



## DEMONETIZATION AND ITS IMPACT ON BLACK MONEY IN INDIA

### KEYWORDS

Demonetization, Black Economy, Cash, Impacts

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### ABSTRACT

On 8th November, 2016, 86% of Indian Currency in value which was in the form of Rs 500 and Rs 1000 notes were demonetized making them void instantaneously with few exceptions. Aim of this move was to clean the black market cash supply and counterfeit notes of course with other allied objectives as well. In the hind sight it appears that demonetization has failed to achieve this objective as significant amount of cash came back into the system. This paper attempts to analyze the impact of recent demonetization on Black Money curbing. Aim is to understand how far the government has succeeded in achieving its objective.

**Introduction:** India being a cash based economy has its own issues. One such issue is the Black money, which is estimated to be in a very high volume in circulation. Black economy has caused and is causing serious negative social and economic impacts on the country. Black Money problem needs to be curbed as in addition to increasing disparity between rich and poor, it also leads to tax evasion and reducing the availability of the money for the government for the country's economic development.

Government on its part has been taking various measures to curb black money. Recent demonetization by the government was also directed towards this objective. Sukanta Sarkar(2010) has also suggested that demonetization can be a way to tackle black economy(1)

But the opinion on this issue has been diverse. As per Jay Dubhashi(2014), "The demonetization is unlikely to curb black money in circulation, for the simple reason that no one really knows how much black money there is in circulation and, even more important, whether black money can really be defined in precise terms in all its shades"(2)

The Basic objective of this paper is to analyze the impact of recent demonetization on Black Money Curbing objective of the government. Aim is to understand how far the government has succeeded in achieving its objective.

Study is based entirely on secondary data. Data sources includes various research papers on the topic, leading newspapers as well as various websites, Last 100 days have been considered to analyze the impact.

**Demonetization: An over view:** As per Investopedia, "Demonetization is the act of stripping a currency unit of its status as legal tender"(3). In the India context, it is the withdrawal of currency noted by Reserve Bank of India (RBI).

At 8 Pm on 8<sup>th</sup> November, 2016, Prime Minister of India, Mr. Narendra Modi announced the decision of making Rs 500 and Rs 1000 currency notes invalid. Barring a few exceptions, most of the transactions in these notes were made illegal. These currency notes accounted for nearly 86% of the value of total notes in circulation. People were given time till 30<sup>th</sup> December 2016 to deposit old currency notes in bank account. Certain withdrawal restrictions were also imposed on people to deal with short supply of cash. As per the Government of India press release on the same day, the objective of this move was, "curbing financing of terrorism through the proceeds of Fake Indian Currency Notes (FICN) and use of such funds for subversive activities such as espionage, smuggling of arms, drugs and other contrabands into India, and for eliminating Black Money which casts a long

shadow of a parallel economy on our real economy". Giving the reasoning behind demonetizing bigger denomination currency notes, It is stated that, "Use of high denomination notes for storage of unaccounted wealth has been evident from cash recoveries made by law enforcement agencies from time to time. High denomination notes are known to facilitate generation of black money"(4).

As per RBI data, 10 2015-2016, approximately 6.5 Lakhs counterfeit notes were found in commercial banks. Out of these almost 4 lakhs were in the denomination of Rs 500 and Rs 1000 (5).

### Prior Instances of Demonetization:

Demonetization has taken place before also, both at global level and also in India. But the result of demonetization as a technique for currency reforms is more discouraging than encouraging.

In the year 1982, Ghana demonetized its 50 cedi currency notes. Aim of this move was tax reforms, controlling corruption and to clear the excess liquidity in the system. However the move backfired with the public losing confidence in the banking system and shifting to foreign currency and physical assets (6).

In the year 1984, Military Government in Nigeria attempted demonetization by introducing new currency notes in a different colours with an aim to crack down corruption. However the move was not successful.

