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AN ANALYSIS OF DEMONETIZATION (8TH NOVEMBER 2016) AFTER TWO YEARS- WITHOUT ANY PREJUDICE

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ABSTRACT

The RBI act empowers the central government to demonetise any series of bank notes, but the government can take this decision only on the recommendation of RBI (the monetary authority of India). The government and RBI in consultation took the decision to demonetise 86 percent of India's cash in circulation (500 and 1000 rupee bank notes) to tackle endemic corruption and counterfeits used by terrorist and other anti- social groups. Parallel economy could be named as black, unaccounted, illegal unsanctioned economy and its impact are loss of revenue to the state exchequer, consumption of non essential items, investments in unproductive channels like jewellery, bullion, real estate, luxury housing and transfer of funds from India through violation of foreign exchange rules and regulations is an outcome of corruption. The main objective of this paper is to examine the impact of this step exactly after two years, on Indian Economy through an analysis of secondary data. According to the annual report for 2017-18 of RBI, 99.3 percent of demonetised currency has come back to the banking system slightly more than one third of the total currency in circulation was in Demonetization greater than Rs. 500 at the end of March 2018, which is nearly the same as the corresponding values in March 2015 and 2016, the last two years before Demonetization. The share of currency in Demonetization greater than Rs. 500 has been more than halved in March 2018, compared to what it was in March 2016. This is basically the result of Rs. 2,000 notes replacing Rs. 1,000 notes. It means things have drastically changed in volume. The supply of currency both in value and volume terms has increased compared to what it was before Demonetization. India still does much worse compared to very small countries in Human Development Index. This paper has examined the overall impact.

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INTRODUCTION

After the dawn of Independence in the year 1947, the basic problem was rehabilitation of refugees from their own country and breaking the vicious circles of poverty in order to put the economy on the road leading to growth and development. The determinants of economic growth are generally classified into two parts – economic and non-economic (both are equally important). Economic factors are natural and human resources, capital formation, technology, scientific resources, innovations, skills and enterprise, while non-economic factors are social institutions and psychological factors, political stability, strong and efficient administrative set up, moral and ethical values.

In 1948, Dr SP Mukhrjee (the then Industry Minister G.O.I) gave a model of mixed economy that is co existence of both private and public sectors under a common economic plan. The idea was to gain the merit of both the modes of economic systems that is capitalistic as well as socialistic. With the success story of economic planning in USSR India also moved on the path of planned programme of economic development by launching a series of five year plans with an objective of establishing a socialistic pattern of society. Private sector was neither capable nor willing to undertake the creation of social and economic overheads in order to motivate direct productive activities. Huge amount of capital and a sophisticated technology were required for these projects having long gestation period. Thus public sector gained the commanding heights in the economy without proving its accountability and transparency. The magnitude of black sector in the form of a

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parallel economy developed and it has become a source of power and prestige linked with conspicuous consumption. A shift in emphasis was observed in the year 1991, when we adopted a series of economic reforms in the name of Liberalisation, Privatisation and Globalisation (LPG). Late in the evening of November 8, 2016, Prime Minister Narendra Modi announced that old Rs. 500 and Rs. 1,000 bank notes would cease to be legal tender from midnight the same day, rendering worthless 86% of the currency in circulation by value. The move aimed at unearthing untaxed income, weeding out fake currency and curbing terrorist finance, led to cash crunch that lasted months. The worst hit by Demonetization were the poorest of the poor, forced to queue for days to exchange their meagre savings. More than a hundred and twenty died in those queues. Millions of small and medium businesses were smashed and entire informal sector devastated.

