

Demonetisation: History and its Impact on Indian Economy

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ABSTRACT

The present paper will analyse how the demonetisation affect the economy all over the world and more specifically the Indian economy. This paper will also investigate what are the negative as well as positive effects of the demonetisation in the different sectors of Indian economy such as agriculture, retail, real estate, fishery and jewellery market etc. It is a necessary step whenever, there is high circulation of fake money, huge store of black money and tax evasion prevailing in the country. This paper will explore the history of demonetisation around the world as well as in India.

Introduction

“In popular parlance, the unofficial economy goes by the name of black money and the official of white money. Black and white is also variously substituted by number two and number one, unaccounted and accounted, unreported and reported, unrecorded and recorded and so on...”

Prof J. C. Sandesara

Demonetisation stands for withdrawal of current legal tender money out of circulation or replacing the old currency at the place of new one currency. All started to speak about demonetisation, after the great step taken by the Prime Minister of India, Narendra Modi. Demonetisation making memorable experience and it

becomes one of the most important economic events in the life of the people. The immediate impact of demonetisation is felt by every person in India. It affects the economy in many ways, mainly through the liquidity side (Tojo, 2016). Its effect will be influential because nearly 86% of currency value in circulation was withdrawn without replacing bulk of the old currency. (MoF, 2017). As a result of the withdrawal of ₹ 500 and ₹ 1000 notes, there occurred huge gap in the currency composition as after ₹ 100, ₹ 2000 is the only due to denomination. Absence of intermediate currency notes like ₹ 500 and ₹1000 will reduce the utility of ₹ 2000 notes (Sandeep, 2016). This will make ₹ 2000 less useful as a transaction currency however it can be a

store value of denomination. The plan of demonetisation was an attempt by the government to soak the stock of counterfeit money out of the economy, which has allegedly been used to fund criminal activities, such as terrorism and drug trafficking etc. In addition, the main aim of the scheme was to pull out the large part of the black money into the banks and make the taxable part of the economy.

The plan of demonetisation could be beneficial for the Indian economy in the longer period, as it will raise government revenue due to a broader tax base and less tax evasion. Besides, this operation will promote the banking habits among the people by using bank accounts and digital payments, which makes the Indian economy cash-independent or cash less and also improve its efficiency and productivity. It is generally accepted that the bold step of demonetisation has taken by the government of India is bigger than the 1991 economic reforms and GST. Some selected sectors such as Infrastructure, construction, retail, healthcare and energy etc. of the Indian industry have started to recover from the economic slowdown. Money markets were showing frugal signs of improvement in liquidity. The situation was fairly balanced and indicated towards an economic growth in early 2017 (K. Shankar, 2017).

Demonetisation help the Governments to collect more tax from tax evaders by limiting the cash deposits in the account (Arun Jaitley, 2017).

Objectives of the paper:

- To study the impact of demonetisation in various countries of the world.
- To analyze the impact of demonetisation on the Indian economy.

Methodology: The paper is based on secondary data which has been collected from various published sources such as reports, journals and newspapers and internet sources.

History of Demonetisation in the World:

The term of demonetisation is not a new concept for the world. The act of demonetisation of currency not only limited in India while it has also been occurred in various other countries like Nigeria, Ghana, Zaire, Zimbabwe, North Korea, Soviet Union, Myanmar, Pakistan, USA, Australia, etc. Firstly, demonetisation means to stop the black money in the economy, and secondly to reduce the cash circulation in the economy to curtail the corruption and to eliminate the fake currency and unofficial funds which are used in terror activities and tax

evasion. Some of the countries which demonetised their currencies are:

Nigeria: after the 1984, demonetisation Nigeria's economy collapsed because demonetisation was not planned. Then the President Muhammadu Buhari introduced different colours notes to invalidate their old currency in order to fight black money.

Ghana: In 1984, Ghana move demonetise their 50 cedi currency notes in order to monitor money and wipe out the corruption. This change was not welcomed warmly because it created confusions across the country and finally resulted in a move back to physical assets and foreign currency.

Zaire: In 1990's the Dictator Mobutu ran the demonetisation drive which result instability in country's economic system. In the 1970, the economy won freedom which made it more vulnerable to foreign funding at that time. The country recovered from bad impacts of demonetisation in the year 2000.

Zimbabwe: In the Zimbabwe, due to chronic inflation in 2010, the government started printing Zimbabwean dollar with a face value of 100 trillion notes with worth just 40 cents. This plan was failed, and later the country replaced their currency with the US dollar. Zimbabwe demonetise their 100 trillion dollars note and was

exchanged in a mocking manner dropping trillion dollars to \$0.5.

North Korea: North Korea also faced demonetisation of their currency in 2010, which led to major breakdown in their economy and people left to starve for basics.

