

# INDIAN DEMONETIZATION: A CRITICAL ANALYSIS

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## ABSTRACT

*Demonetization simply mean removing currency from general usage or circulation. It is the process of withdrawal of currency from circulation. The motive for this kind change was simple: India's Finance Ministry claimed that 500 and 1,000 rupee notes are being used to fuel the black market, finance terrorism, drive counterfeiting, fund illegal drug sales, and pay bribes. The objective of this study is critically analysis impact of demonetization in India. This Article is a modest attempt to collect data from northern, southern and central India to analyze the impact of demonetization through imperial evidence all over India. The argument suggested in favor of demonetization is that the cash that would be extinguished would be "black money" and hence, should be correctly extinguished to set right the obstinate incentive structure in the economy. Therefore the study conclude the short run and medium-term impacts shock Indian economy.*

**Keywords :** Demonetization, Indian Economy.

## INTRODUCTION

Demonetization means old currency must be recovered and replaced with a new currency unit. It involves either introducing new type of notes or coins of the same value or completely replacing the old denominations with the new denomination which is usually carried out as an ambush on the black money. In demonetization has occurred thrice in India. The first demonetization take place on 12th January 1946 (Saturday), second done on 16th January 1978 (Monday) and third one on 8th November 2016 (Tuesday). India Government announced demonetization of the high valued currency notes with an objective to unearth the black money, curb the corruption, and counterfeit currency as well as terror funding. This decision is considered as one biggest cleanliness drive against the black money whose benefits will be reaped in the long run. However, the sudden impact of demonetization causing major cash crunch in the economy affecting day to day requirements of

the common man and businesses mostly it effect on people work in agriculture sector. It would not be an overemphasis to say that the demonetization announced by the Prime Minister of India on November 8th might have been one of the biggest self-incited macroeconomic shocks in the absence of a short term crisis. A lot has been written and speculated about demonetization since its introduction.

Government of India has implemented a big change in the economic environment of the country by demonetizing the high value currency notes – of Rs 500 and Rs 1000. These stopped to be legal tender from the midnight of 8th of November 2016. People have been given time upto December 30, 2016 to exchange their currency notes held by them. The proposal by the government involved for eradication of these existing notes from circulation and a gradual replacement with a new kind of notes. In the short term, it was proposed that the cash in circulation would be considerably squeezed since

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there are restrictions placed on the amount that individuals can withdraw. In the months to come, this squeeze may be relaxed somewhat. The motives offered for demonetization was: one, to control counterfeit notes that could be contributing to terrorism and second, to undermine or eliminate the “black economy”.

There was also possibly two ways in which the pre-demonetization money supply will stand changed in the new management: first, there would be agents who are holding cash which they cannot able to explain and hence they cannot deposit their money in banks. This portion of the money will be extinguished hence it would not be replaced in any manner. The government might choose to replace only those part of the currency which was in circulation as cash. In the other words, the break would be available only as electronic money. This mechanism used to force a transition to cashless medium of exchange. The empirical extent of these two type of components will be unraveled only over the next six months. The purpose of this study is to match and analyze the impact of demonetizations and their significance in the economic development of India. This paper also covers various other nations who tried demonetization. The present study is a modest attempt to collect data from northern, southern and central India for critically examine impact of demonetization.

### RESEARCH METHODOLOGY

For the study both primary as well as secondary data was used. Primary data was collected from 60 micro small and medium enterprises (MSMEs) from northern, southern and central India. The business firms surveyed are broadly from sectors viz. (1) Agriculture, (2) Automobiles, (3) Construction, (4) labor intensive sectors (5) Retail, (6) Tourism and Hospitality. For the secondary sources of data collected from various reports and publications of Government of India, RBI, CSO, IMF relating to foreign direct investment, economic journals, books, newspaper, magazines, internet and other previous research etc.

### SURVEY ON IMPACT OF DEMONETIZATION ON ECONOMY

Since commerce are the backbone of the economy, the researcher conduct survey to analyze the impact of demonetization on the business firms and to assess the impact on various sectors of the economy. It was observed that small firms are impacted seriously across all the sectors industries as these are highly driven by cash transactions. The survey discovered few challenges faced by the factories which include fall in attending rates in the factories and rising huge production cuts. The sectors which was highly impacted by demonetization includes agriculture sector, followed by retail sector, construction, labour intensive sectors, automobiles sector and Tourism & hospitality.

