



## Demonetization-Necessity and it's Impact on Indian Economy

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### ABSTRACT

The Government has implemented a major change in the economy environment by demonetizing the high value of currency notes – of Rs. 500 and Rs. 1000. India has carried out demonetization earlier two times, i.e. first was on 12<sup>th</sup> January 1946 ( Saturday ) and second one was on 16<sup>th</sup> January, 1978 ( Monday ) under Morarji Desai Government. This is the third time demonetization happen in India i.e. on 8<sup>th</sup> November, 2016 ( Tuesday ). So like this in India demonetization has occurred three times. On this ground government announced that INR 500 and INR 1000 notes will cease to be legal tender effective immediately. People have been given a time up to 30<sup>th</sup> December, 2016 to exchange the notes which are held by them. The purpose of this study is to compare and analyze the impact of demonetization and their significance in the economic development of India by comparing with other countries. The demonetization move has been taken in view to club black money, corruption and issues like circulation of fake currency and terror funding. Here I am going to discuss the reasons of it as well as its necessity to implement in India. I would also like to focus on how the tool of demonetization can be used to eradicate parallel economy. This is one of the biggest steps initiated by government in addressing the various issues like black money, circulation of fake currency, corruption, terrorism etc.

**Keywords:** *Demonetization, Indian Economy, Black money, corruption*

### INTRODUCTION:

On 8 November 2016, the Government of India announced the demonetization of all ₹500 and ₹1,000

banknotes of the Mahatma Gandhi Series. Prime Minister of India Narendra Modi announced the demonetization in an unscheduled live televised address at 20:00 Indian Standard Time (IST) on 8 November. In the announcement, Prime Minister Modi Sir declared that use of all ₹500 and ₹1000 banknotes of the Mahatma Gandhi Series would be invalid past midnight, and announced the issuance of new ₹500 and ₹2000 banknotes of the Mahatma Gandhi New Series in exchange for the old banknotes. 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. The sudden nature of the announcement and the prolonged cash shortages in the weeks that followed created significant disruption throughout the economy, threatening economic output. With demonetization effort 86% of India's currency was nullified that aimed to wash the stock of 'black market's cash supply' and counterfeit notes out of the economy and convert it into the licit, banked and taxable, part of the economy. To reduce the impact of sudden commercial collapse, a 50 day period ensued where the population could (ideally) exchange their cancelled cash for newly designed 500 and 2,000 rupee notes or deposit them into bank accounts.

### MEANING:

**Demonetization refers to an economic policy where a certain currency unit ceases to be recognized or used as a form of legal tender. In other words, a currency unit still loses its legal tender status as a new one comes into circulation.** The government can take such decisions to stop the circulation of a denomination of notes or coins in the economy. The

currency unit that has been demonetized is withdrawn from circulation. During the implementation of this policy, the currency unit that has lost its status as a legal tender is deposited with the banks or other authorized financial institutions and replaced with units that still have legal tender status.

**Demonetization can also be referred to as the process of moving people from a cash-based system to a cashless system (digital system).**

**OBJECTIVE OF THE STUDY:**

The objective of the study is,

- To study the positive and negative impact on economy.
- To know the present scenario of Black Money in India.
- To identify the necessity of demonetization of high level currencies of India.
- To study the impact of Black Money on Indian Economy.