Soviet Union: In 1991, under the governance of Mikhail Gorbachev, the Soviet Union demonetised their higher denominations of Ruble bills, the 50s and 100s. The move did not go well and resulted in takeover of Mikhail's leadership within eight months of the plan.

Myanmar: Around 80% of Myanmar's currency was demonetised in 1987 by the military to curb black money, but the move resulted in a lot of protests and the country witnessed several killings.

Pakistan: From December 2016, Pakistan phases out the old currency and bring it with new designs to curb the black money. The Pakistan government gave one and half year time to their people to replace their old currency. After this notified period the noted were declared null and void. Even, after this long period of demonetisation could not produce the positive results to remove the problem of black money and counterfeit money.

USA: In 1969, due to the circulation of the black money at large level, the country was losing its so-called royal image and it was under threat. The US president Richard Nixon declared all bills above \$100 null and void. The outcomes of this demonetisation remained positive. Even today the \$100 bill is available for circulation at the large scale.

Australia: The Australian government demonetise their currency in 1996 to curb the black money and improve security features on their currency notes. They replace the long life polymer-based notes at the place of all paper-based notes. Demonetisation has positive effect on the Australian economy. This step improved the life of the bills and helped in making Australia a business-oriented country.

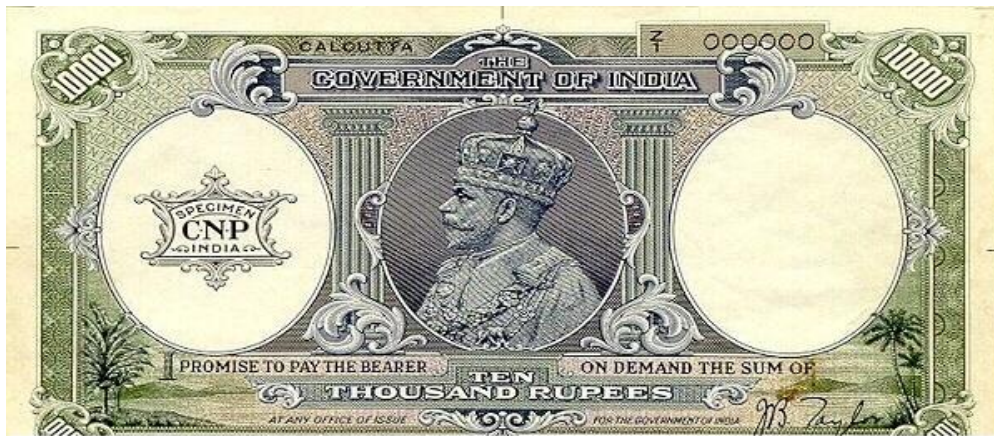
Demonetisation in India: history and background

Nowadays demonetisation of the Indian currency becomes a hottest topic for discussion. This is not the first time when Indian government

demonetised their currency. Prior to this step, India demonetised their currency two times during pre and post independence period. The sudden move to demonetisation of currency ₹ 500 and ₹ 1000 is not a new thing it is a third time demonetisation of Indian currency. The first step to demonetise of the Indian currency was taken in January 1946. According to the RBI data ₹ 1,000, ₹ 5,000, and ₹ 10,000 bank notes were in circulation prior to January 1946. In 1934, ₹ 500 and ₹ 1,000 notes were introduced and after four years in 1938 higher demonetisation bank notes of ₹10,000 were introduced and all of them were again demonetised on 16 January 1978 (Nithin K.S. and Sharmila, 2010). The ₹ 500 notes came into circulation in October 1987 and ₹ 1,000 note reintroduced in November 2000 and again demonetisation of Indian currency on 8 November 2016.



Source: <http://indian-banknotes.blogspot.in/>



RBI Rs.10000 Note in, 1938

Source: <https://www.ncaacademy.com/know-all-about-history-of-indian-currency-demonetisation/#prettyPhoto>

The currency was banned first time.

The currency notes ₹ 1,000 and ₹ 10,000 were removed from the circulation in 1946. It was the first time, when India demonetised her currency. At that time demonetisation did not produce impacts at greater level, because the higher value currency ₹ 1,000 and ₹ 10,000 was not available to the common people.



Source:

Source: <http://indian-banknotes.blogspot.in/>

The second time demonetisation of currency

The second time demonetisations of currency was occurred in 1978, when the Janata-party government led by Morarji Desai. The sole aim of the withdrawal of the currency notes ₹ 1,000, ₹ 5,000 and ₹ 10,000 was to drive away the black money out of circulation



Source:<http://www.freepressjournal.in/featured-blog/indias-history-with-demonetisation-from-1946-to-2016/988212>

The third time demonetisation

The present BJP government demonetise the currency at third time on 8 November 2016. The main objective of this demonetisation was to curb the black money, hoarded by a significant proportion of the population. Another main aim to squeeze counterfeit money from the circulation which was used for the terror activities. While currently circulated ₹ 500 and 1,000 notes were declared invalid from the midnight 8 November 2016, Prime Minister Narendra Modi said that new currency of ₹ 500 and ₹ 1000 will be introduced from 10 November, 2016. This step gave a panic attacks to millions of Indians for a long period of time. It brought disastrous effects to the poor and

the deprived sections of the society. As a result, common man lost their faith in economic and the banking system.

