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CONSEQUENCES OF DEMONETIZATION ON INDIAN ECONOMY

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Abstract:

In an effort to promote a digital economy and reduce the prevalence of black money, corruption, and counterfeit currency, the Indian government implemented a major economic policy initiative in November 2016 known as demonetization. This article delves into the many ways in which demonetization has affected different parts of the Indian economy. Demonetization has had mixed effects, according to the research. In short term, it caused problems like a liquidity shortage and a slowdown in economic activity. But in the long run, it helped with things like making the economy more formal, broadening the tax base, and digitizing more transactions. While deposits surged, new problems including rising non-performing assets (NPAs) surfaced in the banking system. Digital payment platforms and organized sectors witnessed growth, while sectors dependent on cash transactions had temporary setbacks. This had an impact on employment patterns. Although it took some time, the informal sector—which deals mostly in cash—was able to adjust to the new circumstances. Many people have different opinions on how effective demonetization was in fighting corruption and black money. Demonetization, despite its critics, sparked efforts to move away from a cash-based economy, which in turn increased financial inclusion and transparency. The Indian economy underwent substantial changes due to demonetization, albeit there were temporary difficulties. In the long run, it will lead to more people paying their taxes, the economy will become more structured, and more people will use digital transactions. Yet, in the age after demonetization, inclusive growth can only be achieved with cautious policy adjustment and support measures.

keywords: *Demonetization, Indian Economy*

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Introduction

Demonetization, a significant economic policy that was executed by the Government of India on November 8, 2016, has provoked strong debates and discussions regarding the impact that it will have on the economy of India. With the intention of reducing instances of black money, corruption, and counterfeit currency, the decision was made to abruptly remove the □ 500 and □1000 currency notes from circulation. These notes constitute a large amount of the cash that was in circulation throughout the country. Nonetheless, the action had far-reaching ramifications that touched a variety of industries and parts of the economy, which resulted in both acclaim and criticism being directed toward it.

Through the course of this paper, we will investigate the myriad ways in which demonetization has influenced the Indian economy. In addition, the article will address the long-term ramifications of the legislation, which will include its impact on digital payments, tax compliance, and the overall economic resiliency of the country. The demonetization of India's currency was a bold and unprecedented step in the country's economic history. Proponents of the policy saw it as a necessary tool to battle corruption and modernize the economy. Critics, on the other hand, contend that the interruptions and harmful impacts on particular industries in the near term outweighed the benefits that were supposedly being provided. In order to provide a full understanding of the relevance of demonetization in defining the trajectory of the Indian economy, the purpose of this essay is to examine several elements of its influence.

Objectives

Objective of this paper is to research the effects of demonetization in different nations over the last several years and to examine the immediate impacts of demonetization as well as perceived impacts on the Indian economy. To achieve the objectives, secondary data has been used. Material and data from the internet sources were used.

What is Demonetization

The process of reducing the value of a piece of currency to zero is referred to as demonetization. To put it another way, reducing the value of a specific denomination of currency to zero, thereby transforming it into a piece of paper that has no worth whatsoever that is higher than that of an ordinary piece of paper. When we talk about demonetization, we are referring to the fact that the Reserve Bank of India has removed the old Rs 500 and Rs 1000 notes from circulation as a valid form of payment. In accordance with Investopedia, the process of demonetization refers to the removal of a currency unit from its position as a form of legal tender.

What was the reason

The key reasons given by the Prime Minister were:

1. To tackle black money in the economy.
2. To lower the cash circulation in the country which "is directly related to corruption in our country, " according to PM Modi.
3. To eliminate fake currency and dodgy funds which have been used by terror groups to fund terrorism in India.

