

## Demonetisation: It's Impact on Indian Economy

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**Abstract:** This research paper spotlights the effects of demonetization in India. The term 'Demonetization' ruled the nation after govt. the demonetized the Rs. 500 and Rs. 1,000 currency notes. This study attempts to showcase the aspects for which demonetizations was implemented, for example, to eradicate black money, corruption, fake currency, terrorism etc. This decision was considered as biggest cleanliness drive against the black money and corruption in the history of Indian economy. While this decision helped the country dispose-off the black money from its system, its impact in the international can be determined only after a certain point of time. But there are various views of experts on demonetization, as some argues that it will hit the black money. It is an established practice in monetary policy to tackle black money. The stock of the black money constitutes a major part of the GDP. It is imperative to evaluate the short run and medium-term impacts that this decision has created in our economy. Further, the impact of such a move would depend upon the extent to which the government decides to remonetize. This paper would give a clear picture of the demonetization and the steps taken by our Central Government to reduce the trauma of common people.

**Keywords:** Demonetization, remonetize, corruption, black money.

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### INTRODUCTION

On November 8, 2016, after a long time the word demonization came into existence in everyone's life. After the move of Demonetization announced by Hon'ble Prime Minister of India, Narendra Modi, all started to speak about it. In November 2016, the Indian government decides to demonetize the five hundred and one thousand rupee notes, the two biggest denomination notes. It was estimated that almost 86% of the country cash supply included these two notes. The aim of the central government was to eradicate black money, counterfeit currency, fight for evasion and terrorist financing. It also included people to be more digitally advanced and to adopt a cashless economy. Countries like Zimbabwe, Australia, North Korea, Ghana, Nigeria, Pakistan etc are also on the list of countries which have practiced demonization. Known to be as a historic move, we can say that India is stepping towards cashless age. The main motto of why demonetization is done periodically that to eradicate black money, black marketing, corruption, counterfeiting etc. As Rs 1,000 and Rs 500 notes constituted almost 86% of the total currency, one economist compared the pain of common people by stating what if 86% of their blood was removed from their bodies.

### MEANING OF DEMONETISATION

According to Merriam Webster Dictionary, The term demonetization has its root word from verb demonetize. Demonetization is a word which has various meanings. It is essential whenever there is the need to change national currency. Here the old unit of currency is replaced with a new currency unit. Actually it is a medium of payment which is recognized by a legal system. Paper currency and coins are common forms of legal tender in many countries. Legal tender is variously defined in different jurisdictions. Central government is replacing the old Rs. 500 notes with newer ones and also doing away with Rs. 1000 notes. It is actually scrapping of certain notes from the circulation for different purposes.

## HISTORY OF DEMONETISATION IN THE WORLD

India is not the only country where demonetization happened. There are other countries also that have tried this and in some countries it was successful and in some it was not. All these countries have tried it for different purpose and for different reasons.

### COUNTRIES GONE THROUGH DEMONETISATION

#### ***SOVIET UNION:***

Mikhail Gorbachev's Government in 1991, demonetized ruble bills, the 50s and 100s. Although it was not somehow successful, however in August 1991, attempt to lead to a successful redenomination of the ruble in 1998 where 3 zeros were removed, which was followed by another currency switch in 2010 when 2 more zeros were removed from the old currency.

#### ***NORTH KOREA:***

The demonetization that happened in North Korea in 2010 left people with no food and shelter. Dictator Kim-Jong Il introduced a reform that knocked off two zeros from the face value of the old currency in order to banish black market.

#### ***AUSTRALIA:***

Australia became the first country to release plastic notes to stop widespread counterfeiting. It did not have any side effects of the economy. So, it turned out to be a favorable demonization for the country.

#### ***ZIMBABWE:***

Zimbabwe once had hundred trillion dollar note, which was demonetized and was exchanged in a mocking way dropping trillion dollars to \$0.5 dollar.

