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**DEMONETIZATION: A GAME CHANGER FROM BLACK ECONOMY TO DIGITAL ECONOMY**

**POOJA MAKEN**  
**ASST. PROFESSOR**  
**ITFT COLLEGE**  
**NEW CHANDIGARH**

**Dr. SHASHI SHEKHAR**  
**PROFESSOR**  
**QUEST GROUP OF INSTITUTIONS**  
**JHANJERI**

**ABSTRACT**

*Demonetization refers to Withdrawal of a particular form of currency from circulation. It is a cleansing action for economic prosperity. On the midnight of 8th November 2016, the Government decided to eliminate the existing Rs 500 and Rs 1000 notes from circulation and gradually introduce a new set of notes. The government of Narendra Modi completely surprised his citizens by suddenly announcing withdrawal of larger denomination currency notes from circulation, forcing Indians to put their cash into banks. That would bring all the money into taxable account. Demonetisation is not the first time in India, but introducing Rs. 2000/- currency note is first time in India. Demonetization is one of the big steps initiated by Government in addressing the various issues like black money, counterfeit currency, corruption, terrorism etc. This Research paper evaluates the Indian economy, to study the positive and negative aspects of demonetization and to assess the sectoral impact of demonetization on the economy.*

**KEYWORDS**

black money, counterfeit currency, demonetization, tax evasion, terrorist financing.

**INTRODUCTION**

**D**emonetization 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 from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency.

The opposite of demonetization is remonetization, in which a form of payment is restored as legal tender.

There are multiple reasons why nations demonetize their local units of currency:

- to combat inflation
- to combat corruption and crime (counterfeiting, tax evasion)
- to discourage a cash-dependent economy
- to facilitate trade

**INDIA'S DEMONETIZATION**

In 2016, the Indian government decided to demonetize the 500- and 1000- rupee notes, the two biggest denominations in its currency system; these notes accounted for 86% of the country's circulating cash. With little warning, India's Prime Minister Narendra Modi announced to the citizenry on Nov. 8 that those notes were worthless, effective immediately – and they had until the end of the year to deposit or exchange them for newly introduced 2000 rupee and 500 rupee bills.

The government's goal (and rationale for the abrupt announcement) was to combat India's thriving underground economy on several fronts: eradicate counterfeit currency, fight tax evasion (only 1% of the population pays taxes), eliminate black money gotten from money laundering and terrorist-financing activities, and to promote a cashless economy. Individuals and entities with huge sums of black money gotten from parallel cash systems were forced to take their large-denomination notes to a bank, which was by law required to acquire tax information on them. If the owner could not provide proof of making any tax payments on the cash, a penalty of 200% of the owed amount was imposed.

Similar measures have been taken in the past. In January 1946, currency notes of 1000 and 10,000 rupees were withdrawn and new notes of 1000, 5000 and 10,000 rupees were introduced in 1954. The Janata Party coalition government had again demonetized notes of 1000, 5000 and 10,000 rupees on 16 January 1978 as a means to curb forgery and black money.

**REVIEW OF LITERATURE**

**Charan Singh (2016)**, RBI chair professor, IIM Bangalore discussed about the mixed results of economic implications of demonetization. According to him, it would inspire confidence of international community that India is serious about its commitment to fight corruption and enhance India's ranking in ease of doing business as well as in various global indices of corruption. However, the ultimate pain in terms of non-availability of required currency notes if not corrected soon, may reflect in reduction of output in agriculture, which may spill over to industry and services.

**Tim Worstall (2016)** favoured demonetisation as it would lead to lower budget deficit, interest rates and inflation. The effects of change on GDP will emerge from system itself because we cannot calculate an economy beforehand.

**Mamun Rashid (2016)** viewed it as a painful exercise for not only the corrupt, but for the poorest and most marginalised people too. Demonetisation can be a futile exercise in the absence of steps to curb the generation of black money. Fake money once again may recirculate. Terror cannot be stopped by banning notes. The economy will be catatonic in short term, followed by a period of easing out. Only time will tell if it was all worth it.

**Dr. Manmohan Singh (2016)**, former Prime Minister of India contended that this measure has thrown the lives of millions of poor people in disarray as cash is the bedrock of lives of these people. This brazen policy measure has neither tackled the stock of black money nor has it stemmed the flow of it. The policy can act as a negative shock to the economy also.

**Acharya, Shankar and Associates (1985)** made an analysis of various aspects pertaining to unaccounted income in Indian economy. The study noted that demonetization and voluntary disclosure schemes failed to check the generation of black money. The researchers suggested for reduction in tax rates, simplification of tax structure, strict enforcement of law and punishment to tax evaders for reining the generation of black income.

