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Demonetization in India: An effort to curb black economy

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Abstract

Indian economy has been suffering from the problem of black money for a long time. Black money is the money which is uncountable for the national income and no tax is paid to government on this amount. Consequently, it becomes very dangerous and root cause of corruption to the entire economic system of a country and it decreases the growth rate of a economy. Keeping this problem in view, the Government of India decided to implement the policy of demonetization to devalue the existing authorized currency. On the eve of 8th Nov. 2016, Indian Prime Minister Sh. Narendra Modi announced his government's decision to cancel the legal tender character of old currency with effect from 09th Nov. 2016. It included the cancellation of legal tender of Rs. 1000 and Rs 500 and insurance of new currency of Rs. 2000 and Rs. 500 in exchange for the old banknotes in form of Indian currency. The present research paper highlights the need and impacts of demonetization in 2016 on Indian economy.

Keywords: Black money, economy, legal tender, devalue, currency, demonetization, cashless economy

1. Introduction

It was the third instance in 2016 when the Government of India promulgated an ordinance to phase out the currency in form of bank notes of Rs. 1000 & 500, and announced by our Prime Minister Shri Narendra Modi that all currency notes of denomination of this amount will lose legal tender from midnight of 09th November 2016. Moreover, the government decided to re-issue new currency notes of Rs. 2000 & 500, but the currency of Rs. 1000 was completely done away from the economy. Later in its press conference, the Reserve Bank of India (RBI) declared that Indian has been cash based economy for a long time since 1947, hence the circulation of fake currency notes continued to be a menace for Indian economy. That is why, in order to contain the rising incidence of fake currency notes and black money, the scheme of demonetization has been introduced with effect from 09th Nov.2016 by the government of India. The Reserve Bank of India and the government also known the impacts of demonetization and declared that several problems will have to be faced by the average middle class person, farmers, banks and some other segments of the economy as a whole for some months.

1.1 Meaning of Demonetization

The demonetization undertaken by Modi Government is known as a great shock to common people and Indian economy. It is the process to replace the currency in circulation by new currency notes. Some of the economists called it '*a surgical strike*' of black economy. Moreover, it has dual meaning; first is to divest of value and second is to withdraw the old currency from use and replace it with new currency notes. However, it is an act of stopping the existing currency notes as a legal tender and to retire the old currency notes or to replace them with new currency notes.

1.2 The Scenario of Demonetization in 2016

Demonetization has its own past in India. The first instance was in 1946 and the second was in 1978 when the government of India had announced to phase out currency notes with denomination of Rs. 1000, 5000 and 10,000 from the economic system.

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But the instance of 9th Nov. is very different from earlier instances regarding the demonetization. This incidence was given a due coverage by media and it affected all segments of the economy. While announcing the scheme of demonetization, our Prime Minister announced that people will have to suffer for 50 days and after this time the problem faced by citizen will gradually decrease. The Congress spokes person Sh. Randeep Singh Surejewala had raised the concern that rural area farmers will have slightly more inconvenience due to the Rabi crop harvest season. Some of the political parties and economists had also raised the concern that there will be an apparent inconvenience to the common man initially to exchange and deposit old currency note in the short span of time for this purpose. Moreover, people living in rural areas will have slightly more inconvenience in terms of transportation and additional expenses in case of no banks in the rural areas. The banks will also have to face many problems because people will choose the easier way of depositing and exchanging the old currency notes. It did happen and the managerial difficulty of handling long queues and the over burden of work was faced by the bank employees and police department. But, this scheme was supported by the common people, middle class, banks and intellectual class of the society, and the initial problems faced by the people gradually decreased. That is why; the scheme of demonetization was appreciated to tackle the problem of corruption and black money in the country.

1.3 Need of Demonetization

While addressing the problem of corruption and the black money, our Prime Minister had declared that the touted benefit of demonetization is that it would drain the black money from the economy and black money holders or hoarders would either have to come clean and pay punitive taxes or have to turn their cash to trash. Consequently, our economic system would be purged of significant amounts of black money and fake currency. Moreover, the highest denomination currency notes used for illegal funding by terrorists and naxalists to expand their network would be curbed out from the economy. Some of the economists argue in favour of demonetization and remark as under:

- To curb the problem of corruption and the black money.
- To reduce the extent of counterfeit money.
- To tackle the problem of fake currency.
- To move to electronic and plastic currency.
- To move to cashless or less cash economy.
- To curb the illegal funding for terrorism and naxalism.
- To make corruption free and digital India for the better future of Indian economy.

