

**Demonetization-a boon or bane?**

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**Abstract**

"Demonetization" is a multi-dimensional phenomenon with far reaching impact on all sections of the society just like a budget i.e. impact on home-makers and households, on taxpayers, savers and investors, on farmers and industrialists, on hoarders and tax evaders and so on. When India adopted this measure in November, 2016 all of a sudden everyone came to be interested in Economics in general and monetary economics in particular. It is a fact that, demonetization dealt a blow to the parallel economy that functioned and made profits without paying tax. Now everybody is forced to come into the tax bracket. But there are people who are vociferous in their criticism that because of this hasty step people suffered, economy slowed down etc. However, one must acknowledge the irony of the fact that while people talk about wanting to be like Singapore in India , but are not able to bear the pain when it comes down to paying taxes. In the above background, this paper reflects on the impact of this monumental effort and argues that its long term benefit will be more.

**Key Words:** Parallel economy, Budget, Digitalization, Demonetization and Black money.

**Introduction**

Demonetization refers to withdrawing the old currency as an official mode of payment by the competent authority of the country. According to Investopedia, demonetization is the act of stripping a currency unit of its status as legal tender. PM Narendra Modi on November 8, 2016, announced that all currency notes of denominations of Rs 1,000 and Rs 500 would be invalid from the midnight of that Day. This move, otherwise known as currency demonetization, had taken the people by surprise. In the 50 days between November 10 and December 30, 2016, Rs 15.44trillion worth of Rs 500 and Rs 1,000 currency notes were withdrawn. These notes constituted 86.9% of the value of total notes in circulation at that time.

**Demonetization over Time**

It is not the first time that the government resorted to currency demonetization on 8 Nov 2016. It was done earlier also. The first demonetization of high currency notes happened in 1946 by stopping the circulation of Rs 1000 and Rs 10,000 notes. After eight years of first demonetization in the year 1954, the Indian government reintroduced high value currency notes of Rs 1000, Rs 5000 and Rs 10,000. In 1978, Morarji Desai government demonetized high value currency bearing denominations of Rs 1000, Rs 5000 and Rs 10,000 notes as a move to tackle the black money in the economy. The move was executed under the High Denomination Bank Note (Demonetization) act 1978. As per this act, all high value currency notes ceased to be illegal after January 16, 1978. People were given a week's time to exchange the currencies (PallaviSengupta, 2016).

Demonetization of Indian currency happened historically either technical in nature or non-technical. The following is the chronological order of demonetization and reintroduction of high denomination notes:

Year	Denomination	Reason
January 12, 1946	Rs1000, Rs 5000 and Rs10,000	Non-Technical demonetization
1949	Kutch'skoris converted to Rupees	Technical demonetization
1954	Reintroduced Rs1000, Rs 5000 and Rs10,000	
1957	Osmania sicca converted to Indian rupees	Technical demonetization
1963-64	Old annas and pice coins converted to paise	Technical demonetization
Jan 16, 1978	Rs1000, Rs 5000 and Rs10, 000 notes declared illegal for the second time and reintroduced Rs2000 and Rs1000 notes.	Non-Technical demonetization
June 30, 2014	Rs500 and Rs1000 printed before 2005 become illegal tender	Non-Technical demonetization
Nov 8, 2016	Rs500 and Rs1000 notes taken out of circulation	Non-Technical demonetization
Nov 10, 2016	New Rs 2000 notes introduced	

**Source:** Retrieved from <http://timesofindia.indiatimes.com/india/Demonetisation-of-Indian-currency-over-the-years/articleshow/55415932.cms>

### **What is the issue?**

Right from Day One, the move attracted sharp criticism from many quarters. More so, after it had come to light that almost 99% of the currency notes are back into circulation. Small industrial units, which predominantly operate in cash economy, have suffered and some jobs have been lost and economic growth is being affected. By suddenly removing 86% of its currency from circulation one major problem that surfaced was not having adequate supply of new notes ready to take their place. One point that might have missed the attention of those behind this bold move that India is more reliant on cash than almost any other country on earth. In other words, India was an incredibly cash-centric economy & cash accounted for upwards of 95% of all transactions, 90% of vendors did not have card readers or the means of accepting electronic payments, 85% of workers were paid in cash, and almost half of the population did not even have bank accounts. Even Uber in India accepted cash — the only country in the world where this option is available — and “Cash on Delivery” was the preferred choice of 70% of all online shoppers.

