

An Analysis of Demonetization and Its Effects on the Indian Economy

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Abstract

One significant development in the Indian economy is the demonetization. Individuals involved in illicit activities such as money laundering and tax evasion experience terror as a result of this. On November 8, 2016, the Indian government said that the 500 and 1000 rupee notes will no longer be accepted as legal money. The value of the cash supply in the nation is made up of 500 and 1000 rupee notes to the tune of almost 86%. Here, the government's primary goals were to battle tax evasion, eradicate black money, end terrorism funding, stop inflation, find counterfeit money, and encourage a cashless society. The news caused a great deal of difficulty for the general public in meeting their everyday transactions. We also note that this demonetization lowers the economy's growth rate. Additionally, demonetization has certain negative effects on the Indian economy. The main objectives of this study to know the reason of demonetization and its impact on economy. As result we see that demonetization affected economy positively as well as negatively.

Keyword: Black Money, Demonetization, Cashless Economy, Parallel Economy, Digital Transactions

Introduction

The Indian economy is believed to be expanding quickly and is seen as a shining example among other rising markets globally. India has several advantages in the global context, including a higher proportion of young people, a developing middle class, rising levels of literacy, and improved technical skills among its workforce, all of which would positively impact any proactive changes made to the current system. (Gajendranayagam & Ganesan, 2017). The official economy is referred to as "white money," whereas the unauthorized economy is known as "black money." The lifeblood of every economy is money. Human needs have grown as civilization and humanity have expanded. The barter system developed in order to satisfy humankind's limitless desires. However, the creation of money eventually proved to be a solid foundation for an economy. Barter seems less convenient than money trade. (Kamatchi Muthulakshmi & Kalaimani, n.d.) The process of depriving a monetary unit of its legal tender status is known as demonetization. It always happens when the country's currency is changed. New notes or coins are frequently used to replace the existing form(s) of money that have been removed from circulation. (Samuel, 2017) Demonetization is the process of taking a certain currency out of circulation and substituting it with a new one. It may also be viewed as the removal of a certain currency from circulation. (Vij, n.d.) Demonetization is the act of removing a money unit's legally sensitive status so that it can be used. Anticipating favorable alterations to the overall liquidity framework, countries frequently implement the demonetization process as a means of modifying the prevailing financial circumstances. Various countries worldwide have employed demonetization at some time to regulate certain situations, such inflation, and

to stimulate their economies. (Mandala & Mohanty, 2019). An important turning point in the Indian economy was demonetization. Those who are involved in illicit activities, such as money laundering and tax evasion, become afraid of it. On November 8, 2016, the Indian government said that the 500 and 1000 rupee notes will no longer be accepted as legal money. The value of the cash supply in the nation is made up of 500 and 1000 rupee notes to the tune of almost 86%. (Jyoti Sarkar & Moumita Karmakar, n.d.)

Literature Review

Kushwaha Himanshu, Kumar Ashwani, Abbas Zainab (2018) studied to comprehend the rationale for demonetisation and its effects on different sectors. The beneficial and negative effects of demonetisation on the Indian economy are also discussed in this paper. Either Direct or indirect means were used to get the black money into bank accounts, or it was reported by paying significant taxes and penalties. The Indian economy will benefit from demonetization since it promotes the use of plastic money, e-wallets and applications, online banking, and other digital payment methods. In the medium to long run, demonetization is good for the economy.

Singh Partap, Singh Virender (2016) defined that with 12.1% of GDP in circulation, India has one of the highest rates of currency circulation. Approximately \$220 billion, or 3.2% of household assets, are anticipated to be in cash on hand. This amount is larger than investments in stocks. Of this total amount of money, around Rs 14 lakh crore (\$190 billion) or 87% is in the shape of Rs 500 and Rs 1,000 notes. The majority of cash that households have on hand comes from economic transactions that are either corrupt or do not disclose to the tax authorities. If the higher denomination money was eliminated, either these would be introduced into the system or the money would just vanish.

