

INDIAN ECONOMY BEFORE AND AFTER DEMONETISATION

Sumit Yadav

Department Of Commerce, Assistant Professor, Baba Balraj Panjab University Constituent College, Balachaur, Punjab

Abstract

Demonetization is an act of cancelling the legal tender status of a currency unit in circulation. Countries across the globe have used Demonetization at some or the other point to control situations such as inflation and to boost economy. In November 2016, Indian government banned the high denomination notes of Rs.1000 and Rs.500 as a move to curb counterfeiting and money laundering. It also announced the issuance of new Rs.500 and Rs.2000 banknotes in exchange for the demonetized banknotes. The announcement of demonetization was followed by prolonged cash shortages in the weeks that followed, which created significant disruption throughout the economy. People seeking to exchange their banknotes had to stand in lengthy queues, and several deaths were linked to the rush to exchange cash. Initially, the move received support from several bankers as well as from some international commentators. The move was also criticized as poorly planned and unfair, and was met with protests, litigation, and strikes against the government in several places across India. This paper studies whether the act of demonetization fulfilled its said objective or not and compares the state of Indian economy before and after demonetization.

Keywords

Demonetization, corruption, counterfeit banknotes, cashless transaction, black money, terrorism

Introduction

Demonetization is a process by which the currency of a country ceases to be a legal tender of the country. Demonetization is an act where the old unit of currency gets retired and replaced with a new currency unit. It can also be considered as withdrawal of a specific currency from market. This was not the first time when Indian currency was demonetized in India, but it has happened twice before. First in the year of 1946 and then in the year of 1978, in January 1946, Rs1,000 and Rs10,000 banknotes were withdrawn but the same Rs1,000, Rs5,000 and Rs10,000 notes were reintroduced in 1954, and were again demonetized in January 1978. So the demonetization that took place in India in November 2016 was after almost 36 years.

Demonetization – November 2016

On 8th November 2016, Government of India had announced that from today onward rupees 500 and 1000 rupee note will not be a legal tender. The decision had wiped out 86 per cent of the total currency from circulation. This sent a shockwave across the Indian economy. To uproot the problems of corruption, black money, and counterfeiting, Prime Minister Narendra Modi orchestrated this master plan which had reportedly swept off a mammoth portion of India's monetary base. It was assumed that this would eliminate the black money from the system and would also increase cashless transactions in the country and untie all knots in tax collection. But on the other hand, rural households and elder citizens had been worst hit due to the sudden monetary reform. The decision to scrap all Rs.1000 and Rs.500 notes had made it to headlines all over the world, attracting both positive and negative comments.

According to The Reserve Bank of India, the most important reason for the demonetization of 500 and 1000 rupees note was the rise of fake currencies of the same notes, and also the higher occurrence of black money in the economy. The fake notes were being used for illegal activities by anti-nationalists like terrorists and India being a nation of a cash-based economy, the circulation of fake currency continues to be a threat.

On one hand demonetization helped to eradicate black money, counterfeiting and corruption and on the other it also gave a boost to the transactions of e-wallets, debit cards, credit cards and online banking. With the cancellation of Rs.500 and Rs.1000 currency notes, e-wallet companies such as Paytm, PayU India, Mobikwik,

etc. gained a good volume of business. Such E-wallets were expected to be the biggest beneficiaries of the decision of demonetization taken by central government.

Many people favored the decision of the government to demonetize the currency for the betterment of economy as whole but many people also criticized it as demonization had created a great turmoic and negatively affected the economy. Three years down the line, India's economy has seen a lot of turbulence with GDP growth going down to six-year-low, fiscal deficit growing significantly, and various sectors, including auto and manufacturing, facing crises. A lot of changes have definitely taken place in the Indian economy since demonetization whether they are positive or negative. This paper analyses whether the act of demonetization has put Indian economy at a better position than earlier or it has worsened the situation.

