

# Demonetization - Less Cash To Cash Less

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**Abstract** - Demonetization is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency. There are multiple reasons why nations demonetize their local units of currency- to combat inflation, to combat corruption and crime (counterfeiting, tax evasion), to discourage a cash-dependent economy, to facilitate trade, In 2016, the Indian government decided to demonetize the 500- and 1000- rupee notes, the two biggest denominations in its currency system; these notes accounted for 86% of the country's circulating cash. With little warning, India's Prime Minister Narendra Modi announced to the citizenry on Nov. 8 that those notes were worthless, effective immediately – and they had until the end of the year to deposit or exchange them for newly introduced 2000 rupee and 500 rupee bills. In 2016, the Indian government decided to demonetize the 500- and 1000- rupee notes, the two biggest denominations in its currency system; these notes accounted for 86% of the country's circulating cash. With little warning, India's Prime Minister Narendra Modi announced to the citizenry on Nov. 8 that those notes were worthless, effective immediately – and they had until the end of the year to deposit or exchange them for newly introduced 2000 rupee and 500 rupee bills. The objective of this research study is to analyze the impact of recent demonetization on the Indian system. The paper finds out the pros and cons of Less Cash to Cash Less in economy.

**Key Words** - Demonetization, Counterfeit Currency, Black Money, Money Laundering

## I. INTRODUCTION

Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new unit of currency. The opposite of demonetization is remonetization where a form of payment is restored as legal tender. There are multiple reasons why nations demonetize their local units of currency. Some reasons include to combat inflation, to combat corruption, and to discourage a cash system. The process of demonetization involves either introducing new notes or coins of the same currency or completely replacing the old currency with new currency.

In 2016 government of India decided to demonetize the 500 and 1000 rupee notes, the two biggest denomination notes. These notes accounted for 86% of the country's cash supply. The government's goal was to eradicate counterfeit currency, fight tax evasion, eliminate black money gotten from money laundering and terrorist financing activities, and promote a cashless economy. By making larger

denomination notes worthless, individuals and entities with huge sums of black money gotten from parallel cash system were forced to convert the money at a bank which is required to acquire tax information from the entity. If entity could not provide proof of making any tax payments on the cash, a tax penalty of 200% of the tax owed was imposed.

In 2015, the Zimbabwean government demonetized the Zimbabwean dollar as a way to combat the country's hyperinflation that was recorded at 231,000,000%. The 3 month process involved expunging the Zimbabwean dollar from the country's financial system and solidifying the US dollar, Botswana pula and South Africa rand as the country's legal tender in a bid to stabilize the economy. The Coinage Act of 1873 demonetized silver in favor of adopting the gold standard as the legal tender of the United States. The withdrawal of silver from the economy resulted in a contraction of the money supply, which subsequently led to a 5 year economic depression in the country. In response to the dire situation and pressure from silver miners and farmers, the Bland-Allison Act remonetized silver as legal tender in 1878. To check undisclosed black money, corruption and fake currency the Government of India on the 8<sup>th</sup> November, 2016 announced demonetization of high denomination currency notes ₹ 500 and ₹ 1000. A new redesigned series of ₹ 500 and ₹ 2000 banknote is in circulation since 10<sup>th</sup> November 2016.

## II. HISTORY OF DEMONETIZATION

The demonetization of high denomination bank notes was a step primarily aimed at controlling illegal transactions. It is a part of a series of measures which government has taken so far and is determined to take against anti social elements.

The French were the first to use the term demonetize, in the years between 1850-1855. Since then many countries have used the word and the policy with immense restriction and discomfort, for it disrupts economy and population at large.

India has not demonetized its currency for the first time. Indian currency had been demonetized earlier:

- first time on 12<sup>th</sup> January 1946,
- second time on 16<sup>th</sup> January 1978, and
- Now on 8<sup>th</sup> November 2016.