#### ***NIGERIA:***

Nigeria's economy collapsed after the 1984 demonetization move that did not go as planned. The military government of then President Muhammadu Buhari introduced different colored notes to invalidate their old currency in order to fight black money.

#### ***GHANA:***

In 1982, Ghana rolled out the decision to demonetize their 50 cedi currency notes in order to monitor money laundering and corruption. The change was not welcomed warmly, creating chaos across the country and finally resulted in a move back to physical assets and foreign currency.

#### ***MYANMAR:***

In 1987, Myanmar's military invalidated around 85% value of money to curb black market. The decision led to economic disruption which in turn led to mass protests that killed many people.

#### **HISTORY OF DEMONETISATION IN INDIA:**

The first instance was in 1946 and the second in 1978 when an ordinance was passed to phase out notes with denomination of Rs 1000, Rs 5000 and Rs 10000. Last November, PM Modi made announcement that high denomination notes would stop being legal tender from 9th November 2016.

#### ***THE FIRST CURRENCY BAN:***

In 1946, the currency note of Rs 1,000 and Rs 10,000 were removed from circulation. The ban really did not have much impact, as the currency of such higher denomination was not accessible to the common people. However, both the notes were reintroduced in 1954 with an additional introduction of Rs 5,000 currency. Rs 500 and Rs 1000 notes were introduced in 1934 and after four years in 1938, Rs 10,000 notes were introduced.

***THE SECOND CURRENCY BAN:***

In 1978, the then Prime Minister of India Morarji Desai announced the currency ban taking Rs 1000, Rs 5000 and Rs 10,000 out of circulation. The main aim of the currency ban was to curb black money generation in the country.

***IMPORTANT FACTS ABOUT INDIAN CURRENCY:***

- According to RBI data, the highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetised in January 1946 and again in January 1978. Rs 1,000 and Rs 10,000 bank notes were in circulation prior to January 1946.
- Higher denomination banknotes of Rs, 1000, Rs. 5,000 and Rs, 10,000 were reintroduced in 1954 and all of them were demonetised in January 1978. The Rs, 1,000 Note made a comeback in November 2000 and Rs, 500 Note came into circulation in October 1987.
- This is the first time that Rs, 2000 currency note is being introduced.
- Bank notes in Ashoka Pillar watermark series in Rs 10 denomination were issued between 1967 and 1992, Rs 20 in 1972 and 1975, Rs 50 in 1975 and 1981 and Rs 100 between 1967-1979. The banknotes issued during this period contained the symbols representing science and technology, progress and orientation to Indian art forms.
- In the year 1980, the legend Satyameva Jayate -'truth alone shall prevail' -- was incorporated under the national emblem for the first time.
- The Mahatma Gandhi Series - 2005 bank notes were issued in the denomination of Rs 10, Rs 20, Rs 50, Rs 100, Rs 500 and Rs 1,000 and contained some additional/new security features as compared to the 1996 MG series.

***LEGAL FACTS ABOUT DEMONETIZATION IN INDIA:***

According to law, the legal basis for the order demonetizing currency can be found in Section 26 of the Reserve Bank of India Act, 1934. Under sub-section (2) of this Section, the Union Government is given the power to declare that any notes issue by the Reserve Bank will no longer be legal tender. The only procedural requirement is that the Board of the Reserve Bank of India recommends the same to the Union Government. In fact, in 1978, demonetization was carried out under a special legislation, namely the High Denomination Bank Notes Act, 1978.

However, the constitutional validity of this law was challenged before the Supreme Court of India in *Jayantilal Ratanchad Shah vs Reserve Bank* of India on the basis that it was a violation of the right to carry out trade and commerce, and in addition, amounted to a compulsory acquisition of property without compensation by the Government. But the Supreme Court of India did not find the mechanism for return of the high denomination to be unreasonable or in any way arbitrary or unconstitutional.