#### AGRICULTURE

Majority of the sample respondents from agriculture sector said that demonetization leads to huge loss directly and indirectly. Agriculture is impacted majorly since transport, sale, marketing and distribution of ready produce to wholesale centres or mandis, is dominantly cash-dependent. Further, it has been reported by the respondents that breaks in the supply chains, disruptions, increased wastage of perishables have severely impacted the sector. The marginal and small farmers who sell their products on day to day basis to the mandis and directly to the consumers have also been impacted.

#### RETAIL

The influence of demonetization has majorly seen on the retail sector as per report from respondents said that cash crunch is leading to a low consumer demand of their products and ultimately causing fall in their sales since Indian retail segment generates a lot of cash transactions. The impact is moderately higher on the small traders and the unorganized retailing segment.

#### CONSTRUCTION

Construction sector is severely impacted as

majority of the respondents responded that demonetization has led to lower gatherings in the form of customer early payment as projects in initial phases of construction are mostly dependent on these advances for construction progress and debt servicing. Demonetization initiative has majorly impacted the fate of the uneducated workforce in the construction sector as the sector absorbs maximum of the unskilled workforce after the agriculture sector. And almost all workers are working majorly on the daily wages in many of the construction activities in the country.

### **TOURISM AND HOSPITALITY AND WELLNESS**

According to the survey, tourism sector was also affected since public consume a major part of their undeclared income on luxuries. Hence, with the inability of tourists to spend due to lack of available currency, the tourism industry is suffering the most. On the other hand, the leisure sector hotels and restaurants segment also facing lot of problems on account of the discretionary nature of spending in this sector and considerably larger base of cash transactions that occur in its when compared to mainstream business hotels. Further, the restaurants also face a slowdown in growth on account of reduced availability of cash and the generally high usage of cash spending in restaurants.

### **LABOR INTENSIVE SECTORS**

Labor sector needs huge amount of money to be paid in cash for daily wage, majority of the respondents reported that they have been highly impacted by demonetization drive. Restraint of withdrawals from banks impacting the weekly payment to contractual workers in mining, textile and leather industries. Furthermore, constraints on cash withdrawals also affecting the factory owners to fulfill daily requirements. This has negatively influencing the procurement and production in the labor sectors. However, the

impact was diminish once the cash flow is back to its original form.

### **AUTOMOBILES**

Automobiles sector was also influenced through demonetization as reported by respondents. The major decline has seen in the demand of two wheelers than luxury cars/four wheelers since cash used primary mode of transaction in the purchase of two wheeler vehicles. Another kind of segment of automobile industry which facing effects of demonetization is the used car industry wherein many car dealers have reported sudden decrease in sales. It is an unorganized industry and therefore, the modes of payments are not exactly regulated.

### **INDIAN GDP AND DEMONETIZATION**

India is world's third largest economy on the basis of Purchasing Power Parity and seventh largest economy in the world on the basis of Normal GDP. India is one of the world's fastest growing economy which was estimated to grow at 7.6% in the fiscal year 2016-17. But after demonetization RBI also clipped the GDP growth rate forecast for the current fiscal to 6.8% from a previous forecast of 7.4%. International Monetary Fund (IMF) cut down India's GDP growth forecast to 6.6 on note ban woes against its earlier estimate of 7.6%. There is no doubt that in short run the effect of demonetization will be somehow negative the surprise move is expected to grind the consumption activity in the economy to a virtual standstill. Service sector which dominates economic activity and involves a sizable kind of chunk of cash transactions will likely be hit the firmest. India's GDP growth sharply recover to 6.3% in fiscal quarter July-September from a three year low in the first quarter, as business jumped in to economic activity ahead of a condensed festive season and accelerated production to build inventory after implementation of GST.



Source: - CSO

## DEMONETIZATION: INTERNATIONAL EXPERIENCES

### 1. Country: Zimbabwe

**Zimbabwe demonetization there currency to combat hyper Inflation :** Hyperinflation was rocking the Zimbabwean economy for over a decade made its people lose faith in their currency. Since 2009 onwards a multi-currency structure was ushered in, whereby currencies of South Africa, Botswana and US Dollar were allowed to be used as legal tender for transactions in Zimbabwe. Six years after implementation of the multi-currency system the Zimbabwe Government decided to completely eradicate the Zimbabwean currency from circulation. On June 2015 the central bank of Zimbabwe announced demonetization and requested its citizens to change Zimbabwean currency for US Dollar before 30th September of 2015.

