



EFFECTS OF DEMONETIZATION

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ABSTRACT

To begin with, this study looks at the earlier accounts of instances of demonetization in India. This research paper furthermore, attempts at studying and trying to grapple with the impact that demonetization has made across the various sectors within the economy of India and the ripple effects that it will make in the future. The sectors that we try and dissect are viz. Finance, E-commerce, Banking, MSMEs etc and the macro Indian Economy.

Key words: Demonetisation, History, Black Money, Cashless Economy, MSME.

Introduction

On November 8, 2016, at the stroke of 8PM, billions of Indians, especially those at the bottom of the pyramid witnessed a watershed moment in the history of one of the fastest-growing economies in the world. As they watched, glued to their T.V sets, Mr.Narendra Modi, the honourable Prime Minister of India, announced the Government's decision to strip off the value of Rs 500 and Rs 1000 notes. What was to unfold in the coming months would test the robustness of the Indian Banking system and the veracity of the Government to its very core.

The move to Demonetize, was earmarked to serve as the hallmark move of a Government determined to deliver on its promises viz. to pull down the curtain on black money and to digitize the way India was going to do business post 2016. One year hence, this article looks back and reflects at the effects that this move has left on the Indian Economy which, clearly,

is still licking its wounds trying to move forward from the initial setbacks that were predicted to be unavoidable and short-lived. Overlooking the blatant and obvious mass inconveniences that demonetization caused, characterized vividly by ever-elongating queues in front of ATMs and Banks and inability to spend liquid cash freely, this article tries to look at the promises that the much divisive move made. Eradication of black-money, instigating people to pay taxes properly for unaccounted cash, bury a knife in the heart of terrorism, take unprecedented strides in making India a cashless economy; these were the taintless promises made that would shine a bright light on the economic sense that demonetization makes for India. But, is India shining brighter one year post-demonetization?

Historical accounts of demonetisation in the past.

The decision by the Government of India in 2016 to ban the Rs 1000 and Rs 500 notes was so unexpected that the whole nation was taken aback in astonishment at what seemed like a move unprecedented. One might be forgiven in thinking so, taking into account the scale and extent of the move and the total surprise that it, undeniably, was. But a little look over your shoulder into the history of the Indian Economy and one can see it was a third time that a move to demonetize came into effect, although the first in its scale and grandeur.

- **The first currency ban**

In 1946, even before its independence, the Rs 1000 and Rs 10,000 notes were taken out of circulation. The ban though, did not have the desired impact as such high value notes were not a theme in the possessions the a common man. This unavailability of these notes for the common man meant they were reintroduced in 1954 with an addition in the form of Rs 5000 as well.

- **The second ban**

In 1978, the then Indian Prime Minister, Mr. Morarji Desai banned the Rs 1000, Rs 10,000 and Rs 5000 notes, taking them out of circulation. The primary objective of the move was to cleanse the economy of its black money and its generation. This ban too did little in regard with the black money problem as it was believed that black money was never stored as currency for long and therefore the second ban could only affect the elite class.

Effects of Demonetisation

The impact that demonetization has made across the different sectors and the intended purposes and objectives that were envisioned are as follows:

i) Transforming personal finance.

If nothing else demonetization made piggybanks and money ‘stashed away’ in unknown corners of the house, redundant. Post demonetization Indians, even the conservative and old-school ones, have become more and more internet-friendly and tech-savvy albeit they were almost given no other options but transform the way they did transactions into a way that is now fast becoming a norm than an exception i.e cashless.

ii) Ensnarement of black money

Arguably the single most important point that the pro-demonetization advocates voiced was that the banning of Rs 500 and Rs 1000 bills would shove the ugly head of black-unaccounted money under the guillotine once and for all. But, in a twist in the tale, almost 99% of the money was deposited back to the RBI. It is believed that the hoarders either found a loophole by which they legitimized their black money or that they never held it in the form of cash in the first place. The fact that this possibility was predicted and reiterated by the RBI and many a financial expert, puts this motive to demonetize under unwelcome spotlight.