***NOTE:***

- ✚ *If we compare the situations between 1978 and 2016, there are vast differences in the economic scenario in India between 1978 and 2016.*
- ✚ *The value of high denomination notes in circulation 1978 was a mere Rs 131 crores – unlike the present situation where the value of high denomination notes in circulation is Rs 14.18 lakh crore or 85% of the value of all notes in circulation.*

***BLACK MONEY AND DEMONETISATION:***

Along with other cleanliness drives conducted by the Government of India, 'Demonetisation' was known to be as the biggest notable cleanliness drive against the black money in the history of our Country. Even if we talk about our social, economic and political aspects of our country, the main drawback in flourishing of our country is the dissemination of black money which caused debilitating effect on the public policies and the institutions of our country. Black money and false currency lead to increase in terrorism, crime and corruption. As of 2015-2016 statistics shown by Reserve Bank of India rulebook, a total of Rs. 16.42 lakh crore worth of currency was in circulation as at end April 2016. Out of this, Rs. 14.18 lakh crore was in from of Rs. 500 and Rs 1,000 denomination notes represent about 2300 crore notes, which were about 26 percent of total notes in circulation.

Many solutions are being drawn but the best solution to counter with black money is the digital transactions or cashless transactions because the more physical presence of currency causes more chances to hide it. Credit/debit money, money wallets, cheques etc are various ways of cashless transactions. As everyone knows India is a diversified country with people of different customs and religions are living so it will take some time to literate people about the usage of the cashless transactions. After having cashless, Corruption will also be automatically reduced by removing black money from economy.

#### ***SUGGESTIONS FOR CURB BLACK MONEY:***

- As all sections of the society are used to paper notes which may even causes misuse by the bad elements of the country.
- Black money, corruption, counterfeit currency and terror financing all are caused by such habits which hinder the growth and development of the Indian economy.
- This decision will help the economy to become more digital.
- The move will either unearth the black money slashed in the form of cash or forces to destroy those unaccounted currencies.

#### ***STEPS TAKEN BY CENTRAL GOVERNMENT TO CURB BLACK MONEY:***

- There was the constitution of a special investigation team under the chairmanship of a former Supreme Court judge and also implementing of some of its recommendations.
- Enactment of a new law viz. 'The Black Money and imposition of Tax Act, 2015' to deal with black money / corruption stashed abroad.
- To have more ease in sharing and exchange if information with foreign counters and the active involvement in International efforts to combat tax erosion/black money.
- Introduction of income declaration scheme 2016 by Central government.
- Mandatory requirement of PAN numbers on high value transactions.
- Taking Action against hoarders through enforcement agencies.
- This move will help in the slashing of the unaccounted money for the bad purposes.

#### **REASON WHY INDIAN ECONOMY SHOULD GO DIGITAL?**

In the recent years, the emphasis to go digitally advance has been improved because of financial inclusion. Financial inclusion is the foremost policy challenges India is facing today. Approximately 61% of India's population had access to formal financial services. Just because of this, Central government had taken major steps in order to include a greater percentage within the umbrella of formal financial services. One of the most famous initiatives in this regard is the Pradhan Mantri Jan Dhan Yojna (PMJDY). PMJDY has done a commendable job of opening approximately 28.68 crore bank accounts and the goal of including over 90% of undeserved sections of the society in the ambit of formal finance in 2021.

#### **ADVANTAGES OF GOING CASHLESS:**

- The recent waiver of service tax on card transactions up to Rs 2,000 is one of the incentives provided by the Central government to promote digital transactions in country. This has been followed by a series of cuts and freebies.
- Another plus of going cashless is that we can pay the exact amount without worrying about not having changed or getting it back from shopkeepers.
- Heavy discounts and offers on many Government control sectors such as railway ticking, railway catering, highway tolls, insurance policies, fuels etc.