In the first time, the measure did not succeed, as by the end of 1947, out of a total issue of ₹ 143.97 crores of the high denomination notes, notes of the value of ₹ 134.9 crores

were exchanged. Thus, notes worth only ₹ 9.07 crores were probably demonetized, not having been presented. It was more of a “conversion”, at varying rates of profits and losses than “demonetization”, as summed up by Sir Chintaman, in his Dadabhai Naoroji Memorial Prize fund lectures, delivered at Bombay in 1957. In the second time, The Finance Minister H.M. Patel in his budget speech on 28 February 1978 remarked:

*The demonetization of high denomination bank notes was a step primarily aimed at controlling illegal transactions. It is a part of a series of measures which government has taken and is determined to take against anti social elements.*

Demonetization was done by the first non congress government on India by Morarji Desai- led Janata Party in January 1978. In January 1946, banknotes of 1000 and 10000 rupee were withdrawn and new notes of 500, 1000 and 10000 rupee were introduced in 1954. The Janata Party coalition government had again demonetized banknotes of 500, 1000 and 10000 denomination to curb black and counterfeit money.

In 2012, the Central Board of Direct Taxes had recommended against demonetization, saying that “demonetization may not be the solution for tackling black money or economy, which is largely held in the form of Benami properties, bullion and jewelry”.

On 28<sup>th</sup> October 2016 the total banknotes in circulation in India was ₹ 17.77 lakh crore (US\$260 billion). In terms of value, the annual report of Reserve Bank of India of 31<sup>st</sup> March 2016 stated that total bank notes in circulation valued to ₹ 16.42 lakh crore of which nearly 86% was ₹ 500 and ₹ 1000 notes. In terms of volume, the report stated that 24% of the total 90,266 million banknotes were in circulation.

Other countries where demonetization has taken place:

- ✓ Singapore (1945)
- ✓ Fiji (1969)
- ✓ USA (1969)
- ✓ Britain (1971)
- ✓ Ghana (1982)
- ✓ Nigeria (1984)
- ✓ Myanmar (1987)
- ✓ Zaire (1990)
- ✓ Congo (1990)
- ✓ Soviet Union (1991)
- ✓ Australia (1996)
- ✓ North Korea (2010)
- ✓ Zimbabwe (2015)
- ✓ Pakistan (2015)
- ✓ Philippines (2015)

Some of the countries who demonetize their currency failed to meet the purpose for which the step had been taken by them, while many other countries like the USA, the UK, and the Soviet Union achieved a great success. India too

has demonetised its currency dates back to the history in 1946 and 1978. The success of demonetization depends not only on the decision but it depends on its effective implementation.

### III. OBJECTIVES

The main objective of this paper is to study the impact of demonetization on 8<sup>th</sup> November 2016 by the present government and to learn the methods of cash less payments.

### IV. METHODOLOGY

The paper is based on secondary data. The secondary data was collected from various published sources like reports, magazines, journals, newspapers etc.

### V. LEGAL FACTS ABOUT DEMONETIZATION IN INDIA

Many people think that the Government is conjuring policies on its own. Well, it is not so. Like every other economic and political measure, demonetization also has a valid place in the Indian books of law. The legal basis for the order of demonetizing currency can be found in section 26 of the Reserve Bank of India Act, 1934. Under sub section (2) of this section, the Union government is empowered to declare that any notes issue by the Reserve Bank will no longer be legal tender. The only procedural requirement is that the Board of the RBI recommends the same to the Union Government. In fact, in 1978, demonetization was carried out under a special legislation, namely the High Denomination Bank Notes (Demonetization) Act, 1978.

### VI. LITERATURE REVIEW

1. MasterCard welcomes and supports Prime Minister Modi's announcement regarding the bank on high value currency notes as it fundamentally addresses the underlying “cash engine” that drives the shadow economy. It will enable further growth in the Indian economy by encouraging cashless transaction and reducing crime rate. The PM's bold action and leadership is a critical step in positioning India to be a leader in the global cashless and digital economy movement. MasterCard is committed to working with the government to provide the cashless solutions that combat corruption, create growth, and inclusion for all members of society.

