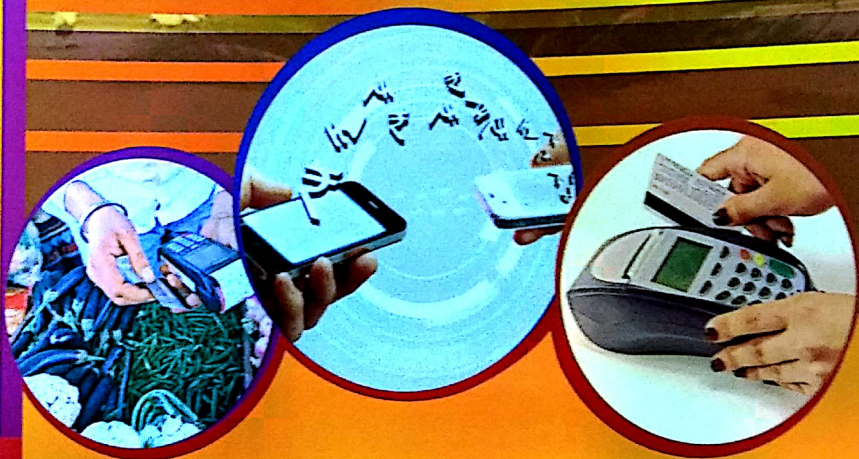


# A Beacon across Economics, Finance, Governance and Leadership in Recent Era

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# Demonetisation: Analysis of Its Impact in India

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## Abstract

The landmark step of demonetisation taken by Prime Minister Narendra Modi seems to have taken a major shift in the history of Indian economy; to push it toward cashless economy and to fight a war against corruption, fake currency, black money, and financing of terrorist activities. To curb black money, the step of demonetisation was taken by Government of India (GOI) on November 8 with declaration of ₹ 500 and ₹ 1000 notes as not a legal tender henceforth. These notes accounted for almost 86% of the total cash circulated in the economy.

The process of demonetisation created chaos in the cash dependent economy like India where almost 78% of transactions were executed in cash only. This step caused long snaking lines outside ATMs, non-functional ATMs, cash crunch and reduction in the businesses in Indian economy. This policy urged people to start using cash substitutes like debit cards and digital wallets, saying it will make transactions cheaper and easier in the long-term. This step was meant to push India "toward cashless economy at par with more developed nations".

So, this concept became a topic of interest for researchers to find out exact impacts of demonetisation in India. This is mainly a conceptual paper. The main stress of this paper is given on finding the impacts of demonetisation.

**Keywords:** Demonetisation, Cashless Digitised Economy, Black Money, Corruption.

## Introduction

Prime Minister announced the demonetisation of ₹ 500 and ₹ 1000 denomination notes on November 8, 2016. He addressed the public to join this drive as a *mahayagya* to weed out black money and to join the "festival of honesty and celebration of integrity". He termed it as a dawn in the era of Indian economy. Although this step has created loads of trouble in Indian economy in terms of cash crunch, lower GDP and slowdown in business, but according to Prime Minister "Stronger the ills, Stronger the pills!" is very much applicable in this scenario as well.

It is anticipated that the concept of cashless economy due to demonetisation will help to switch over from paper to electronic media, is likely to cut deeper inroads into the strengthening of functioning of the government, reduction of costs for bankers and customers alike. Also, the risks in handling and transportation, the delays in executing the payment and the possibility of disputes over the settlement of the transaction are minimal.

Even the RBI has also recently unveiled a document — “**Payments and Settlement Systems in India: Vision 2018**” — setting out a plan to encourage electronic payments and to enable India to move towards a cashless society or economy in the medium and long term.

In short, it is expected that “A step toward digitised economy will help to plug all these loopholes and making it sure that there are no leakages. This will result in smooth functioning of economy, reduction in interest rate, reduction in tax regime, availability of sufficient cash with banks and this will provide a bigger spurt to Indian economy”.

## Meaning of Demonetisation

Demonetisation is an act of removing a currency from its status of legal tender; this causes a change in the national currency of a country. In this step, current circulated currency is pulled back from the circulation; it is replaced with other new notes and can only be exchanged at the banks. Demonetisation can be partly and fully; sometimes countries completely change the old notes with new notes and with changed denomination. The government being sovereign can take such decision.

The opposite term of demonetisation is known as remonetisation that includes restoration of earlier form of payment as legal tender.