#### ***POLITICAL IMPACT OF DEMONETISATION ON INDIA:***

Most of the educated people in our country were seeing the positive side of demonization and was also supporting it. Speeches regarding the curbing of black money made by Prime Minister Narendra Modi were able to draw huge votes for BJP. Especially youth and educated people, despite of any religion are supporting the steps taken by the Central government to curb black money.

## REVIEW OF LITERATURE

Leaders of opposite political parties however oppose the demonetization drive. Congress vice-president **Rahul Gandhi** on an interview with NDTV India says that demonetization a 'Modi-made disaster' and alleged that the PM undertook this exercise to repay 50 super rich families who built up his image so that he got the post. Rahul also claimed that this move by the Modi government will turn out to be a big scam.

**Dr. Manmohan Singh**, previous prime minister, during the winter session in Parliament says that this move as unlawful and against democracy. Dr. Singh further added that nowhere in the world, people are restricted to withdraw only 2,000 rupees from their account. Opposition parties strongly oppose the Demonetization implementation process.

Nobel Laureate **Amartya Sen** has called the Narendra Modi government's demonetization move "despotic action that has struck at the root of economy based on trust." But **Nandan Nilekani**, The architect of Andhra, in an interview with ANI has welcomed Prime Minister Narendra Modi's demonetization scheme and said it will help bring more and more people into the banking system.

Delhi Chief Minister **Arvind Kejriwal**, during his press conference in New Delhi on 20<sup>th</sup> November 2016, accused Prime Minister Narendra Modi of protecting his "corporate friends" while carrying out demonetization and sought to link him with some "big politicians" whose names had come up during a probe by CBI and Income Tax department. He also asked why Modi was not taking action against those named in the list of Swiss Bank account holders as well as in Panama papers.

Addressing the media personnel's in a party office on January 3, 2017, the BSP Chief **Mayawati** accused the Modi government of not caring about the problems of the people in the wake of the November 8 note ban and following the beaten track of luring people during elections.

Addressing to mass rally in Lucknow, Uttar Pradesh Ex Chief Minister **Akhilesh Yadav** on 26<sup>th</sup> December 2016 said it is cheating with the nation which led to the halting of the entire trade sector of the country. He also said that people came to power on the basis of Ganga cleaning but politics has been played over it for last two and a half years. Yet no work has been done.

### **SOCIAL IMPACT OF DEMONETISATION ON INDIA:**

On November 8, 2016 the announcement of Rs 1,000 and Rs 500 to not be treated as a legal tender from 9<sup>th</sup> November resulted in creating havoc among the people. People were facing several issues such as marriage issue and health issue. To list the worst effect of demonetization, the impact on **health sector** was worst as hospitals were refusing to accept the old currency. Several cases of deaths and agitation caused by people were registered due to demonization.

However the impact on **educational sector** was very less as all the universities and colleges have been instructed to enable online transactions in their official websites. But still a lot of black money was retrieved from the educational institutions through income tax raids which was received as donations from students and hoarded as black money Demonetization has brought the **trafficking** of women and girls for sex work to a stop. It has been estimated that this has been a Rs 24 trillion industry in India.

**Common people** encountered many problems as the announcement was done in beginning of the month when people were about to draw their salaries from their accounts but they were only able to draw Rs 2,000 daily from ATM. Road blockades and quarrels among the people who waited in long queues was also noticed. There was restlessness among people because even standing for the whole day they were only able to draw Rs. 2,000 from their account. There were also no special provisions made for the senior citizens at the banks.

**Narcotics trade** was not left alone as it also suffered the impact of demonization. Most of the marketing takes place through Afghanistan and other ports. That's why drug peddlers found it difficult to sell their remaining stock after the high Vale currency went missing from the economy.

The most positive impact of demonization was on reducing the *terrorism*. One of the main objectives of demonization was to stop the flow of fake notes flowing in from Pakistan. The demonetization of Rs 500 and Rs 1000 notes to crush back economy has come at a wrong time for *farmers*. Millions of farmers are unable to get enough cash to buy seeds and fertilizers for their winter crops. Production of essential commodities is under threat hurting farmers who are just recovering from the two-year drought. India's 270 million farmers live mostly in the cash economy.

