

AN OVERVIEW OF DEMONETIZATION

Vipin Jain*

*Teerthanker Mahaveer Institute of Management and Technology,
Teerthanker Mahaveer University, Moradabad, Uttar Pradesh, INDIA

Email id: vipin555@rediffmail.com

DOI: **10.5958/2249-7137.2021.02571.4**

ABSTRACT

Demonetization is a tool used to combat inflation, black money, corruption, and crime, as well as to depress a cash-based economy and aid commerce. When a country's currency is changed, demonetization is the most important and necessary step. The old currency component must be removed and replaced with a new currency component. The currency was demonetized for the first and second times in 1946 and 1978, respectively. Banks are the most common benefactors of demonetization. Demonetization was declared by India's Honorable Prime Minister on November 8, 2016; the Indian government has taken a brave move by demonetizing the 500 and 1000 rupee notes (fully ban). These two largest currency notes account for 80 percent of the total cash supply. These currency notes have influenced almost every aspect of the economy. The real image of India will alter dramatically, and the Indian economy will emerge as one of the world's strongest in the medium to long term, as predicted by our country's Prime Minister.

KEYWORDS: Banknotes, Currency, Cash Supply, Demonetization, Transaction.

1. INTRODUCTION

Demonetization is defined as the conversion (removal of all or part of) of a country's existing currency notes to a different format. Demonetization, in other terms, is the process of replacing part or all of the old currencies with new ones, or introducing new notes/coins of the same currency. On November 8, 2016, the Indian government issued an astounding and unexpected announcement: the specified banknotes (SBN) would no longer be legal currency with immediate effect. According to the decision, the public was given fifty days to deposit their 1000 and 500 rupee notes at banks in order to remove them from circulation. Instead, a new 2000 rupee note and a revised 500 rupee note were issued(1)(2). The Indian Ministry of Finance (MoF) required the plan, which emphasized three main objectives in its language: combating corruption, deterring counterfeiters, and penalizing hoarders of undeclared wealth, often known as "black money". While discussions on the policy's basis were restricted to pointing out that the amount of cash in circulation is directly proportional to the degree of corruption, and that decreasing cash in circulation will decrease corruption. By value of currency in circulation, the removed notes accounted for up to 86 percent. The fact that a substantial proportion of new notes required to be produced at the time of announcement created a severe scarcity of cash, resulting in government-mandated limits on cash withdrawals from banks(3)(4).

As a large nation, India is heavily reliant on agriculture, with farmers, particularly those in rural areas, mostly unaware of virtual money such as credit cards or internet transfers, with about 90%

of transactions conducted in cash. Demonetization has a long history in India, dating back to the pre-independence era in 1946. In 1978, the notes of 1000, 5000, and 10,000 were demonetized to combat counterfeiting and illicit money(5)(6). The goal of this policy assessment study is to assess the Indian government's demonetization program, which was implemented in 2016. Such economic decisions should be examined and analyzed in light of theoretical ideas and prior arguments, since they are a mostly unexplained phenomenon(7)(8). The article will hopefully add to the theory and practice of monetary policymaking and economic decision-making in order to discover a better cash alternative. The paper's last parts briefly discuss demonetization initiatives in other nations, their impact, the reasons for such initiatives in India, and the good and negative consequences on the Indian economy.

1.1 History of Demonetization:

The current demonetization experience in India is not the unique one. The Reserve Bank of India (RBI) issued the largest denomination notes of 10000 rupees in 1938, while India was still under British control(7). In 1946, the British Indian Government ruled out 1000 and 10,000 rupee banknotes after a few years. Higher denomination banknotes of 1000, 5000, and 10,000 rupees were reissued in 1954 before being demonetized in 1978 to keep unaccounted money out of circulation [8]. Demonetization has not just been implemented in India. This strategy was implemented by several nations across the globe at various periods in the previous century and early in the current century. All of the nations that adopted such policies had certain similar goals, such as reducing corruption and black money, as well as combating inflation. The following is a list of nations that have implemented demonetization policies. The majority of nations using this strategy have failed to achieve the desired outcomes. After demonetization, a number of nations, including Nigeria, Zaire, and the former Soviet Union, suffered negative growth rates and economic declines(9)(10).

