, Pakistan 117<sup>th</sup> rank and Sri Lanka 84<sup>th</sup> rank. Following are the areas which are most vulnerable to corruption.

- Real Estate:** Peoples such as politicians, businessmen and NRI's often use cash to buy property in the name of their relatives or trusted employees without paying the tax. It has been noted that during buying and selling of property the real estate developers generally demand 70% payment in check and 30% in cash.
- Tendering Processes and awarding Contracts:** Construction activities such as roads and bridges construction work are dominated by construction mafia i.e. grouping of corrupt government officers, materials suppliers, politicians and construction contractors. According to World Bank report only 40% of fund handed out for the poor reaches its needed peoples, due to corruption all social spending contract proven to be waste.
- Education:** Corruption in education system reached an all time high; particularly when the nation visualizes education as a driver of growth. Vyapam scam and DMAT scam are the few examples which indicate corruption in education system. Many private colleges like medical, engineering and other professional courses demand capitation fees.



- d) **Bureaucracy:** To get the work done in a public office the people have to pay bribes. Taxes and bribes are common between states borders-Transparency international estimates that truckers pay annually Rs222 billion in bribes.
- e) **Money Laundering:** In India money laundering is popularly known as Hawala transaction. As per Anti Money Laundering (AML) Basel Index, Out of 149 countries, India has been ranked 93<sup>rd</sup> in 2012, 70<sup>th</sup> in 2013 and 78<sup>th</sup> in 2016.High denomination notes are easy to transfer from one place to another place.
- f) **Drug Trafficking:** In India drug trafficking is rising issue in many states like punjab,uttar pradesh,west Bengal as per Narcotics Control Bureau(NCB).For buying and selling of drugs involved huge amount of cash.

### Black Money

The world bank in July 2010 estimated the size of the black money for India at 20.7% of the GDP and rising to 23.2% in 2007.A black money damage country's economy. It generates inflation which adversely affects the poor and the middle classes more than the others. It reduces government revenue which could have been used for welfare and development activities. Following are the ways where black money are used,

- a) **Election Poll:** It has been noted that in 2014 lok sabha election different election party spend Rs30,000 crore of black money while the official data was Rs7,000-Rs8,000 crore.
- b) **Transfer Pricing:** Some Indian corporate under-invoicing their exports and over-invoicing their imports from tax heaven countries. In this way the promoters of public limited companies transfer their unaccounted money.
- c) **Participatory Notes (PNs):** High net worth investors (HNI), channelize their black money in the Indian stock market through P-notes'-notes are legally issued by FII's without KYC norms.
- d) **Swiss Bank A/C:** According to Central Bureau of Investigation (CBI) in February 2012, estimated that around US\$500 billion of illegal money is deposited in tax havens countries mainly in Swiss bank a/c, it's an hint of scam involving ministers.

### Fake Indian Currency Note

The circulation of fake currency in denomination of Rs500 and Rs1000 are comparatively larger as compared to other denomination notes. It is difficult to recognize the fake currency notes which are similar to genuine notes. For printing the notes India import its paper from three countries-American Banknote Company (USA), Thomas De La Rue (U.K.) and Glesecke and Devrient Consortium (Germany). The fake currency generally printed by Pakistan. In Indian economy the high denomination note printed on the paper which is brought from Thomas De La Rue the U.K.based company, the same company supplied paper to Pakistan also. Thus, high denomination value note like Rs500 and Rs1000 can easily printed by Pakistan. This currency has been used for illegal practices such as terrorism and drug trafficking. As per RBI,in 2015-16 the total Indian currency notes in circulation was 90.26 billion out of this not more than 0.63 million i.e. 0.0007% were detected fake currency. The value of fake notes in 2015-16 was Rs29.64 crore, which is 0.0018% of the Rs16.41 lakhs crore. The value of fake currency in circulation at any given time is Rs 400 crore, and 250 in every million notes are fake currency, according to joint study conducted by the Indian Statistical Institute (ISI) and National Investigation Agency (NIA) in the year 2015.

### Government Initiative toward Demonetization

Before demonetization, government took a variety of following steps:-

- In 2014, the government launched Jan Dhan Yojana to open accounts to those who does not have bank accounts; as on 20<sup>th</sup> April 2016, nearly 220 million accounts had been opened.
- In February 2016, the Government of India approved the guideline for promoting payments through cards and digital means.
- On 1<sup>st</sup> June 2016, Government of India came up with Income Declaration Scheme (IDS) 2016, It's an opportunity for those who didn't disclose their unaccounted income or assets and come out by paying the applicable tax, cess and penalty totaling 45% of the undisclosed income. By this scheme Government of India received Rs65000 crore.