#### ***ECONOMICAL IMPACT OF DEMONETISATION ON INDIA:***

The role of Reserve bank of India was very important in this cleanliness drive. A positive and warm response was received from the banking experts. Both private and public sector are facing severe issue of NPA (Non-Performing Assets) or bad loans. It has expected that demonization will help the banks to recover bad loans and will improve their financial position. Demonetization will lead to increase in formal banking sector which will result in transparency. From 4% to 28% this jumped in figure has been recorded by the Income Tax Department in regard of paying taxes by people. When black money within India gets curbed, it will result in the overall economic development of the nation.

*The following table captures and compares the impact through different financial segments from a smaller term to a larger impact:*

<b><i>Sectors</i></b>	<b><i>Effect through end-December</i></b>	<b><i>Likely long term effect</i></b>
<i>Money / Interest rates</i>	Cash declined sharply, Banks deposits increase sharply. RBI's balance sheet largely unchanged, Interest rates, loans and government securities declined. Implicit rates on cash increased.	Cash will recover but settle at a lower level, Deposits will decline, RBI's balance sheet will shrink, Loan rates could fall further, if much of the deposit increase proves durable.
<i>Financial system saving</i>	Increased	Increase, to the extent that the cash deposit ratio falls permanently.
<i>Corruption</i>	Decline	Could decline, If incentives for compliances improve.
<i>Black money</i>	Stock of black money fell, as some holders came into tax net.	Formalization should reduce the flow of unaccounted income.
<i>Private wealth</i>	It declined, since some high denomination notes were not returned and real estate prices fell.	Wealth could fell further, if real estate prices continue to decline.
<i>Public sector wealth</i>	No effect	RBI's wealth will increased when unreturned cash is extinguished.
<i>Digitalization</i>	Digital transaction among new users	Some return to cash as supply

	increasing sharply.	normalises.
<i>Real estate</i>	Prices decline, as wealth fell while cash shortages impeded transactions.	Price could fall further as investing undeclared income in real estate becomes more difficult, but tax component could rise.
<i>Broader economy</i>	Job losses, decline in farm income, social disruption.	Should gradually stabilize as the economy is remonetized.
<i>GDP</i>	Growth slowed, as demonetisation reduced demand, supply liquidity, and working capital and increasing uncertainly. Cash incentive sectors were affected more. Recorded GDP will also over stated.	Could be beneficial in long run if formalization increases and corruption falls. Informal input could decline but recorded GDP will increase as the economy becomes more formalized.
<i>Tax Collection</i>	Income taxes rose because of increased disclosure.	Indirect and corporate tax could decline, to the extent growth slows.
<i>Uncertainty / credibility</i>	Uncertainty increased, investment decisions and durable goods purchases postponed.	Credibility will be strengthened if it is accompanied by complementary measures. Tax arbitrariness and harassment could attenuate credibility.

\*Source: *The Economic Survey 2016-17*

## CONCLUSION

Central government's recent decision to demonetize the high value currency is one of the major steps towards the eradication of black money and corruption in India. If the money disappears, as some hoarders would not like to be seen with their cash pile, the Indian economy will not benefit. On the other hand if the money finds its way in the economy it could have a meaningful impact. Demonetization in Indian economy is having negative impact on the different sectors. Majority of the negative effect are short run effects. All these effects are solved when the new currency notes are widely circulated in the economy. Yes, it is true that People are facing some problems in the exchange of currency notes. Even though people are facing such a problem people are ready to bear these problems for its positive effect on the economy. If Union government successfully clears all the problems, drawbacks associated with the issue of demonetization, this demonetization will become the successful economic revolution in India's history and we can expect a better tomorrow with corruption free India.

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