Muthulakshmi E. Kamatchi, G. Kalaimani evaluated the demonetization tool's potential for eliminating the black market has been attempted in this piece. One of the major initiatives the government took to solve the different problems like black money, counterfeit money, corruption, terrorism, etc. was demonetization. One of the key steps towards the elimination of dirty money in India is the central government's recent decision to demonetise high-value currency. The general populace will be somewhat impacted by the demonetization push, but these decisions are unavoidable in the greater good of the nation. Ganesan G, Gajendranayagam B (2017) addressed the experiences and effects of demonetization on the Indian economy, focusing on how these concerns relate to different sectors of the country's economy both before and after the policy was implemented. The impact of demonetization on several Indian economic sectors was demonstrated by the current study. In contrast to other years, India's gross value added is somewhat down, although the half-yearly numbers for the current fiscal year show a growing trend.

Samuel Yashna, Anoop K. Saxena (2017) took an effort to examine the short- and long-term effects of demonetization in relation to the various sectors of the Indian economy. The main goal of currency swapping is to eliminate black money from the Indian economy; it is also discussed whether demonetization would be helpful in achieving this goal. It could be accurate to predict that demonetization will help the Indian economy in the long term. The country's tax system would be affected by the currency switch in the years to come. The government will be able to execute projects of national importance with the extra money it receives from greater tax collection and bank deposits, which will result in reduced interest rates on loans.

Dimpal Vij (2018) attempted to figure out these short-term implications of demonetization on Indian Economy both good and bad. This study employs a descriptive, analytical technique based on secondary data to figure out these positive and negative consequences of this demonetization on Indian economy in

recent one year. Demonetisation done by our honourable Prime Minister Modi last year was with the very good intention to reduce corruption and black money from the economy, bring transparency and greater formalization in the economy.

Objectives of this research

- To know the history of Demonetisation
- To know the reason of Demonetisation
- To find the impact of demonetization on Indian economy
- To research how demonetization affects Black Money.

Research Methodology

This paper, which is descriptive in nature, explains the reasons for demonetisation, its effects, and both its advantages and disadvantages for the Indian economy. The secondary data used in the study. Data were collected using internet.

History of Demonetisation

Apart from India, several other nations have used demonetization policies at various points throughout history in an effort to reduce corruption, manage black money in the economy, and other issues. In order to reduce unaccounted money in the economy, India initially implemented the demonetization strategy in 1946 and again in 1978. For this reason, the Indian government revoked the legal tender status of all larger denomination banknotes valued at Rs. 1,000, 5,000, and 10,000 in 1978. The Indian government likewise implemented the demonetization strategy in 2016, at which point it revoked the legal tender status of the 500 and 1000 rupee notes for a number of reasons, including the suppression of corruption and the management of illicit money. Long lines of people had to wait in order to exchange their currencies, and the haste to do so was blamed for a number of deaths.

The Central Board of Direct Taxes issued a study in 2012 that included a recommendation against demonetisation, stating that the black money and shadow economy, which are mostly kept in the form of jewellery, gold, and benami properties, would not be solved by demonetization. The Reserve Bank of India (RBI) said on May 19, 2023, that the Rs 2000 denomination banknotes will no longer be in use (Jana et al., n.d.).

Reason of Demonetization

There was a parallel economy in the nation as a result of the undeclared money. These illicit funds entered the bank accounts either directly or indirectly.

- Demonetisation was a daring and groundbreaking move by the Indian government to combat black money, and it will have a significant effect on the nation's black market economy. This action may be used to identify pockets and people who have black money. A small number of companies, such as real estate brokers, jewelers, foreign exchange dealers, and private money lenders, frequently own substantial sums of unreported funds in the form of currency notes.
- If the currency spirals out of control due to issues like hyperinflation, governments may choose to implement demonetization(Jana et al., n.d.).
- Demonetization can also be used to prevent illegal activities including tax evasion, terrorism, and counterfeiting.

- A new monetary standard is implemented by demonetization. For example, in 2002 the European Union adopted the Euro, a central currency that would eventually replace the prevailing monetary standards of a few countries.