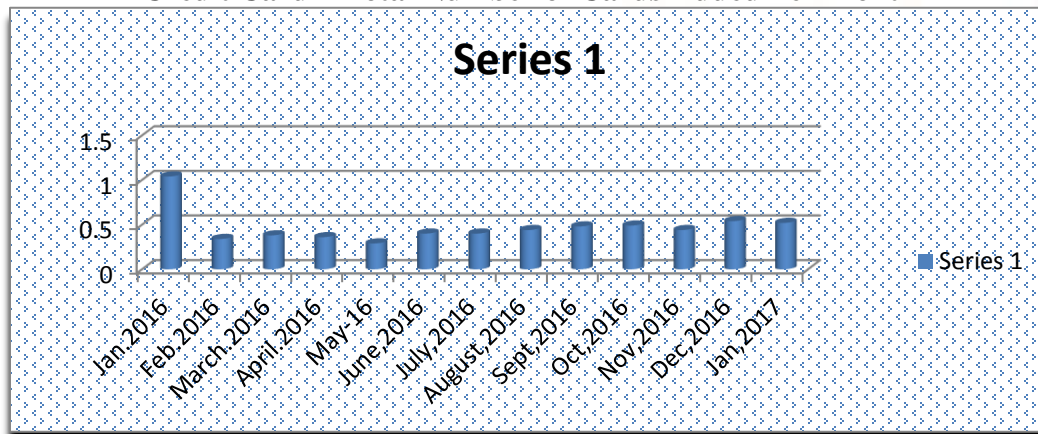
**Necessity:**

The major necessity to announce the demonetization was to, to curb Black Money in India. The inflation rates have been a major concern for the Indian Government. Rising demands of the people from the government made the Indian government to take such a huge step to make change in the monetary process.

**Cash Transaction:**

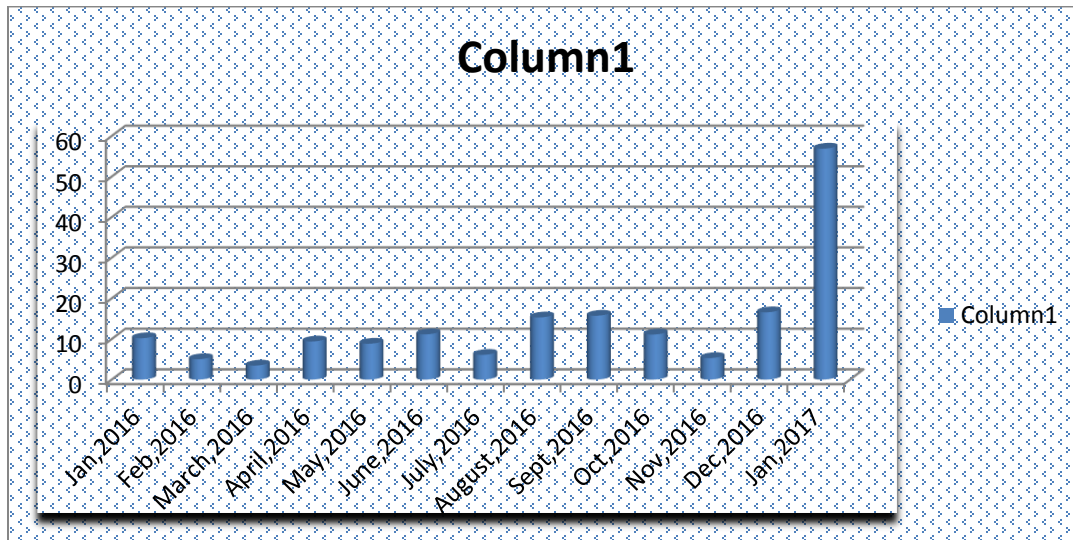
India is cash based economy in which 98% of the transaction by volume and 65% by value are made by using only cash. We know that cash is very difficult to handle and carry; it has become difficult for the government to keep a tract of the same. According RBI information out of all transaction 87% are cash transactions in India. The number of credit and debit cards in India is steadily rising but Indians still prefer debit cards over credit cards. In January,2017 a total of 28.8 million credit cards and 818 million debit cards were in operation, according to the Reserve Bank of India.

**Credit Card---Total Number of Cards Added Per Month**



Between January, 2016 and January,2017, India added some 0.52 million credit cards and added 56.86 million debit cards, while the number of cards is increasing slowly, people are gradually becoming more comfortable in using them as well, and there's an increase in their usage.

## Debit Card--Total Number of Cards Added Per Month



➤ **Abolish black money:**

People having black money generally keep their black money in highest denomination currency notes. This step would abolish black money from the economy as the owners will not be in a position to deposit the same in the banks. This step would make black money kept in cash which generally used to create chaos and terror or is lying with terrorists, Maoists, naxalites, scrap.

➤ **Elimination of Counterfeit Currency:**

It is not rocket science to understand that counterfeit currency is generally circulated in highest denomination notes to impact most. So, by demonetizing the highest currency notes India could almost eliminate 100% fake currency out of circulation in one stroke.

➤ **Higher Tax Collection:**

This led to higher tax collection as business men are depositing cash lying with them as current year income with advance tax. Defaulters of bank, property tax, electricity bills and telecom bills are clearing their long pending bills and thus utilizing their old currency notes.

