



DEMONETISATION: AN EXUBERATE SIGHT OR PLIGHT OF INDIAN ECONOMY?

KEYWORDS

Demonetisation, Black Economy, Corruption, Higher Denomination, Currency

Jisha Rajendran

MA Applied Economics (Christ University), BA Programme (Delhi University)

Vidhi Maggo

MA Economics (IGNOU), BA (Hons) Economics (Delhi University)

ABSTRACT

Presently Indian Economy is ridden with the sudden move of the government, with regard to demonetisation of the higher currency notes which has caught every person by surprise and has unbridled an extraordinary monetary turmoil. In this light, shedding light on the background, current scenario of demonetisation in India, pros and cons of the strategy and understanding the prospects is of utmost importance, so as to know the likelihood of success of the move in India. It was evident from the discussion that demonetisation could either follow the successful path, like Europe, or could receive a severe blow like Russia, Korea and their likes, depending on its implementation and further strategies that will be adopted by the government, as complementary measures to the ongoing demonetisation drive.

Introduction

Recently, in Indian Economy the term "Demonetisation" has become a buzz word. Sudden disappearance of higher denomination currency notes from the circulation has caught every person by surprise and has unbridled an extraordinary monetary turmoil. Serpentine queues at numerous public and private sector banks and ATMs across the country to simultaneously withdraw, deposit and exchange plethora of cash, has grabbed the attention of the public in the past few days. In this light, there has been a flood of debate across the world about whether the innate currency reform would essentially limit the parallel economy, the extent to which the abrupt shortage of cash would offend economic growth, the political intentions behind this action and whether there prevailed a fiscal windfall awaiting the government due to the destruction of a small part of the stock of currency. Whereas, the government has supported its move by calling it a "short-term pain for long-term gain", opponents of this reform have condemned this very act by ostensibly defending their position and advocating the difficulties faced by the common man as a result of sudden phasing out of currency. In due recognition of this reality, the attempt of this paper is to throw light on the concept of demonetisation and highlight the dark and bright side of this act in general and in case of Indian economy in particular.

Background

In the opinion of Kumar (2016), demonetisation refers to the phenomenon of taking away from the currency its value as a legal tender. Demonetisation, as a process, is essential whenever there is a variation in the domestic currency. In this context, the old unit of currency is retired and is indeed replaced by a set of new currency. The notion of demonetisation is not new in the present modern history. In fact, there prevail many countries in the contemporary world that have exercised upon the act of demonetisation. For instance, in 1982, Ghana announced the decision to demonetise its 50-cedi currency notes so as to check corruption and money laundering. 80% of the currency of Myanmar was demonetised in 1987 to regulate black money and even faced massive protests. Soviet Union demonetised their higher denomination currency in 1991, however, the act did not fare well. In 2010, North Korea also demonetised its currency which resulted in its economic slowdown in the short-term. Similarly, as pointed out by Rajkumar & Shetty (2016), Indian economy has also engaged in the act of demonetisation before, that is for the first time in 1946 India embarked upon the gesture of black marketing by doing away with higher currency notes of 1000 and 10000 and replaced them with new ones, though it was more of a "conversion" than "demonetisation". For the second time, the Independent India demonetised again in 1978, aiming at regulating illegitimate activities. Recently, in November, 2016, the

government has again demonetised the higher denomination, however, the long-term fate of this decision is yet to be seen in near future.

Current Situation

The present government has embarked upon a major reform in the economic environment of the country by demonetising the high denomination currency notes of ₹1000 and ₹500. As per the verdict of the Prime Minister, these denominations have stopped to be the legal tender from the midnight of 8th November, 2016 (Mint, 2016). The citizens of the country have been given time up to 30th December, 2016 to exchange the currency notes detained by them. This stance of the government incorporates the eradication of these existing currency notes from the circulation of money supply and a steady replacement of these with an array of new currency notes. In its wake, as stated by Dasgupta (2016), the government has also introduced the new currency note of ₹500 in lieu of older one. It must be pointed out that the government has made it clear that in the short run, it is envisioned that the currency in circulation would be significantly squeezed since there are restrictions positioned on the amount that people can withdraw from the banks and ATMs (Shepard, 2016). However, in the coming few months, it is postulated that this restriction and limitation shall be majorly relaxed. The reasons that have been cited by the government for the stance of doing away with ₹1000 and ₹500 currency notes are two-fold: firstly, to control the fake currency notes that could be funding the terrorist activities against national security and secondly, to combat the menace of "black economy" (Dhume, 2016). However, the introduction of ₹2000 note has put the intention of the government of demonetising under scrutiny. This is precisely because whereas, on one hand it is stated that eradication of higher currency notes curbs black money, on the other hand, the very act of the government in introducing a higher denomination of ₹2000 in place of a smaller denomination of ₹1000 has put its fight against corruption in jeopardy.

Advantages and Disadvantages of Demonetisation

The implementation of demonetisation is becoming gloomier each day, with the economic and social benefits of such a move fading in the relentless mess. Under such circumstances, it is vital to discuss the pros and cons of such a move, by shedding light on the empirical evidences and examining the likelihood of replicating the same model in the Indian scenario. For this purpose, the underlying section discusses the advantages and disadvantages of demonetisation.

Advantages of Demonetisation

The success stories across developed nations like the introduction of Euros in 2002 and the decimalisation of the British pounds reflects a

positive outlook for the demonetisation in India.

