

# DEMONETIZATION CONUNDRUM: A HARBINGER OF GROWTH OR THE OMINOUS SIGN OF LOOMING SLOWDOWN

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## ABSTRACT

*After 8/11/2016, a profound effect of demonization is observed in the large section of Indian society. The effects of demonetization have been widespread, sweeping over the economic, social and political arena. It caused mixed reactions in the population, sheer excitement in the upper class, youth and cause of concern and anxiety in the common worker, and sense of fear in the black money hoarders. In the present article, authors attempted to critically analyses the social, economic and political effects of the scheme by considering various issues and challenges involved in the demonetization process. For this purpose, advantages and disadvantages of the program on several areas were discussed based on short-term and long-term effects.*

## 1. INRODUCTION

India has witnessed, recently, the biggest policy shift in the name of demonetization, in which currency notes of 500, 100 rupees were withdrawn from the economy, and currency notes of 2000 were introduced. Technically, the word 'demonetization' refers to the withdrawing higher currency notes from the system. However, in the Indian context, higher currency notes were also introduced simultaneously. Although the use of demonetization could be termed as misnomer by several researchers, in this study, it is referred as demonetization only due to its frequent and abundant use by several ministries of government of India. The demonetization was hailed as a revolutionary to cleanse the economic system of India by none other than the Prime minister himself. In parallel, Reserve Bank of India

projected the objectives of the scheme, as per the notification in the press release 2016-2017/1142 on 08/11/2016, such as, to curb the counterfeit currency and terror funding, and nullify the black money hoarded in cash.

The theatrical announcement of the scheme caused the mixed reactions in the population, sheer excitement in the upper class, youth and cause of concern and anxiety in the common worker, and sense of fear in the black money hoarders. All form of media (print, electronic and social media) remained a buzz for month's long duration highlighting several aspects of the scheme. The Indian has witnessed huge ideology based debate on economic policies like never before, in which the interests of a person hailing from slums to the person living in exquisite colonies were involved.

The demonetization has not been the novel concept altogether. Several countries have tried this in the history, such as, Ghana in 1982, Nigeria in 1984, Myanmar in 1987, and North Korea in 2010. In the history, the demonetization was exercised either on the small fraction of the currency or in the phased manner. The demonetization of 86% of the entire circulated currency in sudden move, as done in India, was certainly unprecedented.

The effects of demonetization have been wide spread, sweeping over the economic, social and political arena. The impact has been so intense that it has just washed the winter session of the parliament. For holistic evaluation of any policy needs to consider the bandwidth of issues and challenges involved in the same. In the present commentary, authors attempted to critically analyses the scheme by encompassing the various aspects.

By being an unprecedented move, the opinions of researchers and policy makers were deeply divided and found to be diametrically opposite. Further, any predefined framework is not available which can provide the deeper insight into the effects of the program on social, economic and political condition of the country. For this purpose, in this study, advantages and disadvantages of the program on several areas were discussed based on short-term and long-term effects.

## II ADVANTAGES OF THE DEMONETIZATION

### 2.1 Short-Term Advantages

- **The removal of untaxed and unaccounted money from the economy:** With the help of demonetization, all the citizens are bound to deposit the currency within the bank, which led to the circulation of money to the bank whether it is taxed or untaxed.
- **The efficiency of banking system:** The efficiency of the bank depends on the liquidity of currency available to bank for credit. The demonetization facilitates the bank to recollect money
- **Stoppage of counterfeit currency and terror financing:** Several intelligence reports suggest the infusion of foreign state sponsored counterfeit currency into the Indian economy. Although the amount of fake currency

remained unaccounted, its existence has never been denied. The demonetization certainly blocks the movement of such currency, temporarily.

## 2.2. Long-term advantages

- **Shift to digital economy:** Although the prime objectives of the scheme as stated by the Prime Minister and RBI did not emphasize the digital economy, in due course of time narrative of war against the black money has been replaced by journey towards cashless or less-cash economy. The digital economy has its inherent advantages. The advantages include the greater transparency, accountability within the system. With the advent of the digital economy in addition of the tax reforms, it would be difficult to evade the legitimate taxes. Hence, the arrival of digital phase in economy would pave the way for increased tax revenue for the government at both center and state level.
- **Influence on tax base:** The tax base is one of the fundamental parameters to measure the health of economy of any country. Generally, it is represented in the form of tax to GDP ratio. The Indian economy, possessing tax to GDP ratio in the range of 15-16%, has been starkly lagging behind when compared with Organization for Economic cooperation and Development (OECD) countries due to its well-known parallel economy. Several sectors are beyond the reach of taxmen and the institutions. The demonetization forced all the stakeholders to redirect their money into the banks. This led to the creation of a benchmark in the banks regarding the cash holdings of individuals and organizations. Such benchmarks have potential to bring several sectors in to the mainstream economy from the shadow economy.
- **Influence on bank rates:** By its fundamental trait, this scheme catapulted the Indian banking from cash starved to cash rich zone. Although, in the transient phase of demonetization, cash deposit may appear exorbitantly high, it may not sustain in the long run due to cash withdrawal. However, there have been no doubts among economists that due to this scheme there will increase in residual cash deposit in the long run. The residual increase can be attributed to several factors such as restriction on cash withdrawal, increased consumer trust on banking system, increased use of digital currency etc. The increased liquidity helps catering the credit to the consumer and increased stability in banking system according to the Basal norms. Hence, this can be concluded that by launching the demonetization, the economic health of banking system could be improved and easy credit can be provided to the consumer in long run.
- **Influence on indirect and direct tax rates:** The demonetization process offers the refilling of coffers of central government due to the expungement of unaccounted money from the economy. This gives headway to the central government to utilize it by giving relaxation in either direct or indirect taxes. The amount of relaxation depends on the success of government in unearthing the black money. However, from the historical evidences on such circumstances indicates that generally government have not succeeded in translating it in reducing the taxes.
- **Influence on fiscal deficit:** The primary notion of the scheme was to extinguish the black money, which will not come to the banking system. By this way, the extinguished currency would have accrued to the RBI's treasure, which could be diverted to the government's book. The central government has expected the extraction of 3