Objectives of the study

1. To understand the meaning and objectives of demonetization.
2. To study the positive and negative impacts of demonetization on Indian economy.
3. To compare the state of Indian economy before and after the act of demonetization.
4. To analyze whether the Indian economy stands at a better position after demonetization or not

Methodology

This study is of analytical nature which compares the state of Indian economy before and after the demonetization took place and also studies the meaning, reason and positive and negative impacts of demonetization on Indian economy. Hence makes use of secondary data. The entire study is based only on observation and documentary analysis. Furthermore, the required & relevant secondary data are collected from various Research Papers, Journals, & Publications, websites and many others. Books have also been referred for theoretical information on the topic as required

Findings

This part is divided into following sub parts as under:

1. Reasons of demonetization.
2. State of Indian economy before and after demonetization.

1. Reasons of Demonetization

Removing black money from the country: Demonetization was a bold move taken by the government of India to curb black money and one that will have the deep impact on the parallel economy in the country. The unaccounted money that is concealed from the tax administrator is called black money. A few businesses like property dealers, jewelers, foreign currency dealers, private money lenders generally hold huge amounts of unaccounted money in form of currency notes. Such unaccounted money had created a parallel economy in the country. Such illegal money has reached the bank accounts through direct or indirect channels.

Curbing fake notes: Fake Indian notes are mainly used in terror related activities. The money mainly flows from Nepal, Pakistan, and Bangladesh. The terrorists are using it to cripple the Indian economy and to create economic terror. Fake Currency Notes had been wasted by the demonetization. It was expected that withdrawing highest currency notes out of the economy would have a serious impact on the fake currency syndicates, thus putting an end to the terror funding in Jammu and Kashmir, Naxalite hit states and North-eastern states. Demonetization was a surgical attack on a fake currency circulating in the economy. Demonetization has converted those fake currency notes into a mere piece of papers.

Encouraging digital economy: Demonetization's aim was to encourage the cashless/digital economy. More and more cash-less or online transactions will lead to more disclosure of income which will increase the direct tax collections. With a reduction in cash transactions, the demand for alternative forms of payment will rise. Electronic mode of payment like online transaction, payment through applications, E-wallets E-banking, usage

of debit and credit cards etc. will surely see the substantial increase in demand. This will definitely reduce the instance of black money.

To hit the Maoists: Demonetization broke the backbone of Maoists in Chhattisgarh, leading to more number Maoist arrests than ever and less number of attacks by them. This step actually made money with Maoists worthless. As reported Maoists had hoarded over Rs.7000 cores with them at Baster in Chhattisgarh. After demonetization all such currency became invalid.

Rise in GDP: Though demonetization has negatively impacted sectors such as real estate and property, construction, and household consumption in general, it was believed that long-term benefits for GDP growth will outweigh the short-term transitional impact.

To stop corruption: It was also expected that the demonetization would prove to be a check on the rampant corruption prevailing in the system. Corruption undermines government's ability to deliver economic growth and adversely affects a number of variables like macro financial stability, investment, human capital formation and productivity. Corruption is one of the major challenges that every economy has to face. It was believed that demonetization would prove to be a surgical strike on corruption putting an end to it.

2. State of Indian economy before and after demonetization

The Indian economy has undergone a lot of changes since demonetization. The state of Indian economy before and after demonetization can be analyzed by studying the impact of demonetization on various indicators of state of economy.

GDP: India's GDP has decreased from 8.8% (July-September 2016) to 5% (July-September 2019). Since the Modi government came to power in 2014, India's GDP growth showed a rise initially but after the demonetization the GDP of India declined by 3.19 per cent, indicating deep unrest in the economy. Under the Modi government, GDP had risen to its highest in March 2016 quarter at 9.9 per cent. But since demonetization the GDP growth in India is continuously falling. SBI in its recent report has said India's GDP would go down further to below 5 per cent amid a decline in consumption, weak investments and an under-performing service sector.

