
Demonetization in India: A Critical Appraisal

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Abstract: Demonetization of currency means discontinuity of the particular currency from circulation and replacing it with a new currency. It refers to the decision of RBI/Government to recall the status of a currency note to be used as a legal tender and at the stroke of the hour on midnight of 9th November 2016, India lost 86% of its monetary base. In this single move, the Government has attempted to tackle all the three issues affecting the economy i.e. a parallel economy, counterfeit currency in circulation and terror financing. Demonetization is an established practice in monetary policy to tackle black money. In the past also, demonetization has taken place twice but not achieved the envisaged success. This time though the government has taken few steps in this direction much before its announcement and has stated multiple objectives behind the demonetization policy. The demonetization policy is being seen as a financial reform in the country but this decision is fraught with its own merits and demerits. So the rationale of paper is to critically analyse the policy with all pros and cons.

Keywords: Demonetization, RBI, Monetary Policy, Black Money

Meaning:

Demonetization of currency means discontinuity of the particular currency from circulation and replacing it with a new currency. It refers to the decision of RBI/Government to recall the status of a currency note to be used as a legal tender. Usually all the currencies issued by RBI can be used as a legal tender as the value they carry is promised by RBI and once the value has been demonetized or revoked, the currency note cannot be used. Globally the central banks follow a practice wherein older currency notes are recalled and new currency notes with enhanced security features are issued so as to overcome the menace of counterfeit currency. In the current context it is the banning of the 500 and 1000 denomination currency notes as a legal tender.

Background and pre demonetization status:

The Indian government had demonetized bank notes on two prior occasions—once in 1946 and then again in 1978—and in both cases, the goal was to combat tax evasion by "black money" held outside the formal economic system. In 1946, the pre-independence government hoped demonetization would penalize Indian businesses that were concealing the fortunes amassed supplying the Allies in World War 2nd In 1978, the Janata Party coalition government

demonetized banknotes of 1000, 5000 and 10,000 rupees, again in the hopes of curbing counterfeit money and black money.

In 2012, the Central Board of Direct Taxes had recommended against demonetization, saying in a report that "demonetization may not be a solution for tackling black money or economy, which is largely held in the form of benami properties, bullion and jewellery. According to data from income tax probes, black money holders kept only 6% or less of their wealth as cash, suggesting that targeting this cash would not be a successful strategy.

On 28 October 2016 the total banknotes in circulation in India was ₹ 17.77 trillion (US \$ 260 billion). In terms of value, the annual report of Reserve Bank of India (RBI) of 31 March 2016 stated that total bank notes in circulation valued to ₹ 16.42 trillion (US \$ 240 billion) of which nearly 86% (around ₹ 14.18 trillion (US \$ 210 billion)) were ₹ 500 and ₹ 1,000 banknotes. In terms of volume, the report stated that 24.4 % of currencies in circulation but for over 85% in terms of value of the currency in circulation. So, Cash is the king in India as majority of the transactions are done in the form of cash. As per RBI, 87% of the transactions in India are cash transactions.

Denomination	Number of Units in Circulation (in millions)	%age of units out of the total circulation	%age value out of the total value of notes
Rs 100 note	15778	17.5	09.6
Rs 500 note	15707	17.4	47.8
Rs 1000 note	06326	07.0	38.6

In June, the Government of India had devised the Income Declaration Scheme that lasted till 30 September 2016, providing an opportunity to citizens holding black money and undeclared assets to avoid litigation and come clean by declaring their assets, paying the tax on them and a penalty of 45% thereafter.

Rationale:

The government's stated objective behind the demonetization policy are as follows;

- The cash circulation in India is directly connected to corruption hence envisaged to reduce the cash transactions. It is an attempt to make India corruption free.
- To tackle the menace of black money/parallel economy.
- To control escalating price rise.
- To stop funds flow to illegal activity and To prevent the cash being used for terrorist activities or terror funding
- To make people accountable for every rupee they possess and pay income tax return.
- It is an attempt to make a cashless society and create a Digital India.