to 4 lakh crore rupees from this exercise. However, as the RBI data reveal almost all of the circulated currency has returned to the banks, which has left not maneuvering space to the government. It is undoubtedly accepted by all researchers, on the front of catching the black money by extinguishing the money, this scheme has failed miserably.

- **Redistribution of cash through bank:** The demonetization helped in diverting the cash to the downtrodden and the marginal section of society from the individuals and entities. By crediting the accumulated cash through welfare schemes, financial inclusion can be achieved. Such financial inclusion may translate in to realizing the higher goals of poverty alleviation.

- **Data generation at the large scale:** Many times in government policies, minor goals are more prominently achieved rather than the major objectives. Similar types of observations were made in the case of Aadhaar card, which was launched at the onset of Mumbai attack. In the due course of time Aadhaar card has become the hallmark of increased transparency in India.

In the case of demonetisation, similar hints are coming. It may appear that on the front of tapping demonetization it may have failed. However, due to refilling the banks with old currency, a huge chunk of data have been generated. This data is pertaining to the cash holding of individual or entities, which can be obtained from the banking sector. This data can be collated, studied and critically examined by clubbing them in several categories. These categories could be types of entity, sectors of economy (agriculture, manufacturing and services), types of products or services (export based or import based), income wise distribution etc. As we know that Indian policies suffer from the inefficiency of forecasting and lack of feedback, these quantified data can be utilized in better forecasting of future policies and verifying the performances of existing policies.

- Employment generation

### III DISADVANTAGES OF THE DEMONETIZATION

Although the demonetization was announced with huge pomp and show and domestic population also appreciated it, it impacted almost all facet of life of people. This section attempts to delineate such disadvantages of the demonetization, which are categorized according to their short term and long term effects.

#### 3.1. Short-term disadvantages

After few hours after the launching of demonetization, all the ATMs of the country, irrespective of their rural or urban location, witnessed unprecedented crowd to withdraw the cash before the demonetization coming into the force.

- **Wastage of human-hour and its economic impact:** As the RBI data reveal, the infusion of the currency back into the banking system has been quick. However, the circulation of the currency from bank to the citizen has been very slow. This is attributed to the lack of printed currency at the helm of RBI, which in turn was influenced by several factors such as, number of currency printing press, their peak printing capacity, and printing efficiency. By being the lack of availability of currency, even after the months of the announcement of the scheme, long queues

were evident. The number of people standing in the queue has not been meager, several days it has reach even up to the crores. This suggests the sheer wastage of human hours standing in the queues, which has direct implication on the economic growth of the country.

- **Impact of the saving based ideology of the Indian women:** In India, generally, housewives prefer the cash saving over the banked saving. This can be attributed to prevalent socio-economic condition. This helps them building the family in hard times and it also acts as a life line in unfavorable conditions. Sudden announcement of demonetization caused the exposure of savings of housewives to the family member, which severely curtailed their economic status and diminished age-old time tested theory of saving. At the time when in India, gender discrimination along with the illiteracy is still the reality, such a disruptive scheme is bound to effect the population adversely.

- **Another receiver of the adverse impacts of demonetization is senior citizens.** In India, social security of the old age person is largely family driven instead of state assisted schemes. Traditionally, family member who takes care of the parents receives the large chunk of parents' property. Over the years, this has evolved in to the win-win situation, where children achieve the financial stability as a reward for taking care of elders. However, this demonetization broke this benign cycle of win-win situation, where senior citizen had to declare or expose their properties and savings to the children. Upon exposing the all the savings to the children, there will remain no incentives for children to take care of their parent.

- **Sudden surge in gold consumption and its import:** The demonetization led to the huge penalty and taxes if a person possesses the unaccounted cash beyond the stipulated amount. This led to fear to the money hoarder and they started to buy the gold in huge amount.

- Unaccounted impact on the rural economy
- Employment generation
- The rate of infusion of money from customer to bank
- The rate of infusion of money from bank to customer
- Economic impacts on seasonal economic activities viz. agrarian activities and marriage economy

### 3.2. Long-term disadvantages

- Other second order collateral damages due to disruption in chained economy
- Lack of investment sentiments can lead to decrease in FDI and FII

## IV CONCLUSIONS

In this study, major pros and cons of demonetization program are critically discussed. This scheme improved circulation of currency in the economic system, strengthen the banking system, curbed counterfeit currency, increased the tax base and helped digitization of economic system. However, the wastage of human hours standing in the queues has a direct implication on the economic growth of the country. This scheme lacks proper planning,



forecasting, and execution which leads to a disastrous situation due to which poor section of the society was the most affected. Demonetization also leads to a considerable number of job loss, decrease in FDI, FII and overall GDP of the country. Hence, such type of scheme should be implemented only after proper planning and research on their possible adverse effect.