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**DEMONETIZATION AND ITS IMPACT ON INDIAN ECONOMY IN INDIA**

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**ABSTRACT**

*Demonetization 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 Government of India decided to demonetize the 500/- and 1000/- rupee notes of the country on November 8<sup>th</sup> 2016. The two biggest denominations in its currency system; these notes accounted for 86 per cent of the country's circulating cash. When liquidity shortage strikes, it is consumption that is going to be adversely affected first. When consumption declined automatically production of the state will be going to decline situation, this will lead to less employment opportunity of the nation. The demonetization policy will force people to pay income tax returns. Most of the people who have been hiding their income are now forced to come forward to declare their income and pay tax on the same. Even though deposits up to Rs 2.5 lakh will not come under Income tax scrutiny, individuals are required to submit PAN card for any deposit of above Rs 50,000 in cash. The government is finding it hard to implement this policy. It has to bear the cost of printing of the new currency notes. It is also finding it difficult to put new currency into circulation. The 2000 rupees' note is a burden on the people as no one likes to do transaction with such high value currency.*

**KEYWORDS**

Currency, Demonetization, Government & Farmers.

**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 forms of money are 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 Coinage Act of 1873 demonetized silver as the legal tender of the United States, in favor of fully adopting the gold standard. Several coins, including two-cent piece, three-cent piece, and half dime were discontinued (Dasgupta). The withdrawal of silver from the economy resulted in a contraction of the money supply, which subsequently led to a five-year economic depression throughout the country. In response to the dire situation and pressure from farmers and silver miners and refiners, the Bland-Allison Act remonetized silver as legal tender in 1878. An example of demonetization for trade purposes occurred when the nations of the European Union officially began to use the euro as their everyday currencies in 2002 (Chaudhuri).

The Government of India decided to demonetize the 500- and 1000- rupee notes of the country on 2016. The two biggest denominations in its currency system; these notes accounted for 86 per cent of the country's circulating cash (RBI Report). 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 (RBI Report).

How much of the demonetized notes will have to be substituted with valid notes in turn depends on two factors? First, how much was presented for over the counter conversion, and how much will be deposited in bank and post office accounts. In 1946, when currency notes of the value of ₹500, ₹1,000 and ₹10,000 were demonetized by an ordinance, such notes in circulation were ₹143.97 crore (Rajakumar). By the end of 1947, 134.9 crore, or 93.7 per cent were exchanged. In 1978, when currency notes of demonetization's 1000, 5000 and 10,000 were demonetized, the total amount in circulation was 145.42 crores. Of this, 89 per cent came back for exchange in India.

Chaos ensued in the cash-dependent economy (some 78% of all Indian customer transactions are in cash), as long, snaking lines formed outside ATMs and banks, which had to shut down for a day (Rajakumar). The new rupee notes have different specifications, including size and thickness, requiring re-calibration of ATMs: only 60 per cent of the country's 200,000 ATMs were operational. Even those dispensing bills of lower denominations faced shortages. The government's restriction on daily withdrawal amounts added to the misery, though a waiver on transaction fees did help a bit (Nag).

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 per cent 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.

**DEMONETIZATION IN RURAL PERSPECTIVE**

Demonetization is very important impact on the people of the rural areas. Who are opposed to the demonetization program usually mentions the difficulties that the farmers might face in procuring seeds (Sridhar). But, the Indian farmer has more or less adapted to this challenge mostly because the concept of trust is far more prevalent in rural areas than in urban areas. Farmers have sold their produce to APMCs without getting paid, with the promise from the traders that they will pay them later. Similarly, farmers have purchased seeds from seed sellers without paying them with the same promise that they will pay them later. So, we have the emergence of a true "cashless" economy one that is based on debt (Sridhar).

Unfortunately, many of the promises made above will have to be broken because of the basic laws of economics. Due to good rains last quarter the agricultural sector performed well and there was increase in agricultural produce. But now their consumers do not have sufficient cash at hand to purchase these primary goods which are sending their prices tumbling down in many urban centres. So, when the traders do not get sufficient cash by selling their goods how are they going to pay the farmer back? But "seed" is just one of the problems facing rural India. The bigger problem is "labour". The rabi cropping and harvesting season is going on. During this time the farms in India employ large amounts of extra labour.