Countries like the United States and the United Kingdom, on the other hand, had a temporary downturn in their economies when demonetization was in place, but they quickly recovered, while only Australia's GDP remained stationary throughout the pre- and post-demonetization eras. Finally, demonetization has been used to modernise a cash-based emerging economy as well as fight corruption and crime (counterfeiting, tax evasion). The Indian government chose to demonetize the 500 and 1000 rupee notes, the country's two largest denominations, in 2016(11). These notes accounted for 86 percent of the country's circulating cash at the time. On Nov. 8, 2016, India's Prime Minister Narendra Modi declared to the public that such notes were useless, effective immediately, and that they had until the end of the year to deposit or exchange them for freshly issued 2000 and 500 rupee banknotes. Long, serpentine queues developed outside ATMs and banks, forcing them to close for a day in the cash-dependent economy (cash accounts for 78 percent of all consumer transactions in India). Because the new rupee notes have different characteristics, such as size and shape, ATMs must be re-calibrated: just 60% of the country's 200,000 ATMs were functioning(12)(13).

Even those who dispensed smaller denomination notes experienced shortages. The government's limit on daily withdrawal amounts made things worse, but a reprieve on transaction fees helped a little. Even in 2018, severe financial shortages were common. 4 Small companies and families struggled to obtain cash, and there were instances of daily wage employees not being paid. The rupee plummeted against the US dollar. The government's goal (and justification for the abrupt

announcement) was to combat India's thriving underground economy on several fronts, including eradicating counterfeit currency, combating tax evasion (only 1% of the population pays taxes), eliminating black money gained from money - laundering, and promoting a cashless economy. Individuals and organizations having significant amounts of black money obtained via parallel currency systems were obliged by law to take their big-denomination notes to a bank, which was obligated by law to get tax information on them. A penalty of 200 percent of the due amount was applied if the owner could not show evidence of making any tax payments on the cash(5).

1.2 Challenges and Responses:

It would not be foolish to state that the demonetization issue has engulfed India, and that debates about its consequences are in the air and in people's lips. There were several apparent difficulties and reactions to this strategy from many sectors. Based on newspapers, publications, and academics, we have attempted to highlight some of the noteworthy ones in this area(14).

- *Rural Banking System Distress:* The decision by the Reserve Bank of India (RBI) to prohibit District Cooperative Central Bank (DCCB) and Primary Agricultural Credit Society (PACS) from accepting or exchanging previous notes was perhaps the most divisive, as these two institutions serve the vast majority of India's rural population, including small farmers and low-income groups. While farmers rely heavily on DCCB and PACS to buy seeds and fertilizers, a significant percentage of the rural populace was forced to relocate to bigger villages or towns in order to exchange or deposit their old notes. Although the RBI did not provide any official explanations for the limitations, it was believed that the government was concerned by what seemed to be abnormally large cash deposits at DCCB and PACS immediately after the announcement. DCCBs in 17 Indian states received approximately 90 billion rupees in deposits between November 8 and 14. The RBI questioned the source of wealth of depositors mainly from the marginal agricultural sector, ostensibly due to fears that DCCBs were being used to store illicit money and launder undeclared income. According to the RBI circular, activities at 372 DCCBs and nearly 93000 PACS have effectively come to a halt. Many of these institutions temporarily ceased operations due to their inability to carry out banking activities critical to the rural sector, such as loan payment collections, cash disbursement, interest and dividend payments, fertilizer distribution, and running public distribution shops for the poor [23]. Regrettably, this decision was made during the peak agricultural season of harvesting summer crops and sowing winter crops, disrupting cultivation and severely affecting the sale and marketing of agro products as traders were unable to pay in cash, particularly for perishable products such as vegetables and fish. Furthermore, many farmers were unable to purchase seeds and other inputs, as well as pay agricultural laborers for their work(15).
- *Disturbance in Small and Medium-Sized Enterprises:* Demonetization not only dealt a severe damage to the agricultural sector, but it also had a major impact on the unofficial business enterprises, which now employ more than 80% of the workforce via micro, small, and medium businesses (MSME). Tiny turnovers, limited reserve, and insufficient access to financial sectors characterize such businesses, which are typically run by individual (usually one or two) owners, have a high cash dependency, and have small turnovers, limited reserve, and insufficient access to financial sectors. The strategy wreaked havoc on such businesses, which were already struggling owing to a continuous decrease in credit flows and an increase