In January 1991, Mikhail Gorbachev in Russia withdrew 50 and 100 ruble notes which formed one third of the total money which was in circulation at that time with an aim to curb black money and also to curb corruption. Move was again not successful and Gorbachev faced a coup in Aug 1991.

The same fate was met in Zaire by dictator, Mobutu Sese Seko for his currency reform plans along with the plans of withdrawing currency in 1993. He was ousted in 1997.

Thus globally demonetization has failed to achieve the objectives it intended to achieve.

In Indian context there have been two such prior instances of demonetization, one on 12<sup>th</sup> Jan 1946 and another on 16<sup>th</sup> Jan 1978. Here also high denomination notes were removed from the circulation with the objective of curbing black money. In demonetization which took place on 12<sup>th</sup> Jan 1946, the denominations of Rs 500, Rs 1,000 and also Rs 10,000 were scrapped and only Rs 100 was spared. The impact of this act then was not much as the percentage of population affected was very small. At that time such high denomination currency notes were the privilege only of rich people in India. Outcome was considered to be a failure as, "by the end of 1947,

out of a total issue of Rs. 143.97 crores of the high denomination notes, notes of the value of Rs. 134.9 crores were exchanged. Thus, notes worth only Rs. 9.07 crores were probably 'demonetized', not having been presented" (7). Thus approximately 93.7% of the currency was exchanged.

On 16<sup>th</sup> Jan 1978, there was demonetization of Rs 1000, Rs 5,000 and Rs 10,000 notes amounting to Rs 145.42 crores. Of this 129.4 crores amounting to nearly 89% were exchanged. Mr. I.G Patel, then Governor of RBI was not in the favor of the move. Thus the fact of the matter is that history of demonetization is not very encouraging, though there are differences in context and scope between previous and present demonetization.

Understanding Black Money: There is no uniform definition of the term, "Black Money" in Economic or academic literature. As per Investopedia, "Black Money is money earned through any illegal activities controlled by country's regulations" (8). According to National Institute of Public Finance and Policy (NIPFP), "Black Money is the aggregate of incomes which are taxable but not reported to authorities." Black Money is basically money which is earned through legal as well as illegal means but which is unaccounted for and hence untaxed.

India being a cash based economy has its own issues. It is estimated that black money in circulation is very high in India. Several Estimates have been as to the quantum of black money in total economy. As stated in White Paper on Black Money which was published in May 2012, "The last official study for estimating black money generation was conducted at the behest of the Ministry of Finance by the NIPFP [National Institute of Public Finance and Policy] in 1985" (9). As per the estimate of The National Institute of Public Finance and Policy in 1985, the amount of black money in the country was approximately Rs. 1,00,000 crore, which comes out to be approximately 20 percent of the national income at that time. As per an estimate by the World Bank in July 2010, size of parallel economy in India was approximately 20.7% of GDP in 1999 and it rose to 23.2% in 2007. On a conservative note, even if we assume that this figure has not increased since then, the size of black economy is approx. 1/5<sup>th</sup> of country's GDP. GDP for 2015-2016 was Rs 135.76 lakh crore. So, by this calculation, the total amount of black money comes out to be Rs 27.15 lakh crore (10).

Next important point is how much of this black money is in the form of cash. As it is widely known and accepted fact that the entire black money is not in the form of cash. People keep black money in various forms such as gold, Real estates and even take it abroad. Following data is provided by White paper on Black Money released by Ministry of Finance in 2012.

**Table 1: Value of assets seized (in Rs. Crore)**

Year	Cash	Jewelry	Other assets	Total Undisclosed Income Admitted (in Rs Crore)
2006-07	187.48	99.19	77.96	3,612.89
2007-08	206.35	128.07	93.39	4,160.58
2008-09	339.86	122.18	88.19	4,613.06
2009-10	300.97	132.20	530.33	8,101.35
2010-11	440.28	184.15	150.55	10,649.16
2011-12	499.91	271.40	134.30	9,289.43

**Source: White Paper on Black Money (2012)**

As stated in White Paper on Black Money, above data deals with search and seizure operations conducted by Income tax Department. Thus going by this, of the total undisclosed income in the past six years which amounted to Rs 40,426 crores, of which only 1974.85 crores was seized in cash which is approx. only 5%. This makes an estimate of Rs 1.33 lakh crore as black money (5% of 27.15 crores).