### **Has Demonetization Been A Futile Exercise?**

Demonetization is one of a series of steps that the government has been taking to tackle black money. First, it had given a three month window for bringing back unaccounted money stashed in offshore accounts, but the response was not good. The next target was black money within India. The Income Disclosure Scheme 2016 has been relatively successful. It collected Rs 65,250 crore, seven times more than what one such scheme in 1997 had mopped up. Further, the government also passed a law to curb benami transactions and India's Double Taxation Avoidance Agreements with Mauritius and Cyprus have been amended. So let's not attempt to see the demonetization move in isolation as this was part of the larger design to unearth black money.

Whether or not India was ready for this cashless revolution is an irrelevant question. Because, India is currently in the middle of an all-out movement to modernize the way things are paid for. New bank accounts are being opened at a heightened rate, e-payment services

are seeing rapid growth, cash-on-delivery in e-commerce has crashed, and digitally focused sectors like the online grocery business have started booming. Even the vegetable vendors on the streets have opened up Paytm accounts and they have a machine outside their shop where someone can scan the bar code and make the payment.

### **Some of the Possible Benefits of Demonetization**

**1. Boost Deposit Base & Savings:** India is one among the highest cash usage economies in the world & 68% of the total values of transactions are conducted in cash (Mayank Jain, 2016). The present decision of demonetization could improve the banks' deposit base to the extent of 0.5 – 1.4% of GDP. In turn, financing savings can be expected to rise by close to this proportion due to switch from savings from unproductive physical assets to financial assets. (Rana Kapoor 2016).

**2. Improves Monetary Transmission & Reduces Lending Rates:**

Demonetization could facilitate rise in the deposit base with banks which could allow banks to reduce the cost of funds. One estimate is that banks may reduce deposit rates by 125 base points (bps) over the next six months as the MCLR (Marginal Cost of Funds based Lending Rate) will take into account the lower cost of funds (Rana Kapoor 2016).

**3. Room for further monetary accommodation:** With the structural changes in the currency in circulation, RBI will be in a comfortable position to ease the monetary policy rate further.

**4. Support Government finances:** This scheme may help the government to improve income tax collections which should help in managing the fiscal deficit target. The structural changes in the tax system especially introduction of GST tax will enhance tax to GDP ratio in the economy.

**5. On a Broader Scale:** This has helped the Indian banks to garner deposits worth around \$29.8 billion (Kalyani Pandey, 2016). The surge in the bank deposits results into greater statutory liquidity ratio demand.

### **Experts Opinion on Demonetization**

The immediate reaction of famous personalities in the banking and other sectors were positive, as they have welcomed the decision. Few of the responses are mentioned below (Ravi Prakash Kumar, 2016):

- The banking stalwart **Deepak Parekh, HDFC Chairman** felt that real estate prices will come down in the medium term and as well land cost will be reduced.
- According to MD&CEO, ICICI Bank **Chanda Kochhar**, "this move will definitely bring about a whole amount of transition to no cash or low cash kind of transactions,"
- The leading lawyer in taxation laws, **Harish Salve** believed that "A parallel black economy will collapse".
- **Narayan Murthy**, founder of Infosys, viewed that this move of the government helps in fighting against corruption and only deceitful would suffer.