➤ **A Speed Breaker for Corruption:**

This step of government will subdue corruption up to a certain level and for a considerable time period which in return will attract foreign investor to Indian market. Indian market has been the first choice of investors considering its large size and huge number of consumers. Till now they were reluctant to invest in India because of prevalent corruption and red-

tapism. Now we can say that India has overcome both the barriers.

**Impact of Demonetization on Indian Economy:**

➤ **Demonetization will hit the economy:**

The demonetization of the 500 rupee note and the 1,000 rupee note—the two highest currency denominations available in India—will likely hit the economy hard in the short term. The surprise move is expected to grind the consumption activity in the Indian economy to a virtual halt. The service sector, which dominates economic activity and involves a sizable chunk of cash transactions, will likely be hit the hardest.

➤ **On Small and Medium-sized Enterprises (SMEs):**

The small and medium-sized enterprise (SME) sector, as we understand, is a big chunk of the economy, contributing to eight percent of the GDP whilst employing more than 80 million people year on year. The labour wages in this sector are largely paid in cash and **wages have been adversely affected** by the demonetization move. Unemployment has also been reported owing to decline in demand of SME goods as the purchasing power of the consumers has contracted in the short term. Other sectors within the SME space like **restaurants and transport operators have also been negatively impacted** since economic activity has declined and also due to the fact that there is high tendency in this segment to accept payments through cash only.

➤ **On Agriculture:**

This is one sector where all transactions are in cash and, given the values involved, involve the higher denomination notes. The withdrawal of the old currency notes has put pressure on the market; farmers are having problems in selling their produce as both the parties have to agree on the mode of payment. Also since there is acute shortage of Rs 500 denomination notes presently, change for the high denomination Rs 2000 notes is not readily available with the vegetable and fruit vendors. This is also taking the buyers away from these vendors to big retail markets thus impacting the livelihood of the unorganized sector.

➤ **Effect of Money Supply:**

With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to reduce in the short run. To the extent that black money does not re-enter the system, reserve money and hence money supply will decrease permanently. However gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pick up.

➤ **Effect on GDP:**

The GDP formation could be impacted by this measure, with reduction in the consumption demand. Ambit Capital, a respected Mumbai-based equity research firm, has officially estimated that the demonetization-driven cash crunch will result in GDP growth crashing to 0.5% in the second half of financial year 2016-17. This means the GDP growth for six months, from October 2016 to March 2017, could decelerate to 0.5% down from 6.4% in the previous six months.

➤ **On Tax Compliance:**

India's **tax-to-GDP ratio is quite low at 16.6%** compared to other emerging economies. It is estimated that since more money, including black money, gets accounted for this will lead to **better tax compliance** owing to better targeting of income. The positive impact could be **lower tax rates as the tax base widens** and more people start paying taxes. The digital push of the government will also result in **higher indirect tax revenue** for the govt. in the form of service tax. Moreover businesses that under-reported their revenue earlier, will have to make proper disclosure, especially, of revenue received through digital or cashless means.

➤ **Impact on bank deposits and interest rate:**

Deposit in the short term may rise, but in the long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the savers when full-fledged new currency supply takes place. This means that new savings with banks is only transitory or short-term deposit. It may be encased by the savers at the appropriate time. It is not necessary that demonetization will produce big savings in the banking system in the medium term. Most of the savings are obtained by biggie public sector banks like the SBI. They may reduce interest rate in the short/medium term. But they can't follow it in the long term.

**CONCLUSION:**

Demonetization of old currency notes surely has had **some positive impact** like reducing the cash flow to terror organizations, dismantling of counterfeit currency infrastructure, better income tax and indirect taxation, boost to digital economy. However, it has come at a huge social and economic cost. Central government's recent decision to demonetize the high value currency is one of the major steps towards the eradication of black money in India. The demonetization drive will affect some extent to the general public, but for larger interest of the country such decisions are inevitable. Also it may not curb black money fully, but definitely it has major impact in curbing black money to large extent. Though the GDP growth will get hit for the year 2017, the effect of demonetization move along with policies like Digital India, Benami Act, cap on cash transactions will spur GDP growth in the coming years.

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