## Demonetisation in India

Prime Minister announced the demonetisation of ₹ 500 and ₹ 1000 denomination notes on November 8, 2016. These notes were ceased to remain legal tender from the midnight of November 8, 2016 only 4 hours after the announcement of demonetisation. These notes can be replaced by people from banks up to December 30, 2016. These issues can be summarised as under:

- Notes of ₹ 500 and ₹ 1000 denomination ceased to be legal tender from November 8, 2016 and can be replaced by banks only.
- Banks were also given a limited time to replace these notes until December 30, 2016.
- Restrictions on cash swap and the condition of depositing of notes into banks within a short period of time.

It is estimated by RBI that there are 15 billion notes of ₹ 500 denominations (approx. ₹ 7,853.75 billion) and 6 billion notes of ₹ 1000 denominations (approx. ₹ 6,325.68 billion) in circulation, and there is huge amount of fake currency in circulation at present. With this move, all the counterfeit currency will become worthless.

## Analysis of Effects of Demonetisation

### Positive Impacts

**Removal of counterfeit currency:** This step is considered as a landmark step for the removal of black and counterfeit currency. As with the help of this step, all the legitimate currency will be deposited with the banks and illegal currency will not be able to make its way toward banks and will disappear.

**Reduction in government liabilities:** This step of the Government will bring positive impacts on the economy in the form of reducing liability and increasing finances for the government. With this step, Government will be able to get money to finance their expenditures without borrowing from the markets.

**Reduction in inflation:** It is considered that this step will help to reduce the price level in the economy, as increase in money supply is considered as the main reason behind the increase in the

price level. Due to demonetisation of ₹ 500 and ₹ 1000 currency, it will help to regulate the money supply in the economy and ultimately help to reduce the inflation level.

**Reduction in corruption:** The main reason behind the execution of this landmark step is considered as this will help to reduce the corruption level as all the transactions will be executed with bank accounts only and will ultimately help to reduce corruption and black money.

**Possibility of rectification of misallocation of notes:** It was seen that in Indian economy there are mainly notes of higher denomination that carry huge value and are mainly in circulation. With the step of demonetisation, it is felt that this step will help to rectify the misallocation of notes in the economy and notes of lower denomination will also be popular.

## **Negative Impacts**

**Contraction of size of economy:** This process will reduce the level of economic activities in the economy by reducing the availability of cash. The reason is money is also used as mode of exchange for legal economic activities. So, demonetisation will contract the economy and reduce the level of economic activities leaving a negative impact upon the economy.

**Reduction in consumption:** Demonetisation of currency that forms 86% of the circulated money will result in the contraction of huge amount of transactions that are mainly based on cash. Money serves as medium of exchange. So, this will hamper consumption activities and will result in reducing the consumption level in the economy.

**Reduction of income and employment opportunities:** The process of demonetisation will reduce the volume of economic activities in terms of reduction in consumption and investment related activities. According to Keynes' theory of income and output determination, demonetisation will lead to reduction in opportunities of income and employment creation.

**Impact on small unorganised sectors:** In the unorganised retailing segments like Kirana stores, transportation, fruits and vegetables, and other perishable products supplying sectors will face negative impacts, as these businesses are supported by purchasing power only. So, these sectors will face reduction in demand and ultimately will have negative impacts.

**Inflation:** As stated in previous segment due to cash crunch, there will be excess supply in some of the sectors as compared to demand and will result in decrease in prices, but finally this will result into curtailment of supply and ultimately increase the price level. This possibility can lead to promoting the inflation in the economy. Moreover, it is expected that all the segments will sell their product at credit, hoping of getting their payments after the end of cash crunch will also lead to increase in prices and will support inflation.

**Negative Impact on Micro Finance:** Due to demonetisation, the Asia's third largest economy is facing cash crunch. Currently, there are some 60,000 micro finance firms in India, serving some 40 million customers. The installments are collected on a weekly basis and now the agents cannot collect ₹ 500 or ₹ 1000 notes from them. This has given hike to number of defaulters. According to, Bandhan Bank CEO, Chandrashekhar Ghosh, it is estimated that the temporary loss to be around ₹ 1,500 to ₹ 1,700 crore. Bandhan Bank, which was one of the largest micro finance institutions before it become a bank last year, has suspended its micro-credit disbursement after the government demonetised ₹ 500 and ₹ 1000 notes on November 8, 2016.