**Tax Research Team (2016)** in their working paper stated in favour of demonetization Its main objective is to analyze the impact of demonetization on Indian economy. This paper shows the impact of such a move on the availability of credit, spending, level of activity and government finances.

**Mukhrjee et al. (November 2016)** [4]. studied about the impact of the present government move for demonetization on the credit availability, government finance, spending and levels of various activities. The researchers stated that in a very short period there would be more serious effect on persons earning income in cash as well as spending in cash while impact will be up to a lesser extent on those earnings in non-cash form but spending in cash. Each sector backing demand by cash

along with the real sector especially the unorganized one will much adversely effected in very short run time. In case of short term effect having complete replacement, an immense strengthening of informal sector credit market would be seen in the rural market and there would be adverse effect on construction sector. The medium term impact would produce results in terms of enhancements in deposits in the economy.

**Mohd. (November 2016)** [5]. studied about the significance as well as challenges of demonetization of currency notes. Secondary data was used for this study collected from various newspapers as well as websites. The researcher concluded through the study made that no doubt this move was going to disturb the routine life of 'Aam Aadmi' (common man of India) influencing largely the unorganized sector including organized sector up to a limited extent but the real consequences of move will have bigger implications on the Indian economy as a whole in the long run.

**Sunita (September 2014)** [6] in her research study attempted to get insight about the reasons as well as measures adopted by the government on demonetization that was implemented in Indian context. It was a conceptual study based on secondary sources. She concluded that the enhancing trade deficit, 1965's war between India and Pakistan, gulf war, political as well as economic stability, dwindling foreign exchange reserves, withdrawn of FII's (Foreign Institutional Investors) and strengthen of dollar were the key reasons behind the move for demonetization by the government in India and the measures adopted by the government included imposition of quantitative restrictions, provision for export subsidies, establishment of dual exchange regime, adoption of floating exchange rate system, increase in FII's limit, enhancement of ceiling up to a limited time frame, use of some proportion of borrowed funds overseas for the domestic expenditure, withdrawn of rebooking of forward contracts post cancellation and reduction of NOOPL (Net Overnight Open Position Limit).

## OBJECTIVES OF THE STUDY

The study put forth three major objectives which include:

1. To study the positive and negative aspects of demonetization.
2. To assess the sectoral impact of demonetization on the economy.
3. To study the experience of impact of demonetization in various countries in past years.

## RESEARCH METHODOLOGY

The paper is based on secondary data. The data has been collected from various published sources like reports, magazines, journals, newspapers and internet etc.

## POSITIVE AND NEGATIVE EFFECTS OF DEMONETIZATION

Here are a few points to support or oppose demonetization.

### ADVANTAGES

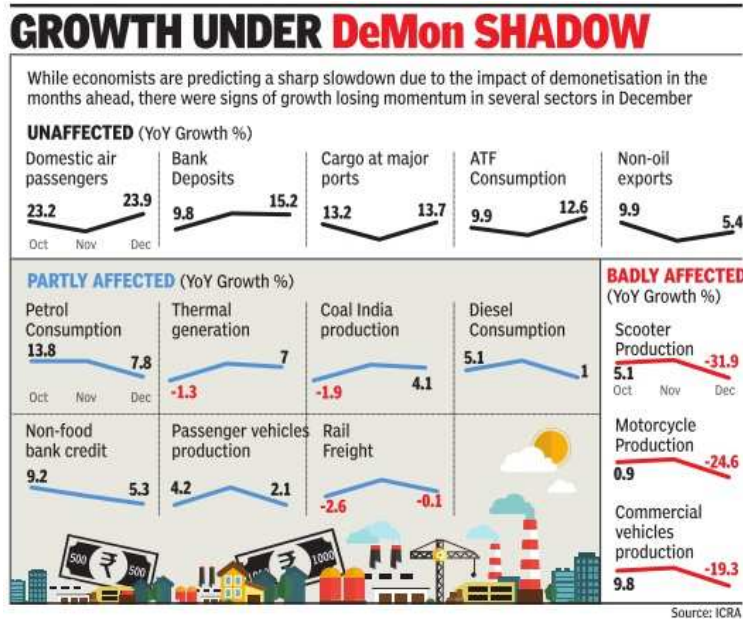
- It will be easy for the Government to track the money being exchanged as exchange can only be done by producing a valid government identity cards like PAN, Aadhaar and Election Card.
- Espionage, Arms smuggling and terrorist related activities will be overcome due to lack of funding.
- The new limits on ATM withdrawals will make the people use the cashless transactions. Card transactions will slowly replace the cash transactions in daily activities.
- Fake currencies are being used for financing terrorism which is being run by the enemy in India. Now Govt. has taken a bold move which enables them to fight fake currency/terrorist funding activities.
- It will help the government to fight Black money, terrorism, corruption and counterfeit currency with one single decision.
- Financial Intelligence Unit (FIU) of India get information about transactions from banks. During this period, banks will take extra precautions. Banks will share information with income tax department as deemed fit. So now it is difficult to get rid of the black money which is mostly in 500 and 1000 notes.
- The traditional benami transactions have already received a big blow as the new legislation has a provision for seven-year imprisonment and fine, replacing the three year jail term, or fine, or both.
- This decision will help institutionalize the real estate sector bringing more transparency in the Indian real estate industry. This step would give the Indian real estate sector more credibility making it more attractive to the foreign as well as domestic investors.
- Housing prices could witness downward pressure, helping revive demand in the sluggish housing segment (this will give much needed bloodline to the sector)
- It will help the common man by putting an end to the artificial increase in Real Estate, Higher Education and Healthcare transactions bringing them within the reach of the common man.