The rabi season is a good season for the labourers in unorganized sector in both the urban and rural areas and the labourers have an option to choose amongst them. This is because coming fresh off from the monsoon season which causes huge disruption in construction in real estate sector (one of the largest employers of unorganized labour) the autumn and the winter periods are the time when they aim to do most of their work.

Similarly, in rural areas the farmers having faced difficulties like floods and silts during the monsoon season pour everything they have into the rabi season to break even. So, this results in massive employment for low income households in both rural and urban areas. But now when there is no cash at hand and when most of the unorganized sector labourers are daily wage labourers how can the employers pay them?

Another important element for the rural economy of North East is the tea gardens. Prime Minister Narendra Modi's Jan Dhan Yojana might have been a great success as far as opening bank accounts were concerned in the country as a whole but it was a massive failure in the tea gardens (Vikram). This was realised by the Assam government only after demonetization program was launched and a haphazard attempt by the state government to make tea garden workers open up Jan Dhan accounts has as yet not been a success and why will it be? Tea Garden workers have been daily wage earners in Assam for the past 150 years- it cannot be reversed in just a few weeks' time (Nag).

It might look like a good deal, but it is actually not a very good deal for the agriculturalists. The sowing and harvesting of a farm which grows crops and vegetables are vastly different from the activities in a tea garden. So, tea garden workers are far slower in completing their work than the laborer's usually employed by the farmers. This means extra income for the middle men but loss for the agriculturalists. The tea garden workers' communities are also facing a lot of uncertainties due to this new ad hoc system coming into play.

## OBJECTIVES AND METHODOLOGY OF THE PAPER

The present paper contains mainly demonetization activities in India. To study the Demonetization and its impact on Indian economy in India. To study the merits and demerits of Demonetization. The paper purely based on the secondary data. The secondary data collected from various reports of the Reserve Bank of India (RBI). The literature also gathered from Books, News Paper and Esteemed Journals etc.

## DEMONETIZATION AND ITS IMPACT ON INDIA ECONOMY

Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc. In this context, the exercise may produce following short term/long term/, consumption/investment, welfare/growth impacts on Indian economy. The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks. Following are the main impacts.

1. Demonetization is not a big disaster like global banking sector crisis of 2007; but at the same time, it will act as a liquidity shock that disturbs economic activities in India.

2. **Liquidity crunch (short term effect):** liquidity shock means people are not able to get sufficient volume of popular denomination especially Rs 500 and 1000 Rupees. This currency unit is the favorable denomination in daily life. It constituted to nearly 49 per cent of the previous currency supply in terms of value. Higher the time required to resupply Rs 500 notes, higher will be the duration of the liquidity crunch. Current reports indicate that all security printing press can print only 2000 million units of RS 500 notes by the end of this year. Nearly 16000 mn Rs 500 notes were in circulation as on end March 2016. Some portions of this were filled by the new Rs 2000 notes. Towards end of March approximately 10000 mn units will be printed and replaced. All these indicate that currency crunch will be in our economy for the next four months.

3. **Welfare loss for the currency using population:** Most active segments of the population who constitute the 'base of the pyramid' uses currency to meet their transactions. The daily wage earners, other labourers, small traders etc. who reside out of the formal economy uses cash frequently. These sections will lose income in the absence of liquid cash. Cash stringency will compel firms to reduce labour cost and thus reduces income to the poor working class.

There will be a trickle up effect of the liquidity chaos to the higher income people with time.

4. **Consumption will be hit:** When liquidity shortage strikes, it is consumption that is going to be adversely affected first. When consumption declined automatically production of the state will be going to decline situation, this will lead to less employment opportunity of the nation. This condition will be facing the problem of low level Growth rate of the state it's one of the main factor of the declined Tax Revenue of our country (Nag).

5. **Loss of Growth momentum-** India risks its position of being the fastest growing largest economy: reduced consumption, income, investment etc. may reduce India's GDP growth as the liquidity impact itself may last three-four months.

6. **Impact on bank deposits and interest rate:** Deposit in the short term may rise, but in the long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the savers when full-fledged new currency supply take place. This means that new savings with banks is only transitory or short-term deposit. It may be encashed by the savers at the appropriate time. It is not necessary that demonetization will produce big savings in the banking system in the medium term. Most of the savings are obtained by biggie public sector banks like the SBI. They may reduce interest rate in the short/medium term. But they can't follow it in the long term.