### **Senthil's Experience**

Senthil Natarajan, who runs Kovai Pazamudhir Nilayam (KPN), one of its kind fruit and vegetable retail chain with 50 stores in Tamil Nadu. Senthil Natarajan, who runs Kovai Pazamudhir Nilayam, always fascinated with what software can achieve, he realized growth was not possible without systems and wrote software for his business to achieve this. KPN employs 1,500+ employees and had a turnover of Rs 275 crore (Rs 2.75 billion) last year. It expects to grow the business by 20% plus this year.

On demonetization, Senthil Natarajan said, though the sales dipped for about 10 days initially in the next few days, people started using credit cards. Credit card usage which used to be 2% to 3% of sales in Coimbatore suddenly went to 50% to 60%, he recalls. After demonetization and GST, he says store-wise sales increased by 6% to 7%, which is in line with the nation's GDP. Criticism for the goods and services tax has come from traders who dealt in cash and were suddenly forced to register for and pay GST. The other big positive of GST, he feels, that does not get highlighted is how the removal of toll check posts after GST has made

crossing state borders hassle free. Now fruit/vegetable trucks would take 6 to 8 hours to cross a state border check post, which earlier used to take up to 24 to 48 hours to do so. While few have been making scathing criticism of the government's move, there are positives too from this great initiative.

### **IMF Chief on Demonetisation**

International Monetary Fund (IMF) chief Christine Lagarde speaking during a Global Economy debate in the sidelines of the World Bank/IMF Annual Meetings in Washington on Oct. 12, 2017 described demonetization and the rolling out of GST as a "monumental effort" and said it is hardly surprising that here "is a little bit of a short-term slowdown" as a result. With regard to the Indian economy slowing down in the last quarter to 5.7 per cent growth, she has expressed confidence that the structural changes in the economy like the Goods and Services Tax (GST) and demonetization have put the Indian economy on a "solid track". Now a question may arise as to whether the said bold move benefited at all. Let's look at the positive side, in terms of the benefits that accrued, of the demonetization:

### **On The Positive Side**

Yes, it has not confiscated hordes of black money. However

- The banks have reported lakhs of suspicious transactions where people have deposited large amount of cash and in due course, the investigative agencies will get into action and track down these people.
- For 2016-17, 1.26 crore new taxpayers (return filers plus non-filers making tax payments) were added to the tax base (till June 30, 2017).
- There was 19% growth in direct tax collections. Collection of advance tax under personal income tax showed a growth of about 41.79% over the corresponding period in 2016-2017; collection of self-assessment tax under personal income tax showed a growth of 34.25%.
- The number of e>Returns of individual taxpayers filed till August 5 increased to 2.79 crore from 2.22 crore filed during the corresponding period of last year, registering an increase of about 57 lakh returns, or 25.3%. Going forward, tax compliance will rise further.
- The number of income tax returns filed for 2016-17 year grew by 25%, (of 9.9% in the previous year) which is crucial to ease pressure on public finances in a country that has well over 1.25 billion people but less than 30 million file tax returns.

### **Any Spillover Benefits?**

Yes. This surprise demonetization move pushed millions of new users onto the country's digital economic grid by virtual fiat. Further, this demonetization initiative has been a boon for India's e-payment providers. Paytm reported a three-time surge in new users -- tacking on over 14 million new accounts in November alone. While Oxigen Wallet's daily average users increased by 167% since demonetization began. Crypt currencies like Bit coin and Asiadigi coin have also been the recipients of a positive upswing from Modi's currency purge — with Bit coin in particular being driven up in value.

It also sparked of some very innovative solutions like farmers' markets of Telangana experimenting with their own electronic payment system where customers with Aadhar-linked bank accounts could buy vegetables using tokens which could be purchased via debit cards at specialized kiosks. These changes indicate towards a more inclusive society in the future. Let's not forget the fact that India is trying to improve its digital economy, which include simpler, more technologically advanced digital payment systems, increased merchant acceptance, improvements in UPI, which allows monetary transfers between any two bank accounts via a smartphone, as well as a reduction in cash-based transactions.