Procedure for exchange of demonetized currency

In order to facilitate the exchange of the demonetized banknotes with the new Mahatma Gandhi New Series banknotes of Rs. 500 and Rs. 2000, as well as the Rs. 100 banknotes from the previous Mahatma Gandhi Series, the Reserve Bank of India established a comprehensive procedure. The essence of the matter is as follows:

- The deadline for citizens to redeem their old banknotes at any RBI office or bank branch and have the amount credited to their accounts was 30 December 2016.
- From November 9th through the 24th, 2016, withdrawal limit was Rs. 10,000 per day and 20,000 rupees per week from bank accounts.
- Beginning on November 10, 2016, customers were allowed to exchange old banknotes worth up to Rs. 4000 for new Rs. 500, Rs. 2000, and Rs. 100 notes at any branch of the bank by completing a request form and providing a valid form of identification.
- Only 50- and 100-rupee notes were dispensed by all ATMs.
- All customers of participating banks were allowed to withdraw cash up to Rs.2000 per card from their ATMs at no cost, later on the limit was increased to Rs.4000 per card.
- Exceptions were given to petrol pumps, CNG stations, government hospitals, train and airline booking stations, state-government recognized dairies, ration shops, and

crematoriums to accept the 500- and 1000-rupee notes until 14 November. International airports were also instructed to facilitate an exchange of notes amounting to a total value of Rs.5, 000 (US$74) for foreign tourists and out-bound passengers.

Advantages of Demonetization

1. One big plus is that demonetization made it easier for the government to trace illicit funds. Tax avoiders stashed away large quantities of illicit funds. The authorities found a large sum of unaccounted cash thanks to demonetization. People have deposited over 3 lakh crores of rupees worth of illegal money into bank accounts, according to estimations given by the Reserve Bank of India. The government has been able to curb the spread of the parallel economy thanks to this.
2. A significant factor contributing to the decision to demonetize was the fact that a substantial portion of illicit funds was being utilized to finance nefarious activities like as terrorism, gambling, and the artificial inflation of key asset classes such as real estate, gold, and others. An effective countermeasure to such operations is demonetization. Since it will take years for people to generate the same amount of black money again, and for the time being, all such activities will decrease, this helps break the cycle of people engaging in illegal activities to earn black money, which they then use to engage in even more illegal activities.
3. Another perk is that when people open bank accounts and disclose their income, the government gets a substantial amount of tax money. This money can then be used to improve society by building hospitals, schools, roads, and other facilities for the poor and needy.

Disadvantages of Demonetization

1. Demonetization’s early state of disarray and panic among the general public is its greatest drawback. The scarcity of new notes had an impact on people's day-to-day budgets as everyone scrambled to get rid of demonetized notes. There were huge lines at ATMs and banks, and small businesses lost money for a little while. People in rural

India had it far worse because there just weren't enough banks or ATMs to handle their currency conversion and withdrawal needs.

2. Another drawback is that the government has to pay to demonetize the old currency and produce new currency. If the costs outweigh the benefits, then demonetization is pointless.
3. Another issue is that demonetization only applied to black money, not all of it. Many people who had invested their black money in other assets, such as real estate, gold, etc., were unaffected.

Demonetization Experiences of some Countries

Russia

In an effort to combat the underground economy, the nation, which was in its final stages of existence at the time, removed large-ruble bills from circulation in January 1991. This action was taken by Mikhail Gorbachev. The reform was not successful in bringing inflation under control; rather, it served primarily to hasten the decline in public confidence in the political system. As political infighting and economic collapse combined, Gorbachev was confronted with a coup attempt in August of that year, which ultimately resulted in the destruction of his authority and led to the dissolution of the Soviet Union the following year. After gaining valuable experience, Russia's redenomination of the ruble in 1998, which involved the removal of three zeroes, was carried out in a more seamless manner.

North Korea:

In an effort to tighten control of the economy and close black markets, the regime of Kim Jong-Il, who was the dictator at the time, implemented a reform in the year 2010 that removed two zeros from the face value of the previous currency. Reports from the time period indicate that the measure, when combined with a poor harvest, resulted in severe food shortages throughout the majority of the country. A rise in the price of rice stoked unrest, which resulted in Kim issuing an unusual apology and, according to reports, the execution of the head of finance for the ruling party.