*Porush Singh, (Country Corporate Officer, India and Division President, South Asia, MasterCard).*

2. This is a bold move by the government to scrap the existing 500 and 1000 ₹ notes. We are confident that the move will cut down the menace of fake currency as well as reduce black money in circulation. This will add a great deal more liquidity to the formal banking system, which will benefit immensely from the legal flow of liquid cash. This is a right time to go cashless, as it is both highly transparent and accountable, making life easy for the government and the common man

*Adhil Shetty, (CEO and Co- Founder Bankbazaar.com).*

3. An unprecedented, bold move leading charge from the front, the PM in the most secretly planned, seamlessly executed a move to root out unaccounted and counterfeit currency. A combination of national security concerns and wider agenda to filter out unaccounted income guided the government to make these move. Figures of high denomination currency in circulation in past 5 years compared to growth in the economy pointed towards indicators of unaccounted money in circulation. Timing was perfect- a month after closure of the income disclosure week and a week after Diwali such that the impact of short term disruptions in festive period is minimized.

*Mukesh Butani, (Managing Partner, BMR Legal).*

4. Useful method; secrecy was a pre requisite: “ This is a useful method of flushing out black money, given that a large percentage of cash holding is in these two denominations. The manner in which it was implemented is not surprising- such actions are always secret till announced, so that insiders do not take advantage of the information at the cost of outsiders” however it would have a negative impact on the small business. The currency needed for everyday transactions have has to be replaced quickly.

*Arvind Virmani (Leading economist; Former India’s representative at IMF; Former Chief Economic Advisor, GOI).*

5. The withdrawal of high denomination currency notes from circulation is seen as a move to curb the black economy. Questions are being asked about its effectiveness and its economic costs. The immediate impact has been adverse and large. The current size of the black economy is 62% of the GDP, or about Rs 90 lakh crore, and what may be held in cash would be only a few percent, say 2 to 3 lakh crore. Thus, the expected bonanza to the government may be marginal. Most of those who generate substantial black incomes may be untouched by demonetization and will continue. The heavy cost to the economy is becoming apparent. Households, farmers and businesses are being adversely affected as transactions have become difficult. A black market has emerged for exchange of currency and there is a premium for gold and foreign currency, which will lead to loss of savings. Thus, while demonetization will hardly impact the black economy, it will impose huge cost on the economy especially on the marginalized.

*Arun Kumar (Retired Professor of Economics, Jawaharlal Nehru University, New Delhi; and author of The Black Economy in India, Penguin (India).*

6. The government’s decision to scrap existing currency notes which make up a large proportion of those in use in transactions is an ill-thought out action which has little economic justification, and acts as a smokescreen for the failure of the government to act in more fundamental ways to address people’s justified anger at ill gotten wealth and

ongoing corruption. However, better alternatives existed to what the Supreme Court has rightly been referred to as “carpet bombing” and not a surgical strike, including the gradual replacement of targeted notes. The loss of trust in the currency and in the ability of the government to manage the economy has, ironically, also dealt a blow to the confidence of the domestic and foreign private investors whom the government is otherwise keen to please. Despite its debacle, the government and its faithful, some pliant economists among them, will likely assert that it has advanced its aims, as it can always claim that things would have been still worse.

*Sanjay G Reddy (Associate Professor, the New School of Social Sciences, New York).*

7. The prime minister’s announcement invalidated 86% of the currency with a sleight of hand, which has plunged the economy into a tailspin. In an economy in which over 96% of the transactions are carried out in cash, such a chaos is inevitable. As regards the policy mix, clearly demonetization of the type undertaken is neither necessary nor sufficient. First, the policy will not impact the incentives for, not deter, the earning of illegal incomes and evasion of taxes. The principal sources of the black economy in activities like political funding and election expenses, real estate transactions, construction and bureaucratic corruption will continue. Second, the stock of black economy does not get affected much for, only a small portion of black money is held in currency.