Effects of Demonetisation on Indian economy

Demonetisation of the currency put the worse impact on the every aspect of the economy. The immediately effect of demonetisation has been realised on the supply of money in the economy because a large amount of legal currency withdrawal from the circulation, which result contraction in the circulation of cash in the economy. Due to decrease in money supply, all economic activates will be negatively affect. The problem of

money supply will be solved by printing more new currency.

Effect on production and consumption: Due to decrease in money supply as a result of demonetisation it reduced the production and consumption of the economy. Demonetisation has negative impact on the business class, due to decrease in money supply which leads to decrease in production as well as consumption in negative way.

Effect on GDP: The fall down in all economic activities due to demonetisation, which resulted in to come down the Gross Domestic Product of the economy. The sudden decline in money supply and increase in bank deposits adversely affect the consumption demand in the country. It also badly affected the informal sector which leads to decrease the GDP growth rate.

Effect on trade: since our economy heavily dependent on the cash transaction and mostly population uses the banking system for monetary transaction. Due to demonetisation all these transactional activities badly affected the trade consumption.

Effect on fishing sector: demonetisation also badly hit the fishery sector of the country. Fishing business is totally depends on cash transaction. People don't have cash due to demonetisation of currency. Thus, in lack of cash transactions fisherman were not able to receive cash for their day to day life economic activities. As a result of demonetisation around 70% sales of fish has decline which leads to low demand for fishing that affected the fisherman negatively (TNN, 2016).

Effects on agriculture: demonetisation has short run impacts on agriculture, small traders, small vendors etc. Agriculturists generally deal with the consumable commodity and not have other form of payment rather than cash transactions. As a result of this, lack of agricultural market demand which affects the farmers negatively.

There are some sectors in the economy that will be most affected by demonetisation because of the high level of cash spending such as

Real Estate: it is one of the most affected sectors. Demonetisation has a negative impact on Real estate by reducing cash transaction. Land parcels are usually paid in cash form. With restrictions on cash

transactions result land prices would fall and make it affordable.

Jewellery Market: demonetisation badly hits the jewellery market. It cut down sales by as much as 70% due to lack of cash transaction. The shopping of gold in India is an activity indulged by both rich as well as poor. Even in the season of festival and wedding demand for gold jewellery drastically reduced.

Banks: the whole economic activities based on the banking sector. The banking sector is back bone of the economy. At the initial stage of demonetisation bank have shortage of liquidity due to lack of new currency circulation. Banking sector have a lot stress of demonetisation. After demonetisation when banks have reduced their interest rate there is a significant increase in bank deposits. According to RBI data deposits rose 13.9% from 10% rose in the last year (ET Bureau 2017).

Restaurants and Entertainment: One of the most common areas of the economy, where people frequently utilised their undisclosed income that is entertainment and restaurant industry. There are plenty of restaurants those accept Credit and Debit Cards. Since a majority of the transactions are in cash form in here, it will be exciting to see how people react to it. Will they

continue to opt for entertainment at the same scale that they did earlier.

Beauty parlours: This has been a booming industry of the economy where, works largely on cash. In the past few years, beauty parlours have mushroomed on almost every street of urban and semi-urban or even in the rural India. Although a few big organised parlours do accept credit and debit card payments, most parlours transact mainly in cash because it is often seen as a luxury spending fuelled by unaccounted income. Thus demonetisation has a negative impact on this sector due to lack of cash circulation in the economy.

Conclusion: The paper concluded that demonetisation has short-term negative impact on the different sector of the Indian economy. The immediate effects of demonetisation felt on the common man, retail sector, agriculture and fishery sector trade in goods and services which result slowdown of economic activities. The major sectors of the economy also face a slowdown such as agriculture, industry, services or organised and unorganised due to demonetisation. As a result, decline in Gross Domestic Product of the economy. It has largely affects the poor and deprived section of the society. However, the long term benefits of demonetisation overrule the short term challenges. Demonetisation

is one of the major steps initiated by the Government of India to address the various issues like black money, counterfeit currency, corruption, terrorism etc. From the history of the demonetisation it has been observed that developed countries got recover soon from demonetisation effects while, developing countries do not get success like the developed countries. Generally, they take a long time to recover from demonetisation and to run their economy in smooth manner.

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