7. **Impact on black money:** Only a small portion of black money is actually stored in the form of cash. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. Hence the amount of black money countered by demonetization depends upon the amount of black money held in the form of cash and it will be smaller than expected. But more than anything else, demonetization has a big propaganda effect. People are now much convinced about the need to fight black income. such a nationwide awareness and urge will encourage government to come out with even strong measures.

8. **Impact on counterfeit currency:** the real impact will be on counterfeit/fake currency as its circulation will be checked after this exercise. Demonetization as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn't have the digital transaction culture. Overall economic activities will be dampened in the short term. But the immeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

## MERITS AND DEMERITS OF DEMONETIZATION

The demonetization policy will help India to become corruption-free. Those indulging in taking bribe will refrain from corrupt practices as it will be hard for them to keep their unaccounted cash. This move will help the government to track the black money. Those individuals who have unaccounted cash are now required to show income and submit PAN card for any valid financial transactions (Rajkumar). The government can get income tax return for the income on which tax has not been paid. The move will stop funding to the unlawful activities that are thriving due to unaccounted cash flow. Banning high-value currency will rein in criminal activities like terrorism etc.

The ban on high value currency will also curb the menace of money laundering. Now such activity can easily be tracked and income tax department can catch such people who are in the business of money laundering. This move will stop the circulation of fake currency. Most of the fake currency put in circulation is of the high value notes and the banning of 500 and 1000 notes will eliminate the circulation of fake currency (Lahiri).

This move has generated interest among those people who had opened Jan Dhan accounts under the Prime Minister's Jan Dhan Yojana. They can now deposit their cash under this scheme and this money can be used for the developmental activity of the country (Rajkumar). The demonetization policy will force people to pay income tax returns. Most of the people who have been hiding their income are now forced to come forward to declare their income and pay tax on the same. Even though deposits up to Rs 2.5 lakh will not come under Income tax scrutiny, individuals are required to submit PAN card for any deposit of above Rs 50,000 in cash. This will help the income tax department to track individuals with high denominations currency. The ultimate objective is to make India a cashless society. All the monetary transaction has to be through the banking methods and individuals have to be accountable for each penny they possess. It is a giant step towards the dream of making a digital India. If these are the merits, there are demerits of this policy as well.

The announcement of the demonization of the currency has caused huge inconvenience to the people. They are running to the banks to exchange, deposit or withdraw notes. The sudden announcement has made the situation become chaotic. Tempers are running high among the masses as there is a delay in the circulation of new currency (Chaudhari). It has deeply affected business. Due to the cash crunch, the entire economy has been made to come to a standstill. Many poor daily wage workers are left with no jobs and their daily income has stopped because employers are unable to pay their daily wage.

The government is finding it hard to implement this policy. It has to bear the cost of printing of the new currency notes. It is also finding it difficult to put new currency into circulation. The 2000 rupees' note is a burden on the people as no one likes to do transaction with such high value currency. Some critics think it will only help people to use black money more easily in future (Goyal).

Further, many people have clandestinely discarded the demonetized currency notes and this is a loss to the country's economy. Demonetization is a generations' memorable experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. Demonetization affects the economy through the liquidity side. Its effect will be a telling one because nearly 86 per cent of currency value in circulation was withdrawn without replacing bulk of it (Rajkumar). As a result of the withdrawal of Rs 500 and Rs 1000 notes, there occurred huge gap in the currency composition as after Rs 100; Rs 2000 is the only denomination. Absence of intermediate denominations like Rs 500 and Rs 1000 will reduce the utility of Rs 2000. Effectively, this will make Rs 2000 less useful as a transaction currency though it can be a store value denomination.

## CONCLUSION

Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc. The announcement of the demonization of the currency has caused huge inconvenience to the people. They are running to the banks to exchange, deposit or withdraw notes. The sudden announcement has made the situation become chaotic. Its effect will be a telling one because nearly 86 per cent of currency value in circulation was withdrawn without replacing bulk of it. As a result of the withdrawal of Rs 500 and Rs 1000 notes, there occurred huge gap in the currency composition as after Rs 100; Rs 2000 is the only denomination. The government is finding it hard to implement this policy. It has to bear the cost of printing of the new currency notes. It is also finding it difficult to put new currency into circulation. The 2000 rupees note is a burden on the people as no one likes to do transaction with such high value currency. A very comprehensive critique of the ill-fated demonetization. It does not stop cross border terrorism... it is verily continued. It does not stop the fake currency, the very new Rs. 2000 notes are merrily faked even during this demonetization period.

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