

Pros and Cons of Demonetization in India

Prof. Dr. D. M. Khandare

Professor
School of Commerce & Mgmt Sciences
S.R.T.M.U., Nanded

Prof. Dr. S.J. Jadhav

Associate Professor & HOD
Shri Datta Arts, Commerce
College Hadgaon, Nanded

Abstract:

Prime Minister Narendra Modi's decision to scrap high value notes of Rs 500 and Rs 1,000 has created a shortage of cash in the system, leading to a lot of discomfort for the general public and businesses. Also, since there is a shortage of newly printed Rs 500 and Rs 2,000 notes, the situation has worsened. The move has also led to a shortage of lower denomination notes such as Rs 100 and Rs 50 that are still legal tender, as people have taken to conserving whatever cash they have in hand. Since our economy is heavily dependent on cash, as only less than half the population uses banking system for monetary transactions, demonetization has hit trade and consumption hard. This paper focuses on positive and negative effect of demonetization and evasion attempts made during this period.

Keywords: *Demonetization, Legal Tender, Monetary Transactions*

Introduction

Demonetization represents much more than destabilization; critics argue that it has struck a body blow on economic activity in India. The decision – which was entirely unsuspected – was announced on 8 November 2016. While the pros and cons of the measure still continue to be debated, the consensus of opinion appears to be that while the proponents of demonetization may have had good intentions, the suffering it has caused to millions of Indians is unwarranted. Since Rs500 and Rs1000 notes make up some 86% of the total currency in circulation in India, especially in the vast rural areas, one economist compared the pain to what individuals might experience if 86% of their blood was removed from their bodies.

Research Methodology:

Looking into requirements of the objectives of the study the research design employed for the study is of descriptive type. Available secondary data was extensively used for the study. Different news

articles, and Web were used which were enumerated and recorded.

Objective of Study

1. To understand the Positive effect of demonetization decision.
2. To understand the Negative effect of demonetization decision
3. To identify the evasion attempts made during demonetization period.

Data Collection

The research paper is based on the secondary data sourced from journals, magazines, articles and media reports.

Positive Effects

1. Addressing the Problem of Corruption and Black Money

One of the touted benefits of demonetization is that it would drain the swamp, as it were. Since hoarders would either have to come clean and pay punitive taxes (or probably be subject to further investigation), or have to turn their cash to trash, the system would be purged of significant

amounts of black money. Erosion of black money is that it is likely to make a larger dent on the wealth of the smaller offenders - the government officers who must be paid for every small piece of paperwork to be approved this group of individuals might have a harder time laundering their cash holdings. A third reason for demonetization is the pernicious practice of political parties "buying votes" with cash handouts during elections, particularly in rural India. This is probably the area where demonetization might have its largest effect in the short term since this requires hoarding of cash.

2. To reduce the extent of counterfeit money

Counterfeit is made in exact imitation of something valuable with the intention to deceive or defraud. More seriously, this has been an ongoing problem and is often tied to "terror" or insurgency funding. At least in the short term demonetization should put a brake on this.

3. The move to electronic currency

India – traditionally cash based economy – recently announced the biggest and most ambitious move to crack down black money and move towards digitization and cashless economy. Online transactions, card payments and mobile wallet taking a move to electronic currency.

4. Radical groups

The Demonetization has badly hit Maoist and Naxalites as well. The surrender rate has reached its highest since the demonetization is announced. It is said that the money these organizations have collected over the years have left with no value and it has caused them to reach to this decision.

#Negative Effects

Cash shortage

The scarcity of cash due to demonetization led to chaos, and most people holding old banknotes faced difficulties exchanging them due to endless lines outside banks and ATMs across India, which became a daily routine for millions of people waiting to deposit or exchange the 500

and 1000 banknotes since 9 November. ATMs were running out of cash after a few hours of being functional, and around half the ATMs in the country were non-functional.

Deaths

Several people were reported to have died from standing in queues for hours to exchange their old banknotes. Deaths were also attributed to lack of medical help due to refusal of old banknotes by hospitals.

Stock market crash

As a combined effect of demonetization and US presidential election, the stock market indices dropped to an around six-month low in the week following the announcement. The day after the demonetization announcement, BSE SENSEX crashed nearly 1,689 points and NIFTY 50 plunged by over 541 points. By the end of the intraday trading section on 15 November 2016, the BSE SENSEX index was lower by 565 points and the NIFTY 50 index was below 8100 intraday.

Transportation halts

After the demonetization was announced, about 800,000 truck drivers were affected with scarcity of cash, with around 400,000 trucks stranded at major highways across India were reported.¹ While major highway toll junctions on the Gujarat and Delhi-Mumbai highways also saw long queues as toll plaza operators refused the old banknotes.