UNEMPLOYMENT: There was a loss of jobs and decline in wages due to demonetization, particularly in the unorganized and informal sector and in small enterprises. Migrant workers were adversely affected by demonetization. According to the report prepared by Centre for Monitoring Indian Economy (CMIE), the number of employed people was 401 million in January–April 2016, 403 million during May–August 2016, 406.5 million in September–December 2016. After demonetization in November 2016, the number fell to 405 million in January–April 2017. So there was fall of 1.5 million in number of people employed in just few months. Further the number of people lost their jobs after demonetization and most of them are the employees of private sector. The unemployment rate rose to 7.2 percent in February 2019, its highest since September 2016, and up from 5.9 percent in February 2018, according to data compiled by the private research house, Centre for Monitoring Indian Economy (CMIE).

DIGITAL ECONOMY: Immediately after demonetization was announced on November 8, 2016, there was a spurt in digital payments. E-commerce companies saw up to a 30% decline in cash on delivery (COD) orders. Digital payments have grown exponentially both in terms of value (rising by 29% in 2017-18) and volume (rising by 45% in 2017-18) of transactions. The demand for point of sales (POS) or card swipe machines has increased. Payments company executives estimate that card transactions in towns with populations of up to 1 million have doubled in three years since demonetization.

E-Wallet Business: The mobile wallets and digital payment happen to be the clear winner since demonetization. As merchants started accepting wallets like Paytm or PhonePe for digital transactions, the trend has shifted from cash based transactions to cashless economy. Paytm's traffic had increased by 435% and its downloads by 200%. Paytm is India's leading mobile wallet which allows users to make transactions "at 850,000 places across

1,200 Indian cities. Like paytm there are many other e wallets that earned a good business, these are PayU India, MobiKwik, Phonepe, and Freecharge and so on. A lot of people are now well aware with these applications and are using them for their daily purposes.

FISCAL DEFICIT: India's fiscal deficit is growing every year since the Modi government took the decision of demonetization. In FY 2014, India's fiscal deficit -- the difference between government's total revenue and total expenditure -- was Rs 5.05 lakh crore, while in FY 2019, it has breached the Rs 7 lakh crore mark. Fitch Solutions recently raised India's fiscal deficit forecast to 3.6 per cent of the GDP for this fiscal year, from 3.4 per cent previously, due to weak revenue collections from sluggish economic growth and government's sweeping corporate tax rate cut.

TAX COLLECTION: Pushing Indians to deposit and account the cash lying in their house also meant a rise in the tax payments for the country. According to government reports the income tax payers saw a record increase in the post demonetization era. 9.1 million New taxpayers were added to the slab which was an 80% rise over the typical yearly rise. This increase in the number of taxpaying citizens in the country has been credited to demonetization. This increase was also resonated in IT returns filing and advance tax payments.

BLACK MONEY: One of the most important points that pushed people to support demonetization was its associating with bringing an end to the black money problem in India. However, almost 99% of the money was deposited back to RBI. Of the Rs 15.41 lakh crore worth of old Rs 500 and Rs 1000 notes that were in circulation before November 8, 2016, Rs 15.31 lakh crore or 99.3% has come back into the system. Approximately Rs 10,000 crore worth of old notes have not returned. The statistics revealed that either the hoarders found a way to legitimize their black money or did not hold them in the form of cash.

COUNTERFEIT BANKNOTES: After demonetization, there was an increase in the number of counterfeit ₹100 and ₹50 banknotes. The number of counterfeit ₹500 and ₹1,000 banknotes saw an increase in 2016-17 and subsequently a decline in 2017-18 because of demonetization. But since 2017-18, there was an increase in counterfeit ₹500 and ₹2,000 banknotes. Compared to the previous year, there was an increase of 20.2%, 87.2% and 57.3% in counterfeit notes detected in the denominations of ₹10, ₹20 and ₹50, respectively in year 2019. Counterfeit notes detected in the denomination of ₹100 declined by 7.5%. In the denomination of ₹200, which was introduced in August 2017, 12,728 counterfeit notes were detected as against 79 during the previous year. Counterfeit notes in the denomination of ₹500 (new design notes), increased by 121% while in ₹2,000, it increased by 21.9% during 2018-19.

