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A study on demonetisation of Indian economy

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Abstract

Demonetization has given a sudden shock to all the constituents of economy. People at once could not understand what to do. Indian economy has always been known as cash economy. People love to make cash transactions to save tax and also to make the exchange happen. A large section of the society who did not even hear about Paytm and other cashless transactions, was with no clue to run his/her business. This section included Thelawalas, daily wages labours/factory labours, farmers, servants, drivers, dhabas being run on highways etc. Transactions take place when both the parties are connected to a common cashless platform, since there was a huge lack of money due to demonetization. However, one hand tech savvy people were with cashless platforms but non-technical and a particular segment of the society were not. Getting change of Rs. 2000 currency note was again a big problem. The present study is empirical in nature and it is qualitative as well as quantitative. 17 persons were interviewed to share their experiences during demonetization.

Keywords: Study, demonetisation, economy, cashless, transactions, farmers

Introduction

Demonetization is the stripping a currency unit of its status as legal tender. Demonetization becomes a necessary when there is a change of national currency. The old unit of currency has to be retired and replaced with a new unit of currency. It includes either introducing new notes or coins of the same denomination or completely replacing the old denomination with the new denomination which is often carried out as an ambush on the black money and market. The opposite of demonetization is called as remonetization in which a form of payment is restored as legal tender. Currency is a commonly accepted form of money, including coins and paper notes, which is issued by a government and circulated within the economy. As used a medium of exchange for goods and services, currency forms the basis for any trade.

The currency or legal tender is issued by a country's central bank or a monetary authority. The national currency of a country is usually the principal currency used for most of the financial transactions in that country. Basically each country has its own currency as Switzerland's official currency is the Swiss franc, and Japan's official currency is called the yen. An exception would be the euro, which is used as the currency for a group of European countries called European Union. In India the currency is called the Indian Rupees (INR). In most of the cases, the central bank of a country has the absolute right to issue money or the currency for circulation.

Demonetization in India

In India demonetization has happened thrice. The first was on the 12th of January 1946 (Saturday), second on 16th of January 1978 (Monday) and the third was on 8th of November 2016 (Tuesday). In the January of 1946, notes of denominations 1,000 and 10,000 rupees were withdrawn from circulation and new notes of denominations 1,000, 5,000 and 10,000 rupees were introduced in 1954. Then Janata Party coalition government again demonetised banknotes of denominations 1,000, 5,000 and 10,000 rupees on 16th of January 1978 with the notion of curbing counterfeit currency and black money. The highest of all denominations ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and was again in 1954. But these notes were demonetized in the January of 1946 and again in the January of 1978, based on the RBI data. The first occurrence was in 1946 and the second in 1978 during which an ordinance was issued to phase out various notes with denominations of Rs 1,000, Rs 5,000 and Rs 10,000 respectively.

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The demonetization of denominations Rs. 500 and Rs. 1,000 banknotes was a policy decision carried out by the Government of India on 8th of November 2016. In the declaration, the use of denominations of all Rs. 500 and Rs. 1,000 banknotes of the Mahatma Gandhi Series would be invalid after the midnight of the same day, and was also announced that the new Rs. 500 and Rs. 2,000 banknotes of the Mahatma Gandhi New Series will be issued in exchange for the above mentioned old currency notes. The move by the government is defended as an attempt to eliminate a reasonable volume of currency notes which is in the circulation because of inflation.

Need and importance of demonetization in India

The Indian government claims that the demonetization effort is to stop the counterfeiting of the current currency notes allegedly used for funding terrorism across the border

by the neighbouring countries, and as an attack on the black money in the country. The move was claimed as an initiative to curb corruption, trafficking of drugs, and smuggling across borders. The supply of currency notes of all denominations has seen an increase by about 40% during the period between 2011 and 2016, the Rs. 500 and Rs. 1,000 denomination notes has increased by 76% and 109% respectively during this period due to forgery. This forged cash is usually used to fund various terrorist activities against India. The outcome of the decision is to eliminate the currency notes of selected denominations has been taken (Governor of the Reserve Bank of India, Urjit Patel, and Economic Affairs secretary, Shaktikanta Das). Nations demonetize their local units of currency for various reasons. Some include combating inflation or corruption, and to discourage a dominative cash system.