It is obvious that the shock therapy of such a magnitude cannot be implemented by the banking system. Over 30% of the people employed in India are casual laborers who receive their wages and pay for their purchases in cash, and they have been put to severe hardships. With trade, tourism and construction activity coming to a standstill and with agricultural sectors requiring but unable to get cash for purchasing seeds and fertilizers at a time when rabi sowing is on, the GDP in the economy will decelerate significantly.

*M. Govind Rao (Former Member, 14<sup>th</sup> Finance Commission; & Professor Emeritus, National Institute of Public Finance and Policy, New Delhi).*

## VII. IMPACT OF DEMONETIZATION

Demonetization undoubtedly affects many sectors and most important is the common man of the country. It has both positive and negative impact on one or the other sector of our country. Being a commerce student we need to check its impact on our economy on large scale. Its impact is felt by every Indian citizen. Demonetization affects the economy through the liquidity side. Nearly 86% of the currency of the currency value in circulation was withdrawn without replacing bulk of it. As a result of the withdrawal of 500 and 1000 Rs notes, there occurred huge gap in the currency composition as after ₹100; ₹2000 is the only denomination.

Demonetization is literally a liquidity shock; a sudden stop in terms of currency availability. It creates a situation

where lack of currencies jams consumption, investment, production; employment etc. in this context they exercise may produce following short term/ long term/ consumption/ investment, welfare/ growth impacts on Indian economy. The intensity of demonetization affects clearly depends upon the duration of the liquidity shocks. Following are the main impacts:

*Liquidity crunch (short term effect):*-Liquidity shocks means people are not able to get sufficient volume of popular denomination specially Rs 500. This currency unit is the favourable denomination in daily life. It constituted to nearly 49% of the previous currency supply in terms of value. Higher the time required to resupply Rs 500 notes, higher will be the duration of liquidity crunch. Current reports indicate that all security printing presses can print only 200 million units of Rs 500 notes by the end of 2016. Nearly 16000 mn Rs 500 notes were in circulation as on end March 2016. Some portions of these were filled by new Rs 2000 notes. Towards the end of March approximately 10000 million units will be printed and replaced. All these indicate that currency crunch will be in our economy for the next 4 months.

*Welfare loss for the currency using population:*-Most active segments of the population who constitute the 'base of the pyramid' use currency to meet their transactions. The daily wage earners, other labourers, small traders etc., who reside out of the formal economy uses cash frequently. These sections will lose income in the absence of liquid cash. Cash stringency will compel firm to reduce labour cost and thus reduces income to the poor working class.

*Consumption will be hit:*-When liquidity shortage strikes, it is consumption that is going to be adversely affected first

*Loss of growth momentum:*-India risks its position of being the fastest growing largest economy: reduced consumption, income, investment etc. may reduce India's GDP growth as the liquidity impact itself may last three four months.

*Impact on bank deposits and interest rates:*-Deposits in short term may rise, but in the long term, its affect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. It is not necessary that demonetization will produce big savings in the banking system in the medium terms. Most of the savings are obtained biggie public sector banks like the SBI. They may reduce interest rate in the short/ medium, term. But they can't follow it in the long term.

*Impact on black money:*-Only a small portion of black money is actually stored in the ford of cash. Usually, black money is kept in the form of physical assets like gold, land, buildings etc. hence the amount of black money demonetization depends upon the amount of black money held in the form of cash and it will be smaller than expected. People are now much convinced about the need to fight black money. Such as nationwide awareness and

urge will encourage the government to come out with even strong measures.

*Impact on the counterfeit currency:*-The real impact will be on counterfeit/ fake currency as its circulation will be checked after these exercises.