**Inconvenience to General People:** This step of demonetisation has created inconvenience to general public to convert their notes from banks and stand for a long in long bank queues. This step is not feasible for people who are not versed with technology.

**Negative Impact on Weaker Segments:** Weaker segments like drivers, maids, cooks, electricians and plumbers who provide services in the informal sector and depend on monthly or

bi-monthly cash payments will be negatively impacted. It is not feasible for a Chai wallah to leave his business and stand in a queue to deposit these notes in banks.

**No Impact on Big Firms:** The big fish will be left out whose black money is in the form of foreign currency, gold and stashed away in tax havens.

**India is Not Fully Ready for Cashless Transaction:** Regions like rural India, North East India, township areas, suburban areas, etc. are not modified enough to go for total cashless transactions.

Many normal people of metropolitan cities too are not fully computer literate and they are not fully accustomed with internet, PayTM, etc. Basically, a huge number of people are not accustomed with cashless transactions.

**Cash crunch:** This step will create a position of cash crunch. As the small denominations are accounted to only 14% to 15% of the total currency in the market, more and more small denominations would have been supplied assuming that currency may not be supplied in a large number due to the ideology of digitalising the currency.

**Real Estate:** This step will negatively impact real estate sector as well as most of the transactions in real estate are mainly cash based. Demonetisation will hit real estate industry very badly; people have now got no clarity on how to go ahead in terms of buying a land or a house. Government has to come up with some sort of awareness campaigns about how the future of real estate could be seen.

**Loss of Life:** Due to demonetisation, some people lost their lives standing in the banks' queues. That loss cannot be covered up by any of the actions of the government. Something has to be done with respect to the people who died due to non-availability of cash.

**Corruption at Different Levels:** This step proved that, given a chance, every individual is prone to corruption. Indian banking system is supposed to be one of the most stable, rigid and strongest across the globe. Our banking system is so strong that it could even face and withstand the global recession in 2008, but all that reputation is at stake now. This bold step leads to many banking frauds and illegal transactions across the country. Bankers, currency chests and may be a few at RBI played a major role in the frauds post-demonetisation. Police, CBI and IT raids are just seeing shocking and disturbing figures of new currency been supplied illegally. Also, poor people are prone to corruption. There are huge deposits in Jan Dhan accounts and bank accounts of poor people which shows even poor people are corrupted and are ready to save the corrupt. So, given a chance, at least 95% of people are prone to corruption.

"There is a famous saying in Telugu, the one who gets caught doing a mistake is a thief, and the one who does not get caught, and doing the same mistake is a king". We expect a very serious action with respect to banking frauds, as we common people are facing the trouble and cannot afford to see things happen this way. But, it is the responsibility of the government to take out all the culprits in order to gain the credibility, as it should not be very difficult to track the new currency as it is just a month old.

**No Change on Interest Rate:** Initially, it was expected that this step of demonetisation will help in reducing the interest rate in the economy, but this is also not possible as the funds deposited with banks will not remain for long with the banks as compared to the funds deposited in saving accounts. So, banks will not be able to create credit on the basis of this deposited amount. This will not help the banks to earn further income on this basis and banks will not be able to reduce interest rate in the economy and there will not be any impact on the rate of interest on various loans and no reduction in EMI is possible.

**Reduction in Demand:** Due to demonetisation, the demand in the various sectors will be reduced, as a significant amount is needed to do transactions in these sectors. These sectors are:

- Gold and jewellery industry,
- Real estate,
- Consumption goods,
- Luxurious goods industry, and
- Automobiles.

## **Conclusion**

The main target of the demonetisation was rooting out of counterfeit currency, financial terrorism and corruption. It is necessary for the proper success of this programme that there should be significant upgradation of the banking system as well as in the telecom infrastructure that would provide the backbone for digital transactions. It is not only the technological aspects, but there is an immense need of behavioural change that is being expected in people from using cash as a medium of exchange to using other cash substitutes both for making payments and receiving payments.

Moreover, growing amount of huge counterfeit currency notes in Bangalore and elsewhere demystifies the government contentions on demonetisation. Corruption is in the system and the system has to be addressed and not withdrawing currency notes. Terrorists have number of ways of finance and mere ban of currency may not affect them. Thus, the measure may at best be, partially successful but people have to pay heavy price for small gain.

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