Demonetisation: Impact on Indian Economy and Indian Society

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Abstract: Demonetisation refers to withdrawl of a particular form of currency from circulation. The old unit of currency must be removed and substituted with a new currency unit. Demonetisation took place on 8 November 2016 by the present Modi Government. This is a bold step which has been taken by the Government for the betterment of the Indian economy and Indian Society. This article discusses the impact of recent demonetisation on the Indian System.

Keywords: Black money, Corruption, Demonetisation, Indian economy.

I. Introduction

Prime Minister Shri Narendra Modi on 8 November 2016 came out with one of the boldest moves ever made by any prime minister of independent India in the form of demonetisation and ceasing ₹500 and ₹1000 bills as legal tender. The move left the country shaken as majority of the people got affected as a situation of cashlessness did occur temporarily. The formal government decision to this effect was taken in the Cabinet Meeting held in the evening of 8 November 2016 and was termed as the master stroke by many economic analysts. The reasons given by the government in favour of the move were measure to curb corruption, flow of counterfeit currency and terrorism. The announcement was made by the Prime Minister himself in a televised address at 2015 hours on 8 November 2016 and it was declared that the use of all existing ₹500 and ₹1000 denomination currencies would be invalid from the midnight of the same day. It was further announced that the new currencies of ₹500 and ₹2000 denominations with new design would be released soon while all other currency denominations would remain as legal tenders.

II. Background

Demonetisation is the act of stripping a currency unit of its status as legal tender. Basically, demonetisation is necessary whenever there is a change of national currency. The old unit(s) of currency must be retired and replaced with new currency unit(s). There are multiple reasons why nations demonetise their local units of currency. Some classical reasons include;

- To combat inflation,
- To combat corruption and
- To discourage a cash transaction system, which itself is costly, risky and time consuming.

The process of demonetisation involves either introducing new bills or coins of the same currency or completely replacing the old currency with new currency.

The Indian government demonetised the two largest denomination currencies of the country. These notes accounted for 86% of the country's cash supply. The government's goal was to eradicate counterfeit currency, fight tax evasion, eliminate black money gotten from money laundering and terrorist financing activities, and promote a cashless economy. By making the larger denomination notes worthless, individuals and entities with huge sums of ill gotten and black money gotten from parallel cash systems were forced to convert the money at a bank which is by law required to acquire tax information from the entity. If the entity could not provide proof of making any tax payments on the cash, a tax penalty of upto 200% of the tax owed was imposed.

The term demonetisation is not new to the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the ₹10000 note in 1938 and again in 1954. But these notes were demonetised in January 1946 and again in January 1978. Since less than 5% of population in India had access to such bills and most banks never had such currency notes, demonetisation did not have a big impact on the country. In January 1946, banknotes of ₹1000 and ₹10000 were withdrawn and new bills of ₹1000, ₹5000 and ₹10000 were introduced in the year 1954. The Janata Party coalition government had again demonetised banknotes of ₹1000, ₹5000 and ₹10000 denominations on 16 January 1978 as a means to curb counterfeit money and black money. These previous demonetisation moves, in general, did not affect the common man and the usual market as the demonetised denominations were of considerably high valued during the period of operations.

III. Facts of the Subject

In the recent past in year 2015, the Zimbabwean government demonetised the Zimbabwean dollar as a way to combat the country's hyperinflation that was recorded at 231,000,000%. The 3-month process involved expunging the Zimbabwean dollar from the country's financial system and solidifying the US dollar, Botswana pula, and South African rand as the country's legal tender in a bid to stabilize the economy.

Another example of demonetisation occurred when the nations of the European Monetary Union adopted the Euro in the year 2002. In order to switch to the Euro, authorities first fixed exchange rates for the varied national currencies into Euros; then the old national currencies were demonetised. However, the old currencies remained convertible into Euros for a while so that a smooth transition through demonetisation would be assured.

The Coinage Act of 1873 demonetised silver in favor of adopting the gold standard as the legal tender of the United States. The withdrawal of silver from the economy resulted in a contraction of the money supply, which subsequently led to a 5-year economic depression in the country. In response to the dire situation and pressure from silver miners and farmers, the Bland-Allison Act remonetized silver as legal tender in the year 1878.

