

Demon-etised India: A Brief Analysis of Rationale behind Demonetisation and its Impact

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Abstract

On 8 November 2016, the whole of India was taken by surprise and left in a state of shock with the announcement of demonetisation of Rs 500 and Rs 1000 currency notes by Prime Minister Narendra Modi. While this is the third attempt in the history of India to devalue the higher currency denominations, it has proven to be more drastic than ever, with more than 86 percent money in circulation getting affected. This move led to a situation of chaos, confusion and unrest in the entire country. This paper discusses the impact of demonetisation across economic, political and social realms. There was a huge liquidity contraction which had serious short term impacts on daily life of millions of Indians working in different sectors of the economy. Every Indian felt the impact of this tragic move of demonetisation on their day to day living, with the poor bearing the maximum brunt. This paper seeks to examine the rationale presented by the NDA- led government, while elucidating upon the aftermath of demonetisation in India.

Keywords: Demonitisation, Black money, counterfeit currency.

Introduction

On 8 November 2016, the whole of India was taken by surprise and left in a state of shock with the announcement of demonetisation of Rs 500 and Rs 1000 currency notes by Prime Minister Narendra Modi. It meant that Rs 500 and Rs 1000 currency notes were no longer legal tender and legitimate means of payment. (India, 2016)

According to the data available with RBI, in value terms, Rs 500 and Rs 1000 notes together accounted for Rs 14.2 lakh crores, which is 86.4 percent of the total money in circulation as on 31 March 2016. (Pandathil & Kadam, 2016)

This bold move led to a situation of chaos, confusion and unrest in the entire country. It has been termed as the “SURGICAL STRIKE ON BLACK MONEY” aimed at fighting corruption, counterfeit currency and terror funding.

Demonetisation: Meaning

According to Investopedia, demonetisation is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency. The current form or forms of money is pulled out from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency. In the Indian scenario, it meant that Rs 500 and Rs 1000 currency notes would be replaced by newly designed currency notes of Rs 500 and Rs 2000. (Investopedia)

History of Demonetisation In India

This bold move to demonetise Rs 500 and Rs 1000 currency notes is not new to India. This is the third attempt in the history of India to devalue higher denomination currency notes. For the first time, Rs 1000 and higher denomination notes were demonetised in January 1946. The highest denomination currency note which was ever printed in the history of India by RBI was the Rs 10,000 currency note in 1938 and which was again printed in 1954. These higher denomination currency notes were demonetised in January 1946 and again in January 1978, according to the RBI data. (NCA Academy, 2016)

Though India has a history of demonetisation of higher denomination currency notes, the recent demonetisation move has been more drastic than ever with its impact being felt across different sectors of the economy.

DATE	EVENT
Nov 08 2016	Rs 500 and Rs 1,000 notes declared invalid. Exchange of currency up to a limit of Rs 4,000 allowed at banks, ATM withdrawal limited to Rs 2,000.

Nov 10 2016	Banks reopen after a day. Massive queues seen outside commercial buildings as the common man gears up to deposit or exchange old currency.
Nov 12 2016	Deaths due to standing in queues begin to be reported. The Sensex registered the biggest single day fall in 9 months.
Nov 13 2016	RBI raised the currency exchange limit to Rs 4,500 and ATM withdrawal limit up to Rs2,500
Nov 15 2016	Banks directed to use indelible ink marks on those who were exchanging money; the election commission raised concerns on this direction.
Nov 16 2016	Parliament session begins; opposition parties protest against the government's move
Nov 17 2016	RBI lowered the currency exchange limit to Rs 2,000
Nov 18 2016	Supreme Court says many are "frantic" over demonetisation. Panic in the country.
Nov 22 2016	Banks received Rs 5.3 lakh crores in deposits since Nov.08, as per RBI.
Nov 24 2016	People could only deposit old notes in their bank accounts. No exchange of currency.
Nov 27 2016	New RBI governor Urjit Patel justifies government's move of demonetisation.

**A timeline showing 20 days of demonetization (Balachandran, 2016)

Rationale of Demonetisation

The Modi government came to power in the year 2014 on the agenda of black money. In this regard, demonetisation has been the boldest step to curb black money and shrink the size of parallel economy in India. The rationale behind this move, as per the government, was to fight corruption and black money, eliminate counterfeit currency and limit terror funding.