Impact of Demonetization

As just 10.8% of the money in circulation is in 2000 rupee notes, the RBI governor predicted that the removal would have a "very very marginal" effect on the economy. Promoting the cashless/digital economy was the slogan of the demonetization movement. Growing numbers of cashless or low-cash transactions will result in more income transparency, which will raise the amount of direct taxes collected. Alternative payment methods will become increasingly popular as cash transactions decline. Demand for electronic payment methods such as online shopping, app payments, e-wallets, e-banking, and credit and debit card use will undoubtedly rise significantly (Kushwaha et al., 2018).

1. Positive Impact

- The corrupt practices will be significantly impacted. Individuals who own black money in cash will be unable to swap much because they fear punishment from the government.
- It will be impossible for those engaged in terrorism and counterfeit money to carry on for at least a long while. Since all of the money will now be on file, the smuggling of weapons and transactions with terrorists will not continue.
- Raising tax revenue will support national development initiatives like developing roads, infrastructure, transit, and many other projects.
- Demonetization undoubtedly helped e-wallets and digital transactions, as seen by the sharp rise in the use of Paytm, Mobiquik, Bhim app, and Aadhar-enabled gadgets. Point of sale (PoS) machine count skyrocketed to 1.6 million in 20 years, with a 62% growth in the six months from October 2016 to April 2017. (Vij, n.d.)
- A considerable rise in the number of people and companies joining the official economy was caused by demonetization. This led to an increase in the tax base, which decreased tax evasion and increased transparency.
- Cash flow into financial markets was significantly aided by demonetization. It strengthened the saving habit. The percentage of gross financial savings rose by 90 basis points (bps) from 10.9% of gross national disposable income (GNDI) in FY16 to 11.8% of GNDI in FY17. People's saving habits were altered by it. Those who used to keep cash on hand or in banks are increasingly investing in insurance firms and mutual funds.

2. Negative Impact

- There was an instant impact on cash market transactions related to commodities. The government's note exchange and cash withdrawal policies are anticipated to have an impact on households, which is why the current liquidity situation is disrupted.
- Due to a lack of liquid funds, a number of societal segments experienced short-term disruptions, including the agricultural industry, small dealers, homes, and daily wage earners.
- There will be additional expenses for replacing the money. The heightened expenses associated with running ATMs necessitate frequent refilling, which will place a significant pressure on banks. Furthermore, the government must bear the costs associated with demonetizing old currency units and printing new ones; if these expenses outweigh the advantages, demonetization is pointless.

- The lack of cash has a negative impact on Indians' spending habits. Short-term sales of consumer durables are expected to be hindered, particularly if cash transactions through unorganized channels are made.

Effect of Demonetization on Black Money

The three primary economic goals of demonetisation were to combat black money, counterfeit notes, and to promote digital transactions in order to establish a cashless economy. The largest of their goals was to combat black money. Cash that is unaccounted for in the financial system or for which the state has not received tax payment is referred to as "black money."

Demonetization was an attempt to reduce the amount of black money entering the nation. However, it was unable to entirely eradicate black money from the economy since the majority of those with substantial amounts of black money or large earnings from illicit operations either swapped or deposited their old 500 and 1000 rupee notes in banks within the allotted period (Jyoti Sarkar & Moumita Karmakar, n.d.).

Conclusion

The nation was not expecting the government to demonetize the old currency and replace it with the new one. In an attempt to combat the threat of illicit money, corruption, financing of terrorism, and counterfeit cash, the action was taken. In the annals of Indian economic history, the decision to demonetize the old currency was viewed as a surgical blow against undeclared wealth, perhaps signalling the advent of a cashless economy. The nation had a significant cash shortage in banks and ATMs following the demonetisation, which had a negative impact on small businesses, agriculture, and transportation. Demonetization made a partial effort to lessen illicit riches, corruption, terrorism, and counterfeit money. It has positive as well as negative impact. Positive impacts are raising tax revenue, reduce black money terrorism. It helped in cashless transactions, increasing investment. It affected economy negatively such as lack of short term fund, additional expenses of replacing money. It promoted financial inclusion, decreased the amount of cash in circulation, and restrained the use of black money and illegal activity. The move to digital transactions sped up digitalization in both urban and rural regions and encouraged innovation and better financial literacy.

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