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Zaire:

At the beginning of the 1990s, when his administration was implementing a series of banknote reforms, Dictator Mobutu Sese Seko was confronted with an increasing number of economic disruptions. In 1993, a plan was implemented to remove obsolete currency from circulation, which resulted in a significant increase in inflation and a significant decline in the exchange rate in comparison to the dollar. Mobutu was removed from power in 1997, following a civil war.

Myanmar:

According to reports from the time, the military junta of the country invalidated as much as 80 percent of the value of the money that was in circulation in 1987. This step, like other initiatives of its kind, was taken with the intention of reducing the amount of money that was being sold on the black market. There were student demonstrations for the first time in years as a consequence. Increasing economic unease was a contributing factor in the escalation of mass demonstrations across the country in the following year, which ultimately resulted in a government crackdown that proved fatal for thousands of people.

Ghana:

The country in 1982 got rid of its 50 cedi note to crack down on tax evasion, address corruption and mop up excess liquidity. The move eroded confidence in the banking system as people turned to foreign currency or physical assets instead. The black market for currency flourished. As rural dwellers had to walk miles to the nearest banks to exchange their money, and after the deadline passed, there were accounts of bundles of notes abandoned as worthless.

Nigeria:

In 1984, the military administration led by Muhammadu Buhari initiated an anti-corruption drive that comprised issuing new banknotes with a different color, necessitating the replacement of old ones within a certain period. The move was one of a series that failed to address a debt-burdened and inflation-ridden economy. Buhari, who is currently in power again, was eventually deposed in a coup the following year.

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Impact of Demonetization

The demonetization that began on November 9, spending by consumers came to a standstill. People could not buy anything except necessities from the energy, healthcare, and consumer staples categories. House prices in metropolitan and Tier 1 cities fell by as much as 30% as real estate activity, which involves large amounts of cash and illegal transactions, slowed down dramatically. Approximately 47.3% of the total CPI is attributable to fluctuations in food item inflation as assessed by the Consumer Food Price Index. The supply and demand for food goods decreased as a result of 86.4% of the value of the currency notes in circulation leaving the banking system and the delayed re-monetization process. Interest rate-sensitive businesses and sectors, such as financials and automobiles as well as sectors like technology got affected by a change in the repo rate.

Now let us consider the situation and try to analyze the situation in terms of the economy and financial position of India.

1.Instant Impacts

a) On the Indian and Asian Stock Markets:

The Indian markets experienced a decline that was slightly greater than that of other emerging markets in Asia at that time. There has been a decline of 3.8% in the S&P BSE Sensex, which was greater than the declines seen in almost all other Asian emerging markets. Through the world, markets were on edge because of the probability that Donald Trump may win the election. While it is possible that the additional decline in the Indian markets in comparison to other markets could have been because of a number of causes, including high valuations, it is highly probable that the demonetization effect was the primary cause of the decline. If we go a bit deeper, we will see that this was very evident. The mid-cap and small-cap indices of the BSE had both experienced a decline of more than 6%. Furthermore, the unorganized sector, which is not represented in the markets, was the one which experienced the most significant impact as a result of the move made by the government. Sectoral indices such as the BSE Realty index, which experienced a decline of up to fifteen percent, accurately reflected the then state of affairs. A number of equities in real estate, including DLF Ltd. experienced a decline of about twenty

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percent as this sector is well-known for its engagement in cash transactions of significant volume. In a similar vein, the stocks of jewelry firms like Titan Industries Ltd. experienced a decline of almost 11% as well. This could be due to the fact that a significant number of gold purchases are made using cash. Furthermore, the stocks of medium- and small-sized financing companies that accept payments in cash experienced a decline of between 8 and 10 percent. There had been a decline of almost three percent in the stocks of information technology companies, which was more or less in line with the general market.

b) On the exchange rate of Indian currency is a vis other currency:

The rupee had declined in value relative to the currencies of 96 nations or economies after the demonetization of Indian currency on November 8, 2016. The rupee had strengthened relative to 60 out of 161 countries' currencies and remained at the same rate as five of them. The rupee strengthened against 125 other currencies if we compare statistics from the six months prior to demonetization, which ran from May 8, 2016, to November 8, 2016. However, the rupee strengthened more than 47 other currencies after a 26-day ban on the 500- and 1000-rupee notes. The value of the Rupee decreased from 66.40 to 68.17 INR per US dollar ($), a decrease of 2.66%. In relation to a few other well-known currencies, such as the British pound, the Canadian dollar, and the Hong Kong dollar, the rupee had dropped. However, it also gained strength over the Australian Dollar, Singapore Dollar, Swiss Franc, Euro, and Japanese Yen. The value of the Indian rupee (INR) decreased relative to the currencies of Bangladeshi Taka, Nepalese Rupee, Pakistani Rupee, and Sri Lankan Rupee. The data is summarized as under:

Period	Stronger	Weaker	Same
After 50 days of demonetization (08-11-16 to 28-12-16)	60	96	5
6 months before demonetization (08-05-16 to 08-11-16)	125	32	4
In Modi government (26-05-14 and 28-12-16)	94	65	2
In Modi govt before demonetization (26-05-14 and 08-11-16	93	66	

2.Perceived long-term impacts:

i. Having eliminated 86% of the entire money supply from the system, the government intended to purge the system of black money and counterfeit currency in order to maintain strict control over corruption.

ii. As per the Ambit Capital research, the formal organized sector is expected to gain market share while the informal economy's position in India could decrease

iii. Shifting the tendency of people from putting their cash savings in tangible assets like gold and real estate, the ongoing campaign against black money will increase the amount of savings that enter the financial system.

iv. The cost of loan capital in India should decrease as a result of the significant rise in financial savings. Furthermore, loan rates are probably going to follow suit as savings rates rise.

v. Push towards a cashless economy through the demonetization operation, encouraging individuals to use digital payments for their purchases. The United Payments Interface (UPI) app is what the government wants consumers to use in order to conduct cashless transactions with their cellphones.

vi. Employment losses are likely in near future in construction and related sectors such as jewelry, textiles, and real estate due to perceived slowdown in these sectors due to demonetization. Job prospects may be dire if India's unorganized economy were to virtually disappear.

Conclusion

A turning point in India's economic history, demonetization in November 2016 had far-reaching effects across several industries. It is critical to consider the results of this daring policy shift as time passes and the economy readjusts. The demonetization process sped up the process of economic formalization and increased economic transparency. It formalized hitherto informal financial transactions by imposing fines on people and companies that did not deposit their undeclared cash holdings into bank accounts. Possible long-term advantages of this formalization include increasing financial inclusion, increasing transparency, and expanding the tax base. The removal of currency from circulation hastened the transition to digital payment systems and the automation of monetary transactions. There has been a marked shift in customer behavior, as seen by the meteoric rise of digital payment systems like UPI and mobile wallets. Efficiency gains, decreased transaction costs, and expanded access to financial services, especially for underserved communities, are all possible outcomes of the current digitization trend. Significant short-term issues were also provided by demonetization. There were halts to economic activity and difficulties for disadvantaged groups as a result of the sudden shortage of cash, which was most severe in rural regions and informal industries that relied on such transactions. Although the economy did recover in the end, the difficult transition period highlights the need for well-executed policies and targeted assistance programs. It is still debatable if demonetization was successful in accomplishing its goals. The impact on reducing corruption and black money may have been little, although it did reveal unreported riches and disrupt illicit financial activity to a considerable degree. Additionally, the advantages must be considered in light of the expenses, such as the printing of new currency notes and the implementation of logistical procedures. The effects of demonetization on the Indian economy are still felt today, having changed the country's financial system and triggering fundamental shifts. Although the whole impact has not yet been seen, it highlights the need for strong governmental actions to tackle long-standing problems and propel economic change. Policymakers should use the lessons from demonetization to create more inclusive and focused plans moving ahead. These strategies should aim to balance short-term disruptions with long-term advantages, so that everyone can benefit from sustained and fair growth.

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