In India, on 28 October 2016, the total banknotes in circulation were valued at ₹17.77 Lakh Crore. In terms of value, the total bank notes in circulation on 31 March 2016 were worth ₹16.42 Lakh Crore of which nearly 86% (around ₹14.18 Lakh Crore) was ₹500 and ₹1000 bills.

IV. Pitfalls of Demonetisation

There is hardly any decision which can boast of not having a single pitfall. India is 90% cash-based economy. Therefore, demonetisation of the two highest denomination currencies was bound to shake the economy of the country. Expectedly, this decision too has a few pitfalls as well;

- An obvious looking point was that of *lack of adequate preparedness* (though government tried to cover it up on the pretext of maintaining secrecy lest people in know make the best out of it).
- It is evident from the experiences of the period of post demonetisation that there is *clear shortage of New Notes* (though government could have got the required number of Notes printed in a foreign country and yet ensured total secrecy by signing three parties Agreement of Integrity).
- *ATMs* were either not recalibrated to dispense the new currency or they were starving of currencies, or both.
- India is a vast country with a significant spread of the *unorganised sector*. The organised sector is confined to only a few, if not precisely elite. India's literacy is still close the half of that of the advanced countries. A sizable of the population of India takes home earnings in cash. Thus, the common man felt hassled by the virtual cashlessness that came to them so suddenly.
- People expressed their anger openly on not being able pay for their essentials as the ATMs and bank counters were went dry in most of the places; even the government machinery, the banks appeared helplessness to tackle the situation.
- People waiting for bulk currencies for arranging family functions felt let down.
- People capable and willing to make cashless transactions appeared handicapped as the payee was not technically ready.

In addition, there are two relevant questions;

- One, according to one estimate, there is only about 6% of the black money in India is in liquid cash, thus, how would this move be able to weaken the black money market which has been projected as the main reason behind the move? If it cannot substantially, it is a big pitfall by itself.
- Secondly, the highest existing currency denomination was withdrawn citing the reason for its ease of stashing, and ease of transportation for illegal means. However, the immediate currency replacement was even higher denomination (₹2000 Bills), which has proved ineffective in the market places of the Indian common man! A pitfall, indeed.

V. Implications of Demonetisation

There may be several implications of the process. There will be a disruption in the current liquidity situation as households are likely to get affected by the demonetised bills' exchange terms laid by the government. Though clarity is unfolding on this, commodity transactions and general cash market transactions are likely to feel an immediate impact.

Unorganised sector proceedings, including small trade market activities, will remain volatile in the short-term, however it is heartening that in a short span this segmented of society has accepted the reality and roadside vendors, cab drivers, *kirana* stores, etc, have already started operating cashless making use of various e-devices.

VI. Envisaged by Government of India

India is vast country with varying interests and therefore it is indeed difficult for the Government to satisfy all sections. However, the Central Government got convinced that it was high time to act decisively. A step like demonetisation of the high values currencies, the government envisaged well, would certainly force the black money to get declared and impact the operations of parallel economy leading it to collapse. Such unaccounted money, which devoured the government a huge amount of income (through various tax measures), was mostly misused in the process of electioneering which did no good to the Indian Republic and many other unlawful activities.

Further, the terrorist networks that were increasingly becoming active, needed a strike that could diminish their power to get themselves supplied. It was considered to be a complementary move to the military operations against the terrorist groups.

VII. Indian Economy

It is a fact that, Indian economy was experiencing the challenge of a parallel economy. The quantum of unaccounted money became so large that the government had to look for some stern steps to revive the real economy of the country. However, as the Indian economy is heavily dependent on cash, as only less than half the population uses banking system for monetary transactions, demonetisation has hit trade and consumption hard. With people scrambling for cash to pay for goods and services, the move is likely to take a big toll on the country's growth and output during the current fiscal. Consumption makes up for around 56% of India's GDP, hence, a drop in spending will pull down growth. The current step could also lead to behavioural changes in households' savings and their consumption pattern, it is expected.