### Effects of Demonetization

Following are the effects of demonetization on Indian economy

- The demonetization of Indian currency notes has particularly hit the agriculture sector, unbanked community and informal sector workers like daily wagers,homemakers,sexworkers and common man-about 13 crore people i.e. 1/3 of working population( 48 crore) who earn cash income are intensively effected because it is difficult for them to meet daily needs for their family.
- Corruption, fake currency notes, black money has been stopped for 2 to 3 years period of time
- The removal of Rs500 and Rs1000 notes and replaced with new series of Rs500 and Rs2000 notes has stopped parallel economy.
- Slow down in the consumption, production, investment and savings for short period. After 2 to 3 years recovery in the GDP is expected.

- After demonetization Indian economy registered significant increase in the on-line transactions and installations of swipe machines, be it at small shops or by street vendors. There has been a rise in the quantum of e-transactions, enabling speedy payments, which is good news for the economy. It has been seen that incredible rise in mobile wallets and it is quite possible that a large number of Indians will move straight from cash to mobile wallets. Government took following steps to motivate people to seek various digital modes
  - a. On 25<sup>th</sup> December 2016 government launched digital lottery schemes-Lucky Grahak Yojana for consumers and Digi Dhan Vyapar Yojana for merchant
  - b. The Vittiya Saksharta Abhiyan has been launched to create awareness and to encourage the people to motivate them to go digital.
  - c. On 30<sup>th</sup> December 2016, the Prime Minister launched a new e-wallet app, BHIM, to make it easier to transact online.
  - d. National Payment corporation of India (NPCI) launched RuPay under the Jan Dhan Scheme. RuPay is an Indian version of a credit or debit card and similar to international cards such as Visa and MasterCard.
  - e. On 25<sup>th</sup> December 2016, government launched an Aadhaar payment app, links the Aadhaar Card of an individual to his/her bank account.

### Advantage of Cashless Economy

The Indian economy is the fastest growing economy in the world. To break the grip of corruption and black money the idea of caseless economy is more appealing. Table no 2 reveals that following countries such as USA, China and Japan's has achieved less cash business transaction. This indicate huge scope for the strengthening the base of the untapped non-cash user market. Increasing the horizon of non-cash users will have implications for access to other financial services. However; the challenge is to strengthen the digital infrastructure of banks and to make transactions safe.

Table no.2		
Particular	GDP Size (\$ trillion)	% of cash of total economy
USA	21	8.6
China	14	12.7
Japan	4.5	11
India	2.46	22

### Findings

After analysis of this study, the following findings have been depicted:-

- Demonetization have a positive and negative impact on the society, but it is clear that it has a negative impact on the short period due to significant changes made by the government of India through demonetisation. Demonetisation have also negative effect on consumption, production, savings and investment. In caseless economy it is not easy to improve these sectors over the short period. GDP is also slow down for next 2 to 3 years due to demonetization, but apart from these negative effects it has also a positive effects on Indian economy that is it is helpful to prevent fake money, corruption, black money in the economy. After 3 years the GDP growth will be faster because the parallel economy should be totally stopped.
- Demonetization has encourage the digitalization of the financial transactions so that fake currencies and their use will be stop, money laundering will go down, While going digital facilities the tracking of financial transactions will be more easy and transparent but it will increases the cost as IT enabled infrastructure would be required on a grand scale.
- Demonetization is helpful to reduce the prices of goods and services
- Government source of revenue has increased, so it can use for some development work.

### Suggestions

Although demonetization has a negative and positive effect on the economy but there should be a need to take care of an improvement by implementing the following suggestions.

- Demonetization has a major negative effect on the survival of daily wages, homemakers, sex workers, common men thus government of India should generate job opportunity for the better survival of life.
- Government should promote self employment through training, financing and subsidies.
- Government should give training to common man so that they become user friendly to caseless economy.
- To open the banks in unbanked areas.

### Conclusion

The main purpose of demonetization is to combat corruption, terrorism, fake money and black money. In the long run this change will be positive for the economy. Black money hoarders will definitely lose out, eventually boosting the formal economy in the long run. Short term fall in real estate prices might benefit middle class citizens. This move by the Government along with the implementation of the GST and digitalization will eventually make the system more accountable and efficient.



**References**

1. RBI Bulletin
2. Ministry of Statistics and Programme Implementation
3. NITI Aayog
4. Ministry of Finance
5. Economic Times
6. Business Line
7. Business Standard
8. Live mint
9. Ministry of Micro, Small and Medium Enterprises
10. National Investigation Agency
11. Central Bureau of Investigation