### DISADVANTAGES

- Demonetization deeply impacts the working sections of society: drivers, maids, cooks, electricians, plumbers. Anybody who provides services in the informal sector and depends on monthly or bimonthly cash payments.
- Inconvenience to common people who would start running to the nearby bank to exchange the 500 and 1000 currency notes.
- Cost of replacing the 500 and 1000 Rs notes. If all this additional money (a spectacular Rs. 6.666 trillion) had to be printed using Rs. 100 notes, it would cost RBI about Rs. 11,900 crores, which is more than a fourfold increase. This is without taking into consideration the increased costs of operating ATMs (since they would need to be refilled more often), and of handling money in general. Scrapping Rs. 500, Rs. 1000 notes a costly idea
- Very difficult for more than half the population who are not well versed with the card transactions.
- How do you expect a chai wallah to leave his business and stand in a queue to deposit these notes in bank?
- What will happen to the public who finds out that the note he is having is a fake one? How is the Government going to handle such situations?
- The small businesses will be affected at least in the shorter run.
- Jan Dhan scheme, UPI/digital payment stack and payment banks are still in the budding stage. It will be a long time before rural India moves to completely cashless transactions. In the short-term, people in rural India who have a significant amount of Rs. 500 and Rs. 1000 notes but no official form of identification will have a tough time in exchanging their notes.
- The big fish will be left out whose black money is in the form of foreign currency, gold and stored away in tax havens.
- Most of the black money would have already been converted into non-monetary assets (land, real estate, gold, foreign currency, foreign bank accounts, etc).
- Counterfeiting the notes again is not impossible.
- The demonetization does not affect the black money in foreign accounts. The demonetization does not affect the black money presently held in stock markets and bank accounts.
- Again, the money stacked in form of cash with the thieves who would also be fools, only a little part of their stained possession could be attained as not all the money is going to in 500's and 1000's denomination.
- The illegal wealth will only be destroyed, neither would it be recovered or removed, nor their owners be punished.
- Politicians and businessmen holding black money in huge amounts have easy way around to avoid losing their money. They are using touts. An amount of say Rs. 200,000 can be credited in 10 accounts with Rs. 20,000 each. No one will be questioning a Rs. 20,000 credit in account of a man with an average paying job. Now, think of this for bigger sums of money. It's already working.

IMPACT OF DEMONETIZATION ON DIFFERENT SECTORS

FIG. 1



1. OVER BLACK MONEY AND FAKE CURRENCY

Black money is considered as a Cancer in any economy. It is a parallel economy, which weakens the foundation of any country. With this single master stroke of demonetization, it was expected that all the black money will either come to account book or will be destroyed.

Estimates suggested that the amount of black money in India prior to demonetisation was around Rs 3.5 lakh crores while the amount held in fake currency was around Rs 400 crores. It was also estimated that around Rs 70 crore fake currencies were being injected into India every year. Following Modi’s announcement, the total demonetized amount was Rs 15.44 lakh crores.

2. OVER BANKING SECTOR

It is well-known fact that near about 86 percent currency circulation in India was composed of 500 and 1000 currency notes. And demonetization of these notes made people deposit their money which was in the form of 500 and 1000 Rs notes into the banks.

Demonetisation has resulted in a rise in deposit growth at a time when banks have reduced interest rates on term deposits. Deposits rose 13.9% or Rs 12.7 lakh crore to Rs 105 lakh crore against a 10% rise last year, according data released by the Reserve Bank of India.