According to Wikipedia, in India, black money refers to funds earned on the black market, on which income and other taxes have not been paid. In the recent times, the issue of black money has gained a lot of importance in India, though more as a political issue rather than an economic one. By attacking this issue, the Modi government has made its intentions to fight corruption very clear. It was an attempt by the government to eject the stock of counterfeit money out of the economy which was being used to fund criminal activities, such as terrorism and drug trafficking. In addition to this, the aim was also to draw a large part of the black economy into the banks and bring such money under taxable part of the economy. This can prove beneficial in the long run as it will reduce tax evasion and may increase the revenues of the government. (Wikipedia)

Impact of Demonetisation

There was a huge monetary contraction which had serious short term impacts which were seen in almost all the sectors of the Indian economy. Every Indian citizen felt the impact of demonetisation in the initial days. The supply of newly designed currency notes of Rs 500 and Rs 2000 was inadequate to meet the demands of the economy. People had to stand in queues for hours to get their money exchanged and deposited. It seemed as if the whole of India was on roads for this purpose. The lower and the middle class suffered the most because of the financial crunch and banks running out of cash in the initial days after demonetisation. Similar was the situation of ATM's throughout the country which failed to serve the purpose of any time money and displayed the boards of "NO CASH". (ET Bureau, 2016)

Economic Impact

Consumption which forms a major part of the aggregate demand of the economy fell sharply (Suneja, 2016). In a situation where cash is not readily available, people have less money at disposal. This is exactly what happened in the context of Indian economy. This led to a decrease in the consumption

level which further led to an overall fall in the aggregate demand. This had repercussion effect on the production sector which led to its slowdown and eventually resulted in fall in employment level. (Janardhanan, 2016) The entire process slowed down the growth momentum of the growing Indian economy.

Almost every sector, whether organised or unorganised faced the brunt of demonetisation. Economic activities witnessed a slowdown. In a country like India, where majority of the transactions take place in cash, pulling out 86% of higher denomination currency notes left people traumatised. Small businesses, commodities and agricultural sector, including the market for consumer durables and non-durables were adversely affected. All such sectors which had linkages with the unorganised economy felt the brunt of this move. The luxury market was also affected as demand fell sharply in a very less span of time. (IANS, 2016)

The RBI in its fifth bi-monthly monetary policy statement on December 7, 2016 placed the GVA (Gross Value Added) growth for 2016-17 at 7.1%, which was lower than 7.6% GVA growth projected in its fourth bi-monthly monetary policy statement on October 4, 2016. (RBI, Press Release, 2016) (RBI, Press Release, 2016)

However, there is a positive side to demonetisation as well. The bank deposits have witnessed tremendous growth and it is expected that the interest rates would fall in the near future and provide some relief to the public. Inflation rates may also come down. It is also expected that in the long run, income tax rates would fall, loans may become cheaper, housing may become more affordable and the fiscal deficit may reduce.

There has also been a significant emphasis on digital modes of payment since the announcement of demonetisation. The Government of India along with RBI has initiated several measures to convert India into a cash less economy. This move has proved to be gainful for E-commerce sector, payment banks, mobile wallets, electronic transfer providers, etc who have registered a higher usage amongst customers since this move. They have been the real beneficiaries in this entire scenario of demonetisation. The number of e-wallet users has increased drastically. "Paytm Karo" has become the new trend and mode of transaction in the economy providing an alternative for cash. This is the phase of changing India.

Political Impact

The issue of black money helped the BJP led NDA in winning the Lok Sabha elections of 2014 by a margin. It won the mandate of the people by showing them that this government had the potential and energy to fight black money. This bold move of demonetisation by the Modi government is definitely a game changer for the party and has strengthened the image of Prime Minister Narendra Modi as a powerful political figure. It clearly showed that the government had the courage and intentions to fight against black money. This step will be gainful for BJP led NDA in the future. They may do fairly well in the upcoming elections in Punjab and Uttar Pradesh. Despite the fact that opposition parties have continuously attacked this decision, the government has managed to maintain the trust of the people and deliver what was promised to them before coming to power- ACTION and not just false promises.

Social Impact

The reaction of the society was a combination of both anger and support. There were sections of the society which criticised the move and highlighted the inconvenience faced by public in day to day life. While there were others who whole heartedly supported this decision and were ready to take the pain for a better India, proving the saying, no pain no gain.

The whole of India was seen standing in queues outside various commercial establishments like banks, post offices to get their money deposited and exchanged. There were many reports of tragic deaths from all over the country but these were sidelined by the major impact made on the mindsets of the people, especially the poor section. (Lal, 2016) This move gave hopes to the poor and the needy who thought that demonetisation is a step against the rich section and the government would take away their hoarded money. It gave them a confidence in their government and hopes for a better future where the inequalities would reduce, the gap between the rich section and the poor section would narrow down. All these hopes were against the background where actually it was the poor and the middle section of the society which suffered the most. It was the common man who stood in queues for hours and many times was forced to return home empty handed because banks ran out of cash.