in non-performing assets in the rural banking system. The overall result was a reported significant reduction in production capacity, as well as losses in profits, wages, and, most importantly, unemployment. Despite the fact that the long-term effects of demonetization on the MSME sector have yet to be fully revealed, a number of sovereign research and industry surveys have identified and recorded certain impending economic problems. According to an outlook poll conducted by the Indian Development Foundation, a private, non-profit research organization, more than 74% of temporary employment in urban small scale businesses across nine northern states were absent, with apparent reverse migration to rural. During the first 34 days after demonetization, the All India Manufacturers' Organization reported a loss of 53 percent of temporary employment in MSMEs throughout the nation, as well as a 50 percent drop in income(16)(17).

- *The Politics of Favoritism:* Nepotism, clientelism, and corrupt electoral politics are all too prevalent in India's political economy. As a consequence, it didn't take long after the demonetization announcement was made public for it to become a heated topic of political discussion and electoral advantage. Several opposition parties, both national and regional, complained that the strategy was primarily intended at weakening opposition financing and, as a result, benefiting the governing party in forthcoming state elections. They also claimed that knowledge about the upcoming policies had been leaked selectively to important members of the leadership and their business allies(18).

1.3 Advantages of Demonetization:

- *Putting an end to corrupt behaviors completely:* One of the most significant benefits of demonetization is that it effectively eliminates illicit money market malpractices. People will now be hesitant to participate in currency hoarding because they are afraid of being punished by the relevant authorities. Cash in black money would no longer be exchanged with banks. Many terrorist nations used hot money, such as counterfeit notes, to purchase weapons and ammunition. With the current demonetization initiative, this is unlikely to happen for at least a decade. To put it another way, weapons smuggling and trading with terrorists will no longer be viable since all of the money will be recorded in a proper and methodical manner.
- *Take a look at a complex financial system:* The financial system will significantly improve if the current demonetization step is effectively implemented. The economy will gradually move away from cash and toward a cashless society(19). Moving to a cashless economy also entails improved credit availability and a reorganization of financial processes. People will increasingly use internet shopping platforms to make purchases. As a result, the government will keep the current white money. Banks and financial organizations may use the newly authorized money to make loans to needy borrowers, and the banks can earn interest on the loans. In terms of base money, the financial or banking sector would get an extra boost of 7-8 Lac Crore. This is when the new notes are distributed, but it is also important to keep an eye on how much currency remains in the financial system once the withdrawal restrictions are reduced(20)(21).
- *The government's responsibility is reduced:* You may see demonetization as a good step since it provides you with a slew of fantastic advantages. The change may lower the risk and liability associated with dealing in liquid money. Soft money is usually simpler to work with

than hard money. Because every note represents a responsibility for the government, this liability may be significantly minimized(22). For those who choose not to declare their income, the old money is once again worthless. The old bills are now worthless scraps of paper. More than 5 Lac Crore is expected to flow to the government as a result of the current demonetization process in the form of extinguished notes, taxes, and fines. The money the government saves this manner is sufficient to fund the country's administration for the full fiscal year(23)(24).