There is a background to the current decision of demonetization of 500 and 1000 rupee notes. The government has taken few steps in this direction much before its November 8, 2016 announcement. As a first step the government had urged people to create bank accounts under Jan Dhan Yojana. They were asked to deposit all the money in their Jan Dhan accounts and do their future transaction through banking methods only. The second step that the government initiated was a tax declaration of the income and had given October 30, 2016 deadline for this purpose. Through this method, the government was able to mop up a huge amount of undeclared income.

However, there were many who still hoarded the black money, and in order to tackle them; the government announced the demonetization of 500 and 1000 currency notes. Accordingly, at the stroke of the hour on midnight of 9th November 2016, India **lost 86% of its monetary base**. The print, electronic and social media has been praising Prime Minister's masterstroke by which he has reportedly destroyed the base of corruption in India. The demonetization policy is being seen as a financial reform in the country but this decision is fraught with its own merits and demerits.

Merits 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. In this single move, the Government has attempted to tackle all the **three issues affecting the economy i.e. a parallel economy, counterfeit currency in circulation and terror financing**.

- 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 for any valid financial transactions. 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.
- 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.
- 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 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 elections are usually associated with black money generation and circulation, with this scheme the funding of elections through nefarious ways will be hit
- It is expected that with this move the Fiscal Deficit of the government may come down
- 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.

Demerits of Demonetization:

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.

- **Small farmers, sellers, merchants, daily wage labourers and traders are suffering** because of lack of proper planning, intelligence and foresight such as recalibration of ATM machines. **There was need to pile up enough 100 Rupee notes and other smaller denomination notes in the market before taking this step.** It is being said by critics that this step was taken only to bolster the image of the Prime Minister as he has been unable to deliver on GDP growth, inflation and bringing the black money from abroad.
- It is also being said that what is being attempted is replacement of currency and not demonetization itself which was unnecessary. This is a terrible setback for the international standing of the Indian economy. At this time, the economy is struggling with slowdown. There is demand sluggishness in the economy leading to practically no private sector investment and stagnant industrial growth. If we look at the farm sector, this is the harvest time. Farmers generally deal in cash and **India is also largely a cash economy. The cash transactions in this economy are far more than the total number of electronic transactions done on a daily basis.** In the tribal heartland of the country, the poor people through middlemen are getting their currencies exchanged for Rs.300 or Rs.400 because of lack of proper information which is hitting them. 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 decision to issue Rs 2000 denomination currency and withdrawal of Rs 500 and Rs 1000 currency will lead to huge challenge as most of the day to day transactions in India are centered around Rs 500 note (more than 47% of the value of notes in circulation is in Rs 500 note form). Thus, 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.

- Further, many people have clandestinely discarded the demonetized currency notes and this is a loss to the country's economy. The growth in eight core sectors such as cement, steel and refinery products, which constitute 38% of the Index of Industrial Production (IIP), was only to 4.9 percent in November as compared with 6.6 percent in October.

Conclusion:

Economists are busy in listing out many more merits and demerit of this policy. The government is saying that there are only advantages of demonetization policy and this will be seen in the long term. Former Prime Minister Manmohan Singh who is a noted economist, former RBI governor and former Finance Minister of the country, dubs the demonetization move as an 'organized loot and legalized plunder'. However, if we compare the merits verses demerits, it will be safe to conclude that the former outweighs the latter. Even though there is suffering and agony among the masses right at the moment but the forecast is that its benefits will be seen in the long run.

The government is taking all the necessary steps and actions to meet the currency demand and soon the trial and tribulations of the people will be over with the smooth flow of the new currency. We can see the silver lining as the number of card issued are on the rise, increasing trade on e-commerce which is equally complemented by increasing number of digital wallets-Paytm, Pockets etc. So far, it can be said that this is a historical step and should be supported by all. One should look at the bigger picture which will definitely fetch results in the long term. This is what the people have been asking for a long time which has finally happened.

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