Notwithstanding present state of Indian Economy, the demonetisation (and non availability of easy cash) has certainly brought in attitudinal change in end consumers and reliance on e-devices / app based transactions is becoming an accepted way of life. Indian Economy is thus moving from cash dependent to less cash leading to cashless economy.

VIII. Indian Society

The demonetisation move came as a huge shock for the Indian society which feels so cosy with the operating cash. The sudden apparently 'no cash' condition tested the endurance of the society to its limit and slowed down the day to day activities on many accounts. The market goers had to curtail, the travellers had to replan, the daily wage earners became temporarily helpless and the lower middle class heaved a sigh of relief that their earnings remained unaffected. The most significant experience for the Indian society would, perhaps, be in terms of being pushed to a 'cashless society' (through Less Cash way).

IX. Was it a Thought Through Plan?

The immediate question raised by most of the educated people, post demonetisation, was whether the move was a well thought-out or just a knee jerk decision? Was it not taken in a hurry without adequate preparation? The question stands valid in a country like India where common man does not have a planned life owing to their meagre earnings. Most of them move on day-to-day basis – wait eagerly for the cash to flow into their hands at the end of their hard day's work. *However, the move was not aimed at them; these were some unavoidable 'collateral damages'.*

Most of these 'possible effects' were known. The Government claims that it took six months for the preparation. It is learnt that a highly competent and dedicated team of veteran economists and analysts were engaged secretly for assessing and analysing the situation that would arise post demonetisation; a proper research was carried out. RBI- the Central Bank was given a 'green' to go ahead with printing of new currencies. The apparent gap between Government and the RBI is due to insufficient printing of the currencies that needed by the market. There are contradictory aspects into it – the limited infrastructure (for printing the currency notes) and the secrecy. While the infrastructure is basically a matter of resources, the secrecy, on the other hand is a matter of strategy. It is also a fact that, maintaining secrecy of a plan is becoming increasingly challenging. Had it been leaked, the possibility of which increases with increasing incubation time, the entire plan would have been defunct; consequently, there was an element of urgency too, albeit, for ensuring of the secrecy. The limited infrastructure could have been handled by getting it printed elsewhere (in a foreign country outside the Government Currency Printing facilities), the abundance of currency would have motivated (maybe read as compelled, to some extent) people to embrace the 'cashless' transaction, perhaps. Cashless transaction is one of the moves, the Government of India trying implement in order to achieve 'Digital India'.

But the moot point is, '*Is India ready for transformation to app based cashless economy'*. Not only Society has to accept it and Government and various NGO / CBO should come forward and partner with Banks and Financial Institutions to create awareness and sense of security but there is a need for *putting laws in place* to deter the anti social elements who may resort to stealing and manipulating.

X. Prognosis

The government of India, while spelling out its agenda in the phased manner alongside the demonetisation move, clearly indicated that it would push India for a 'Digital India' and the government will create infrastructure for its implementation. Given, the increasing e-literacy in India, it is certain that the people of India would embrace the 'cashless economy' faster than the government would have expected. The consequences will fetch the government much higher revenue in the days to come.

XI. Role of COER (College of Engineering Roorkee)

The role of individual entities in the entire process of demonetisation and post demonetisation would be critical. The entities, in particular, those involved in educating the society and serving/contributing with its research output like COER, should play a positive role. This can be achieved in terms of sensitising the people about the possible effects of the process and showing the possible quantitative analyses.

XII. COER through Following Organs Plans to Contribute in Creating a Cashless Society

- *Sensitise masses of positive effects* of moving onto cashless society and enabling them to learn and use apps which can help to live normal lives without cash. The three NGOs part of COER can play an effective role in this.
- A beginning has already been made by COER School of Management by conducting a Seminar on Demonetisation on 13 December 2016, to educate Faculty Member, Staff and Students about Demonetisation and Cashless Economy.
- COER School of Management plans to organise event "*Market: Understanding Consumer Behaviour*" in BHEL residential area, wherein the visiting population shall be motivated and encouraged towards app based Cashless transactions.