- *Tax evasion is less prevalent:* One of the most significant benefits of demonetization is this. The extreme measure has the potential to significantly decrease tax evasion. The income tax authorities will keep track of any money that is deposited or exchanged. As a result, a growing number of individuals will be reluctant to engage in tax evasion schemes. Dealing with real estate and the jewelry industry will always be on the radar. Loan transactions will also be scrutinized on a regular basis. The IT department would be particularly cautious in preventing such misdeeds. Tax evasion may provide a significant boost to the Indian economy. Increased tax revenue allows the government to implement public-benefit initiatives(25).
- *Increased levels of GDP:* Reduced tax evasion may result in more clean money flowing into the economy. Tax and interest rates are anticipated to fall in the long term, since greater income tax revenues provide more room for lower loan interest rates. Housing loans may be available at a lower interest rate. As a result, the economy's disposable income will increase. When a growing number of individuals have disposable money, the economy's GDP (gross domestic product) may rise dramatically. In the long term, increased buying power among individuals may have a beneficial effect on consumer demand(26). As a result, the section includes a discussion of the main pros or benefits of demonetization!

2. DISCUSSION

Demonetization has been used to maintain a currency's worth or fight inflation. In order to avoid disruptive inflation when significant new silver resources were found in the American West, the Coinage Act of 1873 demonetized silver as legal currency in favor of completely embracing the gold standard. Several coins were phased out, including the two-cent piece, three-cent piece, and half-dime. The removal of silver from the economy caused the money supply to shrink, contributing to a recession throughout the nation. In 1878, the Bland-Allison Act remonetized silver as legal currency in reaction to the recession and political pressure from farmers, silver miners, and refiners. In a more recent example, in 2015, the Zimbabwean government demonetized its currency to fight the country's hyperinflation, which reached annualized rates of up to 231,000,000 percent. In order to prop up the economy, the Zim dollar was removed from the country's financial system and the US dollar, Botswana pula, and South African rand were established as the country's legal currency.

3. CONCLUSION

Demonetization is a tool employed by the federal government to combat corruption and undeclared funds. Similarly, it impacted and brought about changes in every sector of the economy. The demonetization process is like a two-faced currency because on one hand, it will benefit the entire nation while on the other, it will cause some short- and long-term problems.

The vast majority of business in India is conducted in cash, with less than 2% of transactions taking place electronically. The main entities that are impacted by demonetization are banks. Banned currencies were reintroduced, allowing people to transact with banks. It became agitated for a brief time while swapping and shifted its normal activities. Though it had a negative impact on large bank operations, it aided the economy in determining the country's growth and development via financial institutions such as banks. As a result of the arguments in favor of demonetization, it is critical to assess the short- and medium-term effects that such a shock is anticipated to have on the economy. This study examines the effects of such a shift on credit availability, expenditure, activity levels, and government finances. The Indian government has declared that the Rs 500 and Rs 1000 currency notes would no longer be legal tender. The goal of the move was to combat black money, corruption, and terrorism. The declaration of 86 percent of currency notes as unlawful money in a matter of seconds on the eve of November 8, 2016, forced an instant disruption in people's lives. Every level of society, whether high, medium, or lower, was thrown into turmoil. The purpose of this study was to examine the overall effects of demonetization on Indian citizens.