iii) Cut-off terrorism supplies

Another salient feature of the potential merits of demonetization was that it would most certainly cut-off the oxygen that terrorism needs to thrive in terms of funding, the lion’s share of which is counterfeit currency. The Government believed that this seriously concerning issue could be contained greatly with the demonetization move. The Income Tax department seized Rs. 474.37 crore in new and old currency from November 9, 2016 to January 4, 2017 (the demonetization period). Although there are no reports that the money taken back could in anyway be tracked back to suspicious terrorist activities, it is obvious beyond doubt that the cash reserves of several malicious fringe groups and terrorists were severely hit during the early period of demonetization.

iv) Inroads within the digital frontier

Demonetization was intended to be a curtain-raiser in the grander scheme of things that the Modi Government had envisioned for India and Indians. Part of which was to make India a

cashless and transparent economy. Initially, people turned towards digital transactions in large numbers with the nature of them ranging from day-to-day grocery visits to paying utility bills. But as the cash flow slowly returned to normalcy, the use of apps and e-wallets began to take a hit.

v) Transparency in Tax Payments

Demonetisation in India also meant pushing its citizens to deposit and account for the cash lying in corners of their houses (even for emergency use). According to Government report, the number of taxpayers in India saw a record rise in the post demonetization era and this can be undeniably put down as a chapter on success in the demonetization story. However, income tax increase has not resulted in a proportionately high direct tax collection. During the period April to September 2017, Net Direct Tax collections stands at 39.4% of the total budget estimates of the direct taxes. For the same period, last year, the share was at 38.65%. This measly increase in tax collection puts into question the decision-making that the Government made in this regard.

vi) Gross Downward (Domestic) Product

No matter how much pro-demonetization economists argue, there is no denying the move had left a lot of questions unanswered, as reflected in the country's GDP that sharply fell during the April-June quarter to a mere 5.7%. Although the Government claim these setbacks to be completely expected and temporary, putting it down to the economy re-adjusting and finding its feet again, the blame for the unpleasant reality of the economic slow-down which cannot be ignored, lies solely at the feet of the Modi Government. The raging question in each 'demonetization-made' economists' and experts' mind is that if these initial pitfalls and setbacks are just minor stumbling blocks as the economy recovers, or if it's the symptom of an economy reeling from a permanent blow served up by demonetization?

vii) Agriculture

The impact that demonetization has made on the agriculture sector has been nothing short of disappointing. The input-output channels were deeply wounded i.e the sale, marketing, transport and distributions of ready produce were adversely affected. This set forth a domino effect resulting in wastage of perishables and lower revenues that show up as trade dues instead of cash in hand.

viii) Micro, Small and Medium Enterprises (MSME)

When the move to demonetize was announced, it was almost unequivocally concluded by experts that the effects of this move would be felt hardest within the MSME sector which is highly dependent on hard cash. The cash cycle in this sector begins from an expense base that is almost always cash-based. Demonetization nonchalantly overlooked the significance of petty cash in the MSME sector, which was the medium, particularly, to pay small jobs that are usually settled in cash like welding, plumbing, tool repair jobs etc. These were vital cogs in the MSME machine that ended up disrupting and obstructing its flow. Going forward, hopefully, the strike on black money could end up pushing this sector forward to new heights.

Conclusion

Looking at the bigger picture, though the demonetization move has seemingly been a bit reckless in its execution in the way the Government went about in its implementation, the fact that the desire to curb black money and block terrorist funding is at its heart, is certainly laudable. Though the short-term effects of this move are mostly troublesome, behind the façade of inconvenience lies a firm focus on the well-being of the nation's economy in the long-run that is surely addressed with the move to demonetize. Whether the short-term pains will be offset by the long-term gains is a question only time can answer. This ultimately will judge the demonetization of 2016, as fantastic or fatal.

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