**Positive Highlights of the Budget, 2018, Which Is a Follow-Up Measure after the Two Monumental Steps of GST & Demonetisation.**

1. Ayushman Bharat is the single biggest health insurance coverage plan in human history. Up to 50, 00, 00,000 of the poorest Indians will benefit up to Rs.5, 00,000 family health coverage.
2. For Digital India up to 5, 00,000 Wi-Fi services to be setup in rural India. With rural India having not even 30% of total active data usage today, in spite of far higher population, this will bring "Bharat" and "India" on par to a great extent. Reduced digital divide is good!
3. Free LPG connections to 8, 00, 00,000 poor women is an incredible help to those Indian women who have suffered in smoke filled kitchen for their entire lives. Their family's health will improve drastically. Also 4, 00, 00,000 poor families to get electricity under *Saubhagyaplan*.
4. Pradhan Mantri Awas Yojana (PMAY) to build 1, 00, 00,000 houses for those who can't afford. A steep target of Housing for All by 2022 is going to transform India. Garibi Hatao has been a slogan from a time even before my birth. But crores of Garib still exist.
5. Rural India will get Rs.3,70,000,00,00,000 money for just road building. This will reduce the divide between villages and cities by a splendid extent. Also will neutralize communist terror in Maoist areas. 35,000 KM upgrade under *BharatMala*. Special focus on NE India is good.
6. Minimum support price for Kharif crops like paddy to be at least 50% higher than the cost of production. In a country where farmer suicide is rampant, this might help cushion the financial burden of farmers. Already crop insurance, health insurance & soil test being offered.
7. Corporate tax rate reduced to 25% for businesses up to Rs.250 cr turnover. In December Trump reduced US corporate tax to 21%. China already announced better tax rates to lure US comp's to stay. India had to keep tax rates low for smaller companies to be globally competitive.
8. Continued focus on MUDRA lending is a good step forward. Already 10, 38, 00,000 people, mostly women, have taken loans under Mudra. With Rs.3, 00, 000, 00, 00,000 available in 2018-19, small entrepreneurs across India can sustain and expand their business. Crores of job addition!
9. Another impressive plan under Budget 2018 is to enable farmers with *GrAM*. Right now 22,000 rural haats are existing. Now government is working to develop and upgrade them into Gramin Agricultural Markets or GrAM - This will have far-reaching direct selling potential for farmers, saying bye-bye to middlemen.
10. There are 56 fully ready airports in India, which are almost totally unused. There are 31 unserved helipads too. 1000s of crores of infrastructure lying waste. This government is going to put most of them into use this year.
11. 24 new medical colleges coming across India. Every one of them will help India's healthcare tremendously next decade. 1, 50,000 new healthcare centers coming up. For a country that has huge medical facility drought today, these are visionary things, which will help in 20 years.
12. Never before in India's history, Rs.14, 34, 000, 00, 00,000 was allocated for rural livelihood & infrastructure in a single Budget. From MSP, to healthcare, to roads, to direct markets, to Wi-Fi.
13. India's most marginalized sections - the Scheduled Castes (SC) and Scheduled Tribes (ST) have been given a bonanza by Modi government in Budget 2018. SCs to get 279 programs and STs 305 programs. SCs to get Rs.56,619,00,00,000 and STs to get Rs.39,135,00,00,000 in fund allocation.
14. Lastly, for decades Muslim appeasement was done by successive governments, but no focus on their upliftment. But, Budget 2018 focuses primarily on education and skill

development of minorities. Allocation has been increased by 62%, or the largest increase for minorities ever!

### **Conclusion**

Demonetization dealt a blow to the parallel economy that functioned and made profits without paying tax has now brought into the tax bracket. As the demonetization initiative encourages the use of plastic and electronic money, cash transactions will become less common. The transition to a cashless economy will also improve savings in financial assets which will benefit the banks and the Government. In the medium term, benefits through higher Government spending, better transmission, greater financial inclusion and movement of household savings from physical to financial would lead to potential growth of economy. It would also help to reduce poverty and corruption in the country.

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