Demonetisation is not a big disaster like global banking sector crisis of 2007; but at the same time, it will act as liquidity shock that disturbs economic activities. Demonetisation as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn't have the digital transaction culture. Overall economic activities will be dampened in the short term. But the immeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

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#### IX. CASH LESS PAYMENT METHODS

The purpose of demonetization is not only to remove black money but also to encourage cashless payment. Instead of breaking your heads by standing in ATM queue you should adopt a cashless method for the transaction. A cashless method is more transparent as every transaction can be traced easily as it leaves its footprints. The cash less methods of Payments are:-

1. **Cheque**-The cheque is one of the oldest methods of cashless payment. It is a known method to everyone. In this method, you issue a cheque for the specific amount to someone else. The cheque gets deposited in the respective bank. The bank processes a payment through a clearing house.
2. **Demand Draft**-Demand draft is another rudimentary way of cashless transaction. It is a safest option to receive payment from anyone. Demand draft (DD) never gets defaulted as it is signed by the banker. The disadvantage of DD and cheque is you need to visit a bank in order to deposit cheque and demand draft. The clearance of cheque or DD takes additional time.

3. Online Transfer- NEFT or RTGS-The third simplest method for the cashless transaction is online transfer using NEFT or RTGS. In order to do online money transfer, you need internet banking facility. Online transfer using NEFT or RTGS is comparatively faster than cheque or DD. Online transfer can be done from anywhere using internet facility.

4. Credit Card or Debit Card-Credit card or debit card is another cashless payment method. The usage of credit card and debit card was limited in India. However, usage of credit card and debit card is increasing now. The limitation of this payment method is an availability of swipe card facility (PoS) at merchant end.

5. E-Wallets-E-wallet is next cashless payment option. E-wallet can be used to purchase products starting from grocery to airline tickets. In order to use E-wallets customer and merchant, both require a Smartphone with active internet connection. The most popular example of E-wallet is PayPal. Apart from PayPal, you can also use Payoneer, Transferwise, Skrill, and PayZa. After registering for E-wallet you need to link your credit card or debit card with your E-wallet id. You can use e-wallet for fund transfer or online shopping. It is a simplest cashless method.

6. Mobile Wallets-The next cashless payment method is a mobile wallet. You do not need a debit card, credit card or internet banking password for making payment using a mobile wallet. Just load money in your wallet via IMPS and use it on the move. You can download mobile wallet app from play store. Few examples of mobile wallets are Paytm, PayUmoney, Oxigen, Lime, MobiKwik etc.

7. UPI Apps-UPI is a mobile payment system which allows you to do various financial transactions on your smartphone. UPI allows you to send or receive money using virtual payment address without entering bank information. Merchants can enroll with banks to accept payments using UPI. Like in the case of a PoS machine, the merchant would require a current account with a bank to accept UPI payments.

The examples of few UPI Apps are SBI Pay, ICICI Pocket, Axis Pay UPI App, Union Bank UPI App, PNB UPI, PhonePe, TranZapp etc.

8. Gift Card-The next cashless payment method is a gift card. Gift Card is a readymade card and can be purchased from a merchant or from the bank. The gift card is loaded with a fix cash amount you can purchase any item from the specific vendor by using a gift card.

9. Aadhaar Enabled Payment System-Aadhaar Enabled Payment System (AEPS) is one of the best cashless payment methods. AEPS is like Micro ATM it uses smartphone and a finger-print scanner for the transaction. In order to use this facility, it is mandatory to link your Aadhaar card to your bank account. You can use AEPS in order to perform transaction like Aadhar to Aadhar fund transfer, Cash withdrawal, Cash deposit etc.

10. Unstructured Supplementary Service Data-You can use USSD cashless option if you don't have a smartphone or internet connection. Unstructured Supplementary Service Data is mobile banking service. From any mobile phone, you can dial \*99# and use this service. You can do all these

things which are available to a person with smartphone and internet connection. Almost all banks including SBI, ICICI, BOB, Axis Bank and PNB supports USSD payment option.

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