Criticism of Demonetisation by some Eminent Personalities

Demonetisation of higher denomination currency notes, which accounted for almost 86 % of the total money circulation in the economy, as a policy measure to fight Black money has received criticism from many eminent personalities all over India. Mentioned below are the views of some of these personalities who criticised the move of demonetisation:

1. Noble Laureate Amartya Sen

Noble laureate Amartya Sen terms demonetisation “a despotic action that has struck at the root of economy based on trust”

Prof. Sen said “It’s (demonetisation) a disaster on economy of trust. In the last 20 years, the country has been growing very fast. But it is all based on acceptance of each other’s word. By taking despotic action and saying we had promised but won’t fulfil our promise, you hit at the root of this.”

(Taken from a newspaper article published in THE HINDU) (PTI, National, 2016)

2. Dr Manmohan Singh, Former Prime Minister, India

“Those who say demonetisation is good in the long run should recall Keynes quote: In the long run we all are dead”

“Demonetisation is organised loot, legalised plunder”

(Taken from Dr Manmohan Singh’s speech in the parliament as published in Hindustan Times) (RajyaSabhaTV, 2016)

3. Montek Singh Ahluwalia, economist, deputy chairman of the planning commission for the period 6 july 2004-26 may 2014.

“Demonetisation to pull down GDP growth”

(Taken from article published in Hindustan Times) (PTI, Policy, 2016)

4. Jeane Dreze, development economist who has closely worked with noble laureate Amartya Sen in the field of development economics

“Demonetisation in a booming economy is like shooting at the tyres of a racing car”

(Taken from an article published in Economic Times) (Venugopal, 2016)

5. Prof. Arun kumar, economics professor, is one of the most widely quoted authors on black money. he has authored the black economy in India (penguin,1999) and Indian economy since independence: persisting colonial disruption(vision books,2013)

“Demonetisation is a foolish step. The poor will suffer the most “

“Black economy and white economy are largely intertwined in India. So when you sell your real estate property you generate black and white income simultaneously. That’s why when the black economy is affected, the white economy is also affected. Demonetisation which is supposed to impact the black economy is affecting the white economy terribly. Demand is going down”

(Taken from an article published in India legal. stories that count) (Badhwar & Mathur, 2016)

Will Demonetisation Solve its Purpose?

Any policy decision which shakes the foundation of an economy is bound to produce severe impacts. Whether these impacts prove to be beneficial or fatal for the economy can only be analysed in the long run. The immediate effect which the announcement had on the issue of black money was seen as positive. It was expected to unearth the hoarded money in the entire country. The public, in general, faced a lot of inconveniences but was satisfied that this move will be fruitful in the future. There were instances where black money was easily getting converted into white money. Money laundering had rapidly gained momentum. Income tax department conducted raids at various places and penalties were also put on the defaulters. Demonetisation was all over the media and there were many rumours of bags full of money found dumped at several places in the country. After more than a month, the situation in the country has improved in terms of liquidity. The liquidity crunch which was seen in the initial days has somewhat normalised. There have been instances of fake currency being injected again into the money circulation, newly designed Rs 500 and Rs 2000 currency notes found with terrorists, public confusion over real and fake currency notes, etc. But the most important aspect of demonetisation is the impact it has made on the mindsets of the common man. They have witnessed their government take a bold action against black money which was adversely affecting our economy for a long time.

According to a report by Deccan Chronicle on November 23, 2016, new bank notes of Rs 2000 were found with two militants (believed to be Pakistani nationals) who were killed by the security forces in Bandipore district of Kashmir. This came as a shock to the government which was expecting that terror funding would be badly hit by demonetisation. (DeccanChronicle, 2016)

There were a lot of question marks raised during this period on the validity of demonetisation and whether it will be successful in meeting its purpose of implementation. Only the future will tell how successful or unsuccessful this move will prove in fighting black money in reality. But for now, the government has received applause from the common man despite all the mismanagements and shortcomings of the system.

Conclusion

Amidst all the chaos and confusion caused by demonetisation, one clear cut impact that the government has been successful in making is on its own image. A country of more than 1.2 billion people saw in Modi a leader who believed in action and not just words. Whether demonetisation will succeed in wiping out black money from the economy or not is still a debatable issue. But for the Indians, Modi has emerged as a “HERO” who had the courage to take such a bold step in favour of country’s progress. It is expected that demonetisation along with other policies (JAM trinity, implementation of GST, etc.) will benefit the Indian economy in the long run.

Although, the dream of cash less India still seems distant, the way Indians have adapted to the digital mode of transactions is commendable.

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