Agriculture

Transactions in the Indian agriculture sector are heavily dependent on cash and were adversely affected by the demonetization of 500 and 1,000 banknotes. Due to scarcity of the new banknotes, many farmers have insufficient cash to purchase seeds, fertilizers and pesticides needed for the plantation of rabi crops usually sown around mid-November

Business

By the second week after demonetization of 500 and 1,000 banknotes, cigarette sales across India witnessed a fall of 30–40%, while E-commerce

companies saw up to a 30% decline in cash on delivery (COD) orders. Several e-commerce companies hailed the demonetization decision as an impetus to an increase in digital payments. They believe that it would lead to a decline in COD returns which is expected to cut down their costs.

Income tax raids and cash seizures

The Finance Ministry instructed all revenue intelligence agencies to join the crackdown on forex traders, hawala operators and jewellers besides tracking movement of demonetized currency notes. It was reported that the Prime Minister's Office (PMO) and the Prime Minister Modi himself were directly coordinating the raids conducted by the Income Tax, Enforcement Directorate (ED) and other agencies.

Railways

As of November 2016, Indian Railways did not have the option to make payment with cards at the counters. After the demonetization move, the government announced to make card payment options available at railway counters in the country.

#Evasion Attempts

Gold purchases

In Gujarat, Delhi and many other major cities, sales of gold increased on 9 November, with an increased 20 to 30% premium surging the price as much as 45,000 (US\$670) from the ruling price of 31,900 (US\$470) per 10 grams (0.35 oz). Income Tax officials raided multiple branches of Axis Bank and found bank officials involved in money laundering acts, exchanging old notes for gold.

Donations in temples

In India, the cash deposited into hundis, or cash collection boxes in temples and gurudwaras are exempted from inquiry by the tax department. This exemption is sometimes misused to launder money. After the note ban, there was a spike in donations in the form of the demonetized notes in temples. Authorities of Sri Jalakanteswarar

temple at Vellore discovered cash worth ₹4.4 million (US\$65,000) from the temple hundi in the form of defunct notes.

Multiple bank transactions

There have been reports of people circumventing the restrictions imposed on exchange transactions by conducting multiple transactions at different bank branches and also sending hired people, employees and followers in groups to exchange large amounts of banned currency at banks. In response, the government announced that it would start marking customers with indelible ink. This was in addition to other measures proposed to ensure that the exchange transactions are carried out only once by each person.

Municipal and local tax payments

As the use of the demonetized notes had been allowed by the government for the payment of municipal and local body taxes, it led to people using the demonetized 500 and 1,000 notes to pay large amounts of outstanding and advance taxes. As a result, revenue collections of the local civic bodies jumped. The Greater Hyderabad Municipal Corporation reported collecting about 1.6 billion (US\$24 million) in cash payments of outstanding and advance taxes, within 4 days.

The tax collection by local bodies have surged over 260% and more than 15000 crore more after 14 days of demonetization. The total indirect tax collection rose to 14.2% only in the month of December according to Finance Minister Arun Jaitley.

Backdated accounting

The Enforcement Directorate raided several forex establishments making back dated entries. Money laundering using backdated accounting was carried out by co-operative banks, jewellers, sellers of iPhones, and several other businesses.

Conclusion

As with most economic reforms, there are costs that are immediate, obvious, and asymmetrical while the gains are diffuse and often hard to measure. With people scrambling for cash to pay for goods and services, the move is likely to take a big toll on the country's growth and output during the current fiscal. Consumption makes up

for around 56% of India's GDP, hence, a drop in spending will pull down growth.

So far, it can be said that this is a historical step and should be supported by all. One should look at the bigger picture which will definitely fetch results in the long term. This is what the people have been asking for a long time which has finally happened.

References:

- Ghani, E., W. J. Kerr, S. D. O'Connell, 2013, The Exceptional Persistence of India's Unorganized Sector, World Bank Policy Research Working Paper 6454.
- Gordon, R. J., 2016, The Rise and Fall of American Economic Growth, Princeton University Press.
- http://economictimes.indiatimes.com/articleshow/55678393.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst
- <http://www.forbes.com/>
- <http://www.stanforddaily.com/2016/12/02/indias-demonetization-and-the-future->
- *"Demonetization leads to highest ever surrender of Maoists in a month - Times of India"*.
- <http://indianexpress.com/article/business/banking-and-finance/demonetisation-reserve-bank-of-india-new-bank-notes-4438899/>
- "ePaper link from Hindi daily Dainik Jagran of 27th October 2016"