1.4 The Scheme of Demonetization

Our Prime Minister took a historical and remarkable step on the eve of 8th Nov. 2016 in order to curb fake currency, black money and corruption from the economy. It was officially announced that the currency notes of Rs. 1000 and 500 are banned from 11th Nov. 2016. However, these notes could be used for two days 9th and 10 Nov. Thereafter, these notes remained acceptable only at some particular places such as petrol pumps, medical stores, hospitals, schools fees, water and electricity bills, LPG shops and toll plazas till 14th Nov. Meanwhile, people could exchange the old currency till 30 Dec. 2016 with the new currency notes of Rs. 500 and 2000 signed by RBI's new Governor, Mr. Urjit Patel and

issued to all banks and post offices. However, there remained a lack of sufficient new currency notes for some days and the common people had to suffer due to it. Nevertheless, we cannot ignore the fact the Government of India kept a keen eyes on the whole process of demonetization and its imperatives were two folds: one, to control counterfeit notes that contributed to terrorism and second, to undermine or eliminate the black money.

1.5 Impacts of Demonetization

Now regarding the impacts of demonetization it is being assumed that all currency which will potentially be extinguished would be currency being used as a store of value in the first and second category transactions or illegal transactions. If the currency is used for any of the other transaction in the economy, either as a store of value or more importantly, as a medium of exchange, then the impact on the economy and the agents in the economy could be substantial and if this currency is used in financing unaccounted income generation, demonetization would result in these activities closing down and a corresponding reduction in the incomes and employment associated with these activities. The spillover impact would be felt by the organized sector as well as since the consumption from the incomes generated would extent to the formal sector as well. Secondly, the process of demonetization would dramatically change the economic environment in the country by forcing agents to move from using cash as a medium of exchange to using cash substitutes. The RBI Governor and PM of India urged the citizens to switch to alternative modes of payments such as pre-paid cards, credit cards and debit cards, mobile banking and internet banking.

The process of demonetization could have the following impacts whether they may be short terms, medium terms and long terms as under in form of positive and negative:

1.6 Negative Impacts

- It has shown a severe contraction in income and consumption in the economy.
- It has adversely affected the Transport Services, Kirana Stores, Fruits, Vegetables and all other perishables and it has also reduced the purchasing power of the consumers.
- A compression of the demand has been seen for non-essentials by all the agents in the economy in the face of uncertainty in the availability of cash. However, who had access to digital medium of exchange have remained unaffected.
- It has adversely affected the employment pattern in agriculture, automobiles and constructions due to lack of cash, farmers have suffered a lot and they could not purchase seeds and pesticide for sowing Rabi crops which can affect the Kharif crop. In the same way, construction sector has been adversely affected. It is argued that this sector works with a significant amount of cash.
- It has very badly affected the real estate, which have earned unaccounted incomes and placed them within the real estate space. Consequently, prices of property and transportation have ceased. Furthermore, it could lead to a compression in investments in the construction and its allied sectors such as cement and steel industry.

1.7 Positive Impacts

- If we analyze the whole scenario of demonetization, it can be traced out that there is a tendency of increase in tax collection in the short term. Today, people want to get rid of unaccounted cash balances. There are evidence that property tax collections have increased higher than last year.
- There is a tendency of increase in bank deposits. But the currency deposited in banks is not withdrawn it could adversely affect the economy and banking system. Nevertheless, most of the economists argue that bank deposits will create more capacity to support economy. Clearly, the additional deposits would appear to be capable of stimulating a significant increase in the potential credit. However, there is an urgent need to upgrade the banking system and telecom infrastructure to provide the backbone for digital transactions.
- It has changed the habit of keeping cash in hands and people have started to use e-banking, e-wallets, credit and debit cards. In future, there may be a change in the habit of cash keeping by rural masses and they could also be move towards less cash practices. It is also hoped that there would also be a reduction in cash transaction in real estate sector.
- This move is likely to be better tax compliance, raise the tax to GDP ratio and improved tax collection could lead to lower borrowing and better fiscal management. Recently, the Government of India has announced tax reduction in her budgetary provisions. Its credit goes to the scheme of denomination.

2. Conclusion

However, this process of demonetization has shown many positive as well as negative impacts in short and medium terms. Nevertheless, we cannot ignore the fact that it would have more and more positive impacts in long term and we would be capable to curb the problem of fake currency, black money and funding for terrorism. But in spite of this it has badly affected the various segments of the society such as automobile and real estate and it allied sectors. Moreover, retailers, traders, paddlers, shopkeepers, farmers, rural and tribal people have to suffer due to lack of cash or to exchange their old currency notes. It has also affected communication, traveling, tourism, education, entertainment and many other services at the initial stage and political parties started protest against this scheme; but in spite of some difficulties this move has been supported by the common people and economists as well as intellectual segment of the society and this move has been successful to grab black marketers and black money holders up to some extent. It has been successful to curb the funding for terrorism and smuggling and a hike in the tax collection has been observed which will boost the economic structure of the country. And it has been seeking a way to identify or trapping the benami transactions. Actually, it is a surgical strike of Indian economic institutions and India would be free from the evils of corruption and black money.

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