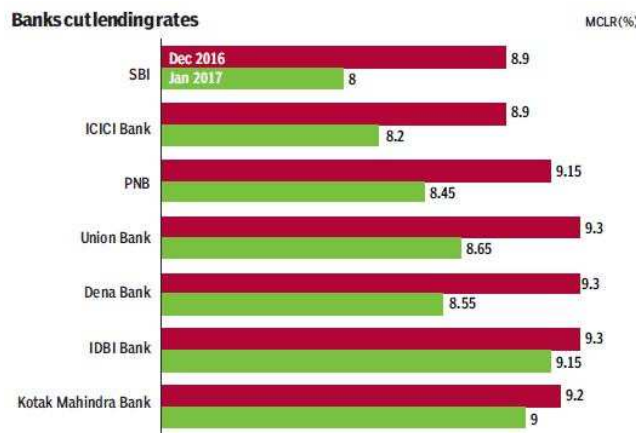
3. ONLINE TRANSACTIONS AND ALTERNATIVE MODES OF PAYMENT

While it is practically impossible to have a 100% cashless economy, the proportion of hard cash in the economy will decrease and our economy will get more digitized. This will result in greater transparency. Now government has put some limitation for Cash Withdraw from bank Accounts. People will go for online payments. They will use digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards) or other online payment to companies for buying goods or Making payments.

4. OVER LENDING RATES

This huge cash deposit base will enable banks to cut down the cost of funds because higher deposits will replace the high cost of borrowing and reduce overall costs of funds. It can be expected that banks can reduce deposit rates by ~125 bps over the next six months. The new directives of MCLR (Marginal Cost of Funds based Lending Rate) will instantaneously take into account the lower cost. This will pave the way for a decline in lending rates, which will expedite the economic activity in the medium term.

FIG. 2



5. OVER REAL ESTATE CLEANSING

It is repeatedly said that real estate industry is built on black money. The extent of black money circulation in the sector is huge. According to report at least 40 percent of real estate transactions in Delhi-NCR are being done in black money. The demonetization move will curb the flow of black money into the real estate sector.

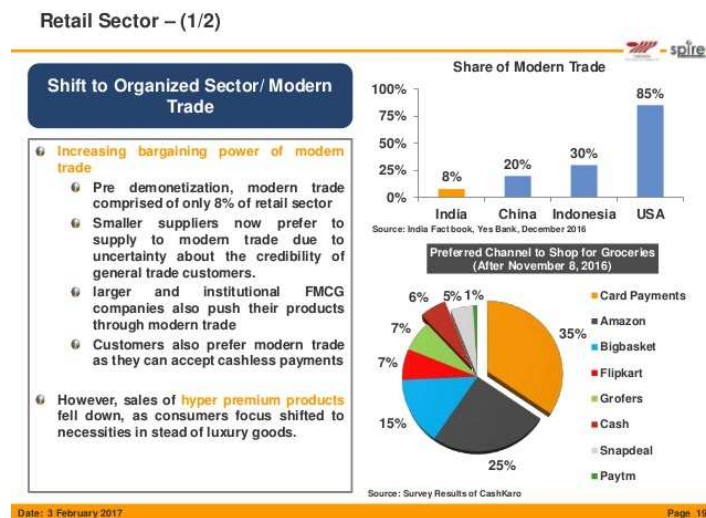
FIG. 3



**6. OVER RETAIL MARKET**

The Indian retail section generates a lot of cash transactions, there might be a decrease in the sales and purchases for the next two quarters. Moreover, the effect is felt more by the small traders and the unorganized retail section, as opposite to the organized retailers. The impact can be seen on few sectors like jewels and automobile; undoubtedly it will take some time to recover. However, the use of plastic currency and online transactions will keep on releasing the money into the retail market.

FIG. 4



**CONCLUSION**

To sum up everything, I would say; demonetization was a really a masterstroke. It has not only helped in fighting against corruption, black money, and tax evasion but also to increase economic growth, decrease poverty, and have an affordable healthcare and living.

Let's talk about objectives of demonetization before talking about the impact of demonetization whether its positive or negative.

1. Primary objective of demonetization is to restrict the shadow economy by fabricating that is being used to fund illegal activity and terrorism.;
2. Second objective is digitization of Indian economy

**Have the objectives got accomplished?**

As per the facts nearly 90% of the total cash in circulation has come back into the banking system and hence, the stated purpose of the Demonetization exercise which was to "extinguish" black money has accomplished, but that is just one side of it.

Let's have a look on impacts of demonetization on Indian economy

**POSITIVES**

- Demonetization move encouraged cashless transactions, which is a boost to Economy
- With increased transparency, trust on Indian Economy is increased. Thereby foreign investments poured in.
- A decent part of black money is removed from the economy and this money can be used for growth and development of economy

**NEGATIVE**

- Growth of GDP was earlier estimated as 7.8%. Post-demonetization, estimates are lowered to 7.1%.
- Small and medium scale businesses, agriculture sector and informal sectors are the worst hit by demonetization

Even though demonetization move created adverse short-term policy impact the real impact of demonetization must be evaluated in the medium/long term, at this point of time we cannot surely conclude whether demonetization is a failure or a success.

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