TERROR ACTIVITIES: Prime minister Narendra Modi said on December 28, 2016 that the demonetization drive destroyed terrorism, drug mafia, human trafficking and the underworld in a trice. Even union minister Arun Jaitley said in August that demonetization left Maoists and separatists in Jammu and Kashmir “fund starved”, and it has greatly reduced the number of protesters taking part in stone-pelting in the border state. But, ground reports seem to indicate otherwise. Documents recovered from the site of an encounter in Abujmarh in Chhattisgarh on November 7, 2017 indicate that the Maoists may have found ways to beat the demonetization trap. According to these documents, a Chhattisgarh-based Maoist group had exchanged demonetized notes amounting to Rs 2 lakh. Even in Kashmir, Stone pelting lately is clearly down, however sporadic terror attacks are still taking place. Demonetization does not seem to have broken the back of terror groups and their financiers.

DIFFERENT SECTORS OF ECONOMY: Demonetization has affected various sectors of economy. Ten sectors in India were majorly impacted by Demonetization namely Agriculture, Real Estate, Construction, Manufacturing, Financial, Aviation, Tourism and Hospitality, Telecom, Healthcare and Automobile. The worst affected sectors being Financial and Real Estate, Construction, Automobile, Tourism and Hospitality. Due to demonetization Indian tourism industry have been severely impacted as the majority of spending is in cash. Further, the slowdown is also faced by the restaurant's businesses with the inability of cash. Demonetization has also affected automobile industry, The major decline in demand has been seen in two-wheelers business as compared to four wheelers/luxury cars because buyers prefer to pay in cash for buying a two-wheeler. The small

farmers selling their products on daily basis to the wholesale centres, mandis and to the consumers have also been impacted by demonetization.

Conclusion

The demonetization of high currency notes by government of India was a very crucial step for the economy. The main objectives behind demonetization were to check black money, corruption, terror funding, invalidating fake notes and boost digital transactions and GDP. But these objectives have not been achieved to the extent it was promised.

Indian economy surely saw a lot of ups and down since demonetization. One of the key effects of Demonetization 2016 has been that more people have made digital payments part of their lives moving towards a cashless economy. This will definitely help in the concentration of black money and it increases transparency. Demonetization also succeeded in curbing terrorist activities by leaving the currency with them invalid. Also since demonetization the number of tax payers and the amount of tax collected have increased.

But as we talk about black money, Reserve Bank of India (RBI) in its annual reports disclosed that almost 99.3% of the old currency had been returned to the banks which means that most of the black money have been deposited to the banks. Besides GDP growth of the country has been showing a downward trend since demonetization, the number of counterfeit banknotes of Rs. 100, Rs. 50, Rs. 500, Rs. 2000 have also increased, various sector of economy like the real estate, agriculture, automobile industries were so hit hard by demonetization that they are still not recovered from it, millions of people lost their jobs leaving there families in vain, hundreds of people died in queues to exchange their currency, thousands of people having some kind of functions or events like marriage had to face problems due to shortage of cash, also the terrorist activities has not stopped completely.

After 3 years of Demonetization, Indian Economic Survey claims that the economy has done away with all the negative impacts of Demonetization. However, economic experts are of the view that the economy is still struggling for a faster growth. It is thus concluded that as compared to the sufferings that the general public had to face only a little has been achieved by the demonetization move. After all the struggle that the common man had gone through, they get nothing. Their lives are the same as they were earlier or may be even worse. Hence this study concludes that the demonetization was a failure and the state of Indian economy has not much improved as it was promised earlier.

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