However as stated by Finance Minister Mr Arun Jaitely in Lok Sabha

as on 16<sup>th</sup> December 2016, "There is no official estimation of the amount of black money either before or after the Government's decision of 8<sup>th</sup> November 2016 declaring that bank notes of denominations of the existing series of the value of five hundred rupees and one thousand rupees shall cease to be legal tender with effect from 9<sup>th</sup> November 2016" (11).

#### **Impact:**

Various estimates were made regarding the amount of demonetized money not likely to come back. As per the submission of Attorney General Mr. Mukul Rohtagi in Supreme Court on Nov, 15 2016, Government was expecting only Rs 10-11 lakh crore cash to be deposited back.

As per an estimate mentioned in SBI report, money coming into the system would be approximately Rs 13 Lakh crore as against 15.44 lakh crores. So, SBI had estimated that Rs 2.5 lakh crore may not return back into the banks post demonetization (12).

However, things took a different turn. As per announcement made by RBI on Nov 28, 2016, 8.45 Lakh crore was back into the banking system between Nov 10 to Nov 27. Then again as per statement from RBI as on 12<sup>th</sup> December 2016, total of Rs 12.44 Lakh crore has been exchanged. Since then there is no official announcement from government sources.

However as per PTI report, cash close to 14.5-15 Lakh crores is back into the banking system. It means 97% of money is back by 30<sup>th</sup> December. Moreover the process is not yet over. Indians who were abroad have time till 31<sup>st</sup> March and for NRIs till 30<sup>th</sup> June probably indicating that some more deposits in old notes are possible. Does it mean that there was very little or no black money in cash or it has already been converted into other assets such as gold, real estate, foreign investment etc? There are media reports which suggest that jewelers have been working overtime on 8<sup>th</sup> and 9<sup>th</sup> November to convert old currency notes into gold (13).

Another reason could be that tax evaders have used the loopholes within the system to inject black money to banking system. For example Jan Dhan Accounts of poor people. As per statement of Economic Affairs Secretary, Shaktikanta Das, "Some people are using Jan-Dhan accounts to deposit black money" (14).

**Way Ahead:** Now, with the hard reality that initial contention of a huge volume of black money will not come back has failed, can we sit with the notion that demonetization has completely failed in curbing black money. Probably this is not true. Success from here will depend upon the vigilance of income tax department. Their attempt to investigate and seek explanation from depositor as the entire money which has come back is not white. Unexplained money will attract higher taxes leading to higher revenue. Moreover even if we tend to believe that black money got converted to white, it can be taken as conversion of black economy to white economy to that extent.

Taking it further ahead, funding mechanism of political parties needs to be taken care of. There is a tendency to support and fund political parties using Black Money. Big Business Houses are donating the huge amount of Black Money to various political parties especially the ruling ones to derive undue profit by getting policy decision manipulated in their favors (15).

Real Estate is another sector where there is significant amount of black money. After demonetization announcement, media reports have stated that activity in this sector has slowed down significantly to the extent of 30% in Metro and Tier I cities in India. This sector needs to be tracked to curb black money.

Moving towards a cashless economy can be a major step towards curbing black money.

#### **Conclusion:**

It is not fair to conclude that just because significant volume of demonetized money came back into the system, demonetization has failed in achieving its objective of Black Money Curbing. These moves will certainly affect the corrupt practices in future by affecting the Psyche of corrupt people. From here authorities needs to be very careful. Money deposited or money exchanged needs to be tracked appropriately. This black money curbing drive has to be taken ahead from here in various ways.

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