### 2. Country: Philippines

**Philippines demonetized there currency to Protect against counterfeiters :** Philippines Government decided to demonetize their old currency notes which they introduced in 1985 with new currency notes which came into existence in 2010. The reason for demonetization was to protect the reliability of their currency and safeguard it against counterfeiters. The new currency notes were newly designed and better security features were used like wider security threads. Citizens can use the old currency notes for their daily base

transactions from January 1st 2015 to 31st December 2015, but during the mean time they were also expected to get their currency notes changed from banks. From January 1st 2016 to December 31st 2016 the old bank notes were cease to have monetary value, hence were not used in the day to day transactions. However, citizens get their notes exchanged from banks before 31st December 2016. And, finally from 1st January 2017 all old bank notes were demonetized.

### 3. Country: Libya

**Reason for demonetization was Inclusion into the banking system :** Reserve Bank of Libya demonetized old notes as an effort to ensure liquidity into its banking sector. The faith in the Libyan Banking system crashed after the removal of their long standing leader Mr. Gaddafi in a civil war. This results people storing money in their houses instead of banks, it was estimated that about 96% of the cash was outside the banking system at one point of time. And, it was widely approved that the only way for banking sector had to be restored for restoring the Libyan economy. Hence, Reserve Bank of Libya demonetized their old currencies and requested to convert their old currencies for new notes within a time span of three months.

### 4. European Union

**Demonetization for Introduction of a single currency :** Euro currency led to the largest demonetization drive in the known human history. About 12 countries had changed their national currencies and adopted the Euro. Nearly about 300 million people were directly affected by the demonetization drive. But, it has to be agreed that the demonetization conducted in Europe was the most well planned and implemented demonetization in the world. First, from January 1999 to 31st December 2001 the Euro was used only as book money. Secondly, From January 1st 2002, the Euro was introduced for the day to day transactions and the old currencies were demonetized. Finally, the old currencies were taken out of circulation from 28th February 2002.

## 5. Country: Australia

**Reason for demonetization was to Protect against counterfeiters :** After the advent of the new bank note currency technology, which was created by the Reserve Bank of Australia (RBA) in association with Commonwealth Scientific and Industrial Research Organization (CSIRO), RBA issued its first polymer based 10\$ bill on January 1988. From 1992 to 1996, the RBA gradually introduced polymer based currencies in all denominations and slowly demonetized its old paper currency.

## 6. Country: Singapore

**Reason for demonetization was to create a new currency :** Singapore used banana notes while it was occupied by Japan. After the fall of Japan in the Second World War Japanese Government refused to honor its promise to the banana notes. The British who start again power after the surrender of Japan demonetized their old notes and introduced a new type of currency to ensure the integrity of the monetary system of Singapore.

Demonetization is the procedure of removing the monetary value of legal tender currency. The only purpose for which demonetization is used for in many countries is to weed out old currencies from their economic system. And beyond that it is not measured as a serious monetary policy tool. However, many countries when pushed to the brink of economic collapse e.g. Libya, Zimbabwe used demonetization to achieve various economic outcomes like bringing money back into their banking system and reducing hyperinflation level. However, the efficiency of such a move is still debated and the evidence from is not conclusive. On the other hand India twice tried and failed to counter the menace of black economy after demonetizing high currency notes. In both those occasions in 1946 & 1978, RBI was not in favor of the demonetization. And, as the events of the 2016 demonetization drive unfold, it becomes clear that the Reserve Bank of India was brought into the loop only in the final moment just before publicizing the demonetization decision to the

people. The question has been raised now regarding under whose advice was this demonetization was initiated has also been unanswered. Back in 2014 then RBI Governor had the following to say about currency demonetization.

“Rajan: I am not pretty sure if what you meant that demonetize the old notes and introduction new notes instead. Past demonetization has been thought off as a way of getting black money out of circulation. Since people then have to come and say “how do I have this ten crores in cash sitting in my safe” and they have to clarify where they got the money from. It is often cited as an answer. Unfortunately, my sense is the clever find ways around it. They find ways to divide up their hoard in to many minor pieces.

You do find that people, who haven't believed of a way to convert black to white, throw it into the Hundi in some temples. I think there are ways around demonetization. It is not that easy to flush out the black money. A reasonable amount may be in the form of gold, therefore even unbreakable to catch. I would focus more on the inducements to generate and retain black money. A lot of the incentives are on taxes”

## CONCLUSION

The impact of demonetization was stroked more in the social sector and the worst affected was also on the economy of poor and the common people. Demonetization also leads to slowdown in the GDP growth rate of the country. The economic literature is very clear about the ways to attack black money and demonetization of currency is not prescribed as a policy tool anywhere. Demonetization of currency was an avoidable option in India. The experts have been very clear about how it was not necessary to demonetize the currency to attack black economy.

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