REFERENCES

1. Raaju KVV, Prasad RV, Banu S. Proscribe on currency (bad economics) crash on Indian business. *Int J Appl Bus Econ Res.* 2017;
2. Kaur N, Ghai W. Performance Analysis of Deep CNN Assisted Optimized HIV-I Protease Cleavage Site Prediction with Hybridized Technique. In: *Lecture Notes in Electrical Engineering.* 2021.
3. Shukla M, Bose S. Impact of Digitalization in Economy and The effects of Demonetization: An Overview. *ELK Asia Pacific Journals-*. 2017;
4. Nanda AK, Singh J. Relationship Between Compressive Strength and Split Tensile Strength for Sustainable Concrete—A Case Study. In: *Lecture Notes in Civil Engineering.* 2021.
5. US Energy Information Administration (EIA). Country analysis executive summary: iraq. *US Energy Inf Administration.* 2017;
6. Rana AS, Bedi TS, Grover V. A new permanent magnet type magnetorheological finishing tool for external cylindrical surfaces having different outer diameter. In: *Lecture Notes in Mechanical Engineering.* 2021.
7. Raj P, Pandikumar M. Historical volatility of NIFTY Returns and Demonetisation -An Overview. *SUMEDHA J Manag.* 2017;
8. Singh H, Oberoi A. Query relational databases in Punjabi language. In: *Advances in Intelligent Systems and Computing.* 2021.
9. Franciska A, net SS-D <https://www.researchgate.net>, 2017 undefined. An Overview On Digital Payments. *researchgate.net.* 2017;
10. Ghai W, Kumar S, Athavale VA. Using gaussian mixtures on triphone acoustic modelling-based punjabi continuous speech recognition. In: *Advances in Intelligent Systems and Computing.* 2021.

11. Dasgupta M. Moving towards “Cashlessness” in an emerging economy: A case study of latest policy steps in India. In: International Cash Conference 2017 – War on Cash: Is there a Future for Cash? 2017.
12. Wani IA, Sheikh IM, Maqbool T, Kumar V. Experimental investigation on using plastic wastes to enhance several engineering properties of soil through stabilization. In: Materials Today: Proceedings. 2021.
13. Sharma U, Sheikh IM. Investigating self-compacting-concrete reinforced with steel & coir fiber. In: Materials Today: Proceedings. 2021.
14. Pathak D, Pratap Singh R, Gaur S, Balu V. To study the influence of process parameters on weld bead geometry in shielded metal arc welding. In: Materials Today: Proceedings. 2021.
15. Parashar S, Chawla VK. A systematic review on sustainable green fibre reinforced composite and their analytical models. In: Materials Today: Proceedings. 2020.
16. Pathak D, Singh RP, Gaur S, Balu V. Influence of input process parameters on weld bead width of shielded metal arc welded joints for AISI 1010 plates. In: Materials Today: Proceedings. 2020.
17. Pathak D, Singh RP, Gaur S, Balu V. Influence of groove angle on hardness and reinforcement height of shielded metal arc welded joints for low carbon AISI 1016 steel plates. In: Materials Today: Proceedings. 2020.
18. Sharma K, Goswami L. RFID based Smart Railway Pantograph Control in a Different Phase of Power Line. In: Proceedings of the 2nd International Conference on Inventive Research in Computing Applications, ICIRCA 2020. 2020.
19. Acharya V V., Ryan SG. Banks’ Financial Reporting and Financial System Stability. J Account Res. 2016;
20. Kwok CCY, Tadesse S. National culture and financial systems. J Int Bus Stud. 2006;
21. Vaddi R, Dasgupta S, Agarwal RP. Robustness comparison of DG FinFETs with symmetric, asymmetric, tied and independent gate options with circuit co-design for ultra low power subthreshold logic. Microelectronics J. 2010;
22. Klemkosky RC. Financial system fragility. Bus Horiz. 2013;
23. Wilson JP, Campbell L. Financial functional analysis: a conceptual framework for understanding the changing financial system. J Econ Methodol. 2016;
24. Kaushik BK, Sarkar S, Agarwal RP, Joshi RC. An analytical approach to dynamic crosstalk in coupled interconnects. Microelectronics J. 2010;
25. Sharma S, Verma R. Performance characteristics of two-lobe pressure dam bearings with micropolar lubrication. Proc Inst Mech Eng Part J J Eng Tribol. 2019;
26. Gupta V, Bhatt V, Chandra S. RF magnetron sputtered aluminum oxide films for MEMS. In: Proceedings of the 14th International Workshop on the Physics of Semiconductor Devices, IWPSD. 2007.