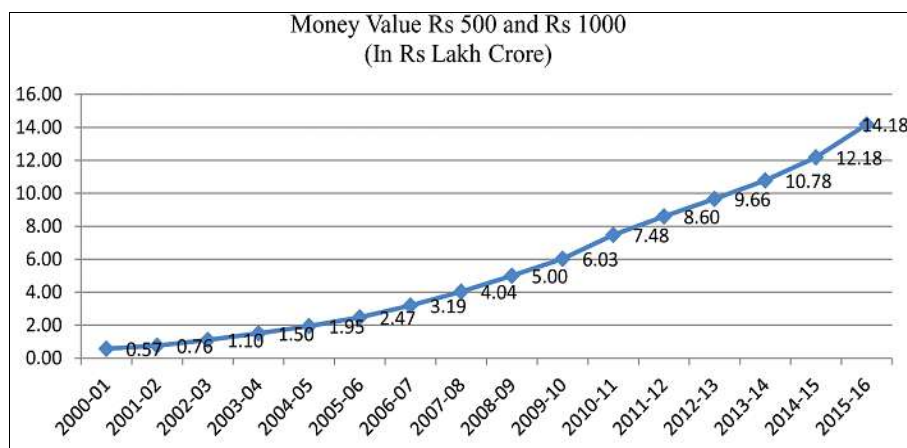


Chart 1: Rs 500 and Rs 1000 Notes: From 25% to 85% of Cash Economy in India

The government's aim was to wipe out the counterfeit currency, scrap tax evasion, abolish black money generated out of money laundering and terrorist funding activities, and to promote a cashless e-economy. By announcing the larger denomination notes to be useless, the individuals and various black money launderers with huge collection of black money generated from the parallel black cash systems were affected and made to convert the cash money through a banking system which requires tax information from the entity. In case, if the entity is not providing any proof of paying any tax on the cash, a 200% penalty of the tax owed was imposed. Besides combating black money, the purpose mentioned is also to curb fake currency (financing terrorism) and also corruption.

Effect of 2016 Demonetisation

Soon after the announcement of demonetization, all banks and ATMs across the country were paralysed because of cash shortages. The cash shortages had many disadvantageous effects on every small business, agriculture, and also on transportation, with people wanting to exchange their old banned notes having lengthy waits in long queues, and several deaths were reported to be linked to the difficulty in exchanging cash. The shortage of cash due to demonetisation process resulted in disorder and chaos, and mostly the people holding old currency notes faced difficulties in having them exchanged because of the endless queues outside banks and ATM machines across India. They also ran out of cash only after a few hours of

being operational, and about half of the ATMs in the country were not functional. Several deaths were reported standing in queues for long hours at the banks and ATMs to exchange their old banknotes. Deaths were also accounted for the lack of medical facilities or preparations due to denial of old currency notes by the hospitals.

In turn as a collective effect because of the demonetisation and US presidential election, the Indian stock exchange indices fell to a six-month low in the week which followed the pronouncement. On the very next day after the demonetisation announcement, BSE SENSEX lost nearly 1,689 points and NIFTY by over 541 points. At the close of the intraday trading as on 15 November 2016, the BSE SENSEX index was low by over 565 points and the NIFTY 50 index was below 8100 on intraday. The first four days after the demonetisation witnessed about Rs. 3 trillion (US\$45 billion) in the form of old currency notes of Rs. 500 and Rs. 1,000 being deposited in the banking system and an amount of Rs. 500 billion (US\$7.4 billion) had been distributed through withdrawals from the deposited bank accounts, ATMs and exchanges over the bank counters. In just four days, the Indian banking system handled almost 180 million transactions. The State Bank of India reported to have received about Rs. 300 billion (US\$4.5 billion) as deposits after just two days of demonetisation. A sudden hike in the online transactions with the usage of debit and credit cards was also reported.

Evading techniques like Gold purchases, Donations, Multiple bank transactions, depositing in the Jan Dhan

Scheme bank Accounts, Railway bookings, Municipal and local tax payments, Backdated accounting were also reported to have happened. According to an information by the Union Minister of State for Finance Arjun Ram Meghwal, as stated in Rajya Sabha 1,716.5 crore pieces of Rs 500 denomination notes and 685.8 crore pieces of Rs 1,000 notes were in circulation as on the November 8th 2016, the date on which demonetisation was pronounced. It actually sums up in a value which comes close to Rs 15.44 lakh crore.

History of India's demonetizes currency

The Indian rupee (INR) is the official currency of the Republic of India. The rupee is subdivided into 100 paise (singular paisa), though as of 2011 only 50 paise coins are tender. The issuance of the currency is controlled by the India. The Reserve Bank manages currency in India and derives its role in currency management on the basis of the Reserve Bank of India Act, 1934. The rupee is named after the silver coin, rupiya, first issued by Sultan Sher Shah Suri in the 16th century and later continued by the Mughal Empire.