Firstly, demonetisation is expected to turn the Indian economy into a cashless economy, thus eliminating the black market to a large extent. According to a report by The Economic Times (2016), coins and notes could eventually be replaced by bytes and bitcoins, thus upgrading the process of investment, earning and spending, by functioning in a virtual economy. It is possible in a nation with over one billion smartphone users, however its likelihood in the immediate future is grim. Additionally, as argued by Patil (2016) demonetisation also led to a plunge in the credit cost, which could be used to increase the investment potential of businesses. Firms can raise money in the local bond market at lower costs because the invalidated cash has been directed to the banks, which has resulted in the money being used in debt securities. This is because as the Rs500 and Rs1000 notes have become invalidated, people have been compelled to deposit this money in the banks, thus raising the loanable funds in the banks, which could be directed towards businesses, thus facilitating the firms to raise the money in the bond market at cheaper costs. Hence, one can conclude that the benefits of demonetisation will only accrue in the long-run, though it would be accompanied by short-term difficulties.

Secondly, with adequate preparations, demonetisation could also be used to facilitate the exchange of a common currency among different nations. An example of such an initiative is presented by Sachdeva (2016), which shows the ditching of the individual currencies by twelve nations of European Union, in order to introduce a single currency, Euro in 2002. However, for such an initiative to unfold, the government was preparing for three years to check all the possible difficulties that could arise in such a situation, so as to combat it effectively. The minting of new coins had started three years ago, and frontloading of the banks with the new money began three months prior to the announcement. Additionally, the ATMs were also pre-loaded with cassettes, which activated midnight of the announcement. Additionally, the ATMs were also loaded with smaller denominations of currency to avoid problems of change, that would follow the changeover. Hence, this example only reaffirms that demonetisation should only be executed after successfully making prior arrangements, to avoid any crisis during the changeover.

Disadvantages of Demonetisation

Demonetisation is often adopted as means of stabilising the economy, however, in the case of India, one can see that the move is destabilising a stable and fast-growing economy. This results in several speculations

Firstly, the economy faces immense distress and loss of confidence in the wake of a currency reform. As indicated by Sachdeva (2016), Soviet Union had adopted such a drastic measure, under the leadership of Mikhail Gorbachev in 1991 and withdrew Ruble notes from the circulation, to curb the black market. The invalidated 50 and 100-ruble bills was seen to constitute one-third of the total money in circulation (Marin, 2002). However, the reform was deemed unsuccessful in controlling inflation, instead it eroded the confidence of the public on the government, thus setting a bad example.

Secondly, it is a well-known fact that to attain the glorious long-term benefits of demonetisation, one has to first overcome the turmoil in the short-run. Apart from the elongated ATM and bank queues, distressed public, one can also see that the overall economy is in a sluggish state, with fall in expenditure, due to the dampened consumer demand, reduced confidence in the government and sharp decline in the corporate bond yields in India (Patil, 2016). Under such circumstances, having a positive outlook regarding a better future tends to become difficult for the public, thus increasing the likelihood of a possible recession as well.

Thirdly, the current strategy of demonetisation is also believed to be

ineffective in curbing the problem of black money and the subsequent parallel economy, because as described by Ponczek (2016), in the present scenario majority of the individuals who had previously appropriated cash illegally, would have already converted their wealth into bitcoins, gold and foreign exchange or other store of value, instead of being kept as cash. Hence, the entire black money could not be wiped out at one instance and only the petty amount could be turned white eventually. Additionally, invalidating the 500-rupee note was not a strategic move, as this note is widely transacted in the Asian countries, on the contrary, the \$100 bills, which were abolished in US was rarely used, even by the richest citizens of the country, thus indicating that the abolition of the note in India would have a greater negative impact on exports and imports, than that experienced in USA.

Future Prospects of Demonetisation in India

From the above discussion, it is evident that demonetisation could either make or break the Indian economy and the result of this step is a much-awaited event. There are several propositions regarding the prospective future of India, under the realm of demonetisation. Firstly, it is put forth by Patil (2016) that the current move by the government could possibly reduce inflation, because the step annulled 86% of the cash in circulation. The increase in loanable funds, due to the rising liquidity of banks could push up the prices of the assets and a situation of low or no cash with the public might compel the people to refrain from indulging in unnecessary expenses, thus lowering inflation. Secondly, demonetisation will result in a digital India, which not only make transactions convenient, but will also eliminate the future possibilities of tax evasion in the future. It has been recorded that since the announcement made by the Prime Minister of India, regarding the demonetisation, people have witnessed a spurt in cashless transactions, however, it is predicted that as things normalise, people would prefer to switch back to the previous cash transactions. Hence, predicting a conclusive result at this stage would not be possible, because the tables can turn anyway.

Conclusion

The aim of this paper was to shed light on the aspect of demonetisation and outline the bright and dark side of this concept in general and in the context of Indian economy in particular. From the findings of this research it is evident that the impact of demonetisation on society is highly debatable. Whereas, on one hand proponents present its bright side in terms of a revolutionary move, the opponents condemn its ugly side to be unfavourable for the economy at large. However, it can be said that demonetisation can only be a component of an inclusive approach to confront black money and corruption, and is expected to enforce considerable discomfort due to its adverse effect on low-end employment and GDP. The more significant fragment of the struggle against corruption encompasses some set of measures like streamlining the tax system to advance compliance, enhancing accountability and transparency in financial accounts and reforming the sectors that have left untapped. Advancements on these would only lead to an actual contribution to plummeting the generation of black money in future.

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