In 2010, a new symbol '₹', was officially adopted. It was derived from the combination of the Devanagari consonant "र" (ra) and the Latin capital letter "R" without its vertical bar (similar to the R rotunda). The parallel lines at the top (with white space between them) are said to make an allusion to the tricolour Indian flag, and also depict an equality sign that symbolizes the nation's desire to reduce economic disparity. The first series of coins with the new rupee symbol started in circulation on 8 July 2011.

In a major step to check undeclared black money, the Government of India on the 8 November 2016 announced demonetization of Rs 500 and Rs1000 banknotes with effect from the same day's midnight, making these notes invalid. Apart from combating black money, the stated purpose is also to check fake currency (used to finance terrorism) and corruption. A new redesigned series of Rs 500 banknote, in addition to a new denomination of Rs 2000 banknote is in circulation since 10 November 2016. The new redesigned series is also expected to be introduced to the banknote denominations of Rs1000, Rs 100 and Rs50 in the coming months.



RBI Issued Rs 2000 Note in 10Nov,2016



RBI Issued Rs 500 Note In 10Nov,2016

History and background

The sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. Rs 1,000 and higher denomination notes were first demonetized in January 1946 and again in 1978.

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 demonetized in January 1946 and again in January 1978, according to RBI data.



RBI Rs. 10000 Note In, 1954

Rs 1,000 and Rs 10,000 bank notes were in circulation prior to January 1946. Higher denomination banknotes of Rs 1,000, Rs 5,000 and Rs 10,000 were reintroduced in 1954 and all of them were demonetized in January 1978.



RBI Rs. 5000 Note In 1954



RBI Rs. 500 Note in Year 1987

The Rs 1,000 note made a comeback in November 2000. Rs 500 note came into circulation in October 1987. The move was then justified as attempt to contain the volume of banknotes in circulation due to inflation.



RBI Rs. 1000 Note in Year 2000



However, this is the first time that Rs 2,000 currency note is being introduced. While announcing currently circulated Rs 500 and Rs 1,000 notes as invalid from midnight 8 Nov, Prime Minister Narendra Modi said new Rs 500 note and a Rs. 2,000 denomination banknote will be introduced from November 10.

- 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.
- In October 1987, Rs 500 banknote was introduced with the portrait of Mahatma Gandhi and Ashoka Pillar watermark. Mahatma Gandhi (MG) series banknotes - 1996 were issued in the denominations of Rs 5, (introduced in November 2001), Rs 10 (June 1996), Rs 20 (August 2001), Rs 50 (March 1997), Rs 100 (June 1996), Rs 500 (October 1997) and Rs 1,000 (November 2000).
- 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.
- The Rs 50 and Rs 100 banknotes were issued in August 2005, followed by Rs 500 and Rs 1,000 denominations in October 2005 and Rs 10 and Rs 20 in April 2006 and August 2006, respectively.

Conclusion

Demonetisation, Prime Minister Modi successfully portrayed himself as a leader willing to take decisive and, if necessary, drastic steps to tackle bribery, money-laundering and channels of income-generation, by-passing the formal mechanisms of the Indian state. While the long-term impact of demonetisation is yet to be seen, the policy illustrates the priorities of the Modi government: Corruption is primarily presented as a cash-based issue; demonetisation did not explicitly target noncash-based corrupt activities such as property transfers, gold or the use of tax havens. By creating and cementing a narrative on corruption that emphasises the role of cash, demonetisation may therefore divert attention from future attempts at shaping anti-bribery and corruption policies taking a more holistic approach.

One of the reasons for this development lies in the increasingly prominent role anti-corruption plays within electoral politics in India. Returning "black money" from foreign tax havens and distributing it to the poor was one the

key promises made in Modi's successful 2014 election campaign; demonetisation, thus, can be seen as more than economic policy but rather as a political tool. With previous schemes, such as a 2016 amnesty offer for tax evaders, being less successful than anticipated, Modi and his party have a strong impetus to portray demonetisation as a show of their commitment to anti-corruption. In order to do so, the government had to establish in the public mind a strong relationship between cash and corruption. This, however, may have skewed the public understanding of anti-bribery and corruption frameworks, downplaying not only other means of acquiring and storing income generated from corrupt activities but also presenting corruption as a conflict between rich hoarders of cash and the marginalised poor. The Prime Minister's attempts to position himself as a "Robin Hood"-type character whose focus is to take illicit cash from the rich and redistribute it among the poor risks reducing ABC initiatives to a precarious binary of "us-vs-them", which in turn may undermine more serious discussions on the role of policy, the law and institutions.

Demonetisation has changed the tone and pace at which corruption is spoken about in India. Crucial for the long-term success of ABC policy-making, however, will be in how far the policy has set the agenda on the relationship between cash and corruption and the role of institutions and the private sector.

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