Literature Review

There are two school of thought- one given by the classical economist and father of Economics in his masterpiece contribution 'Wealth of Nations' published in the year 1776- there should be no state intervention of any kind in order to have a smooth functioning of an economy. There was an automatic system of built-in flexibility to maintain the position of equilibrium at the point of full employment. The basic objective was maximisation of wealth. Under the capitalist mode of system, a surplus is generated by the labour and it is appropriated by the capitalists. Society is divided into two groups: Haves and have nots. Socialistic system is an outcome of the consequences of the capitalistic mode of system. Under this system resources of the economy are owned, directed and managed by the state under the guidance and control of a planning authority. Private property and law of inheritance both are missing under this system. Both the systems have their own merits and demerits. But both left and right feet are necessary for walking. That is why the India adopted a model of mixed economy but public sector gained commanding heights in the economy. With the expansion of economic activities, magnitude of black sector has grown and formed a new class- neo rich. The conspicuous consumption of neo-rich, their vulgar display of pomp and opulence, their unlimited accessibility to finance, their nest eggs in various places and countries, their importance in important places, all these are well known. That is why several attempts have been made to quantify black incomes in India by setting up various committees and commissions. According to Wenchoo committee "It is... no exaggeration to say that black money is like a cancerous growth in the country's economy which if not checked in time is sure to lead to its ruination".

Main Theme

In 2014, the Lok Sabha election was mainly fought on the issue of corruption and development. Under the leadership of Shri Narendra Modi, the new government was formed at the centre, who promised that black money slashed abroad would be brought back within 100 days of coming to power. So far as estimates about black money slashed abroad, some place it was 10 percent of GDP, while some other says it was equal to 100 percent of GDP. CBI placed this figure at 500 billion dollar, the US based financial integrity estimate 440 billion dollar. But it was promised that each Indian would get of Rs. 15 lakh.

Since Independence, a number of measures have been taken by the govt. to unearth black incomes.

- To check tax evasion based on the recommendations of various commissions and committees.
- Voluntary Disclosure scheme floated by the government.
- Special Bearer Bond Scheme.
- Demonetization attempt in 1978, of high denomination notes (Rs. 1,000, Rs. 500 and Rs. 10,000).

Notes tendered to RBI amounted to Rs. 125 crore as per data available till august 1981. Demonetization failed because it could not make a dent on unearthing black money. Only a very small proportion of total notes in circulation were demonetised (11 percent only). Indian economy and its tax base have long been hobbled by a parallel economy running on cash hoarded by people, avoiding paying taxes. Use of illicit money is so prevalent that raids on dishonest politicians and businesses regularly turn up people holding crore of rupees in cash, sometimes slashed away in false ceilings and walls. Much of illicit money in India is believed to be used in real estate purchases. A substantial amount of black money is secreted away to account overseas. Fake notes were also a major concern for India, because 250 of every one million bank notes in circulation were fake.

Objective of Demonetization (8th Nov. 2016)

'The ban will help to choke the flow of counterfeit high value bank notes militant groups use to fund their attacks against the country enemies from across the border have run their operations using fake currency notes'. Total value of currency notes in circulation in March 2016 = Rs. 16,415 billion = 47.8% of Rs. 500 + 38.6% of Rs. 1,000 + 9.6% of Rs. 100 + 1.2 % of Rs. 50 + .6 % of Rs. 20 + 1.9 % of Rs. 10 + .3 % of Rs.2 and Rs.5 = 86.4 % of Rs. 500 and Rs. 1,000.

Objectives

The main objective of this paper are as follows:

- To examine the impact on the national economy.
- To examine whether the purpose of Demonetization could be fulfilled.
- To analyse the management aspect of Demonetization.

MATERIALS AND METHODS

This paper is based on secondary data taken from authentic and standard sources like various issues of Economic surveys, Annual Reports of RBI, Research papers published in standard national and international journal of repute, daily news paper etc. Analysis of different objectives has been carried out in this paper.

Objective-1

Mr. Modi pitched his decision of Demonetization as a moral cleansing of society, puritanical zeal that saw the PM making an emotional appeal to the nation to give him just 50 days to set the black economy right. The Reserve Bank of India released its annual report for 2017-18 on August 29,2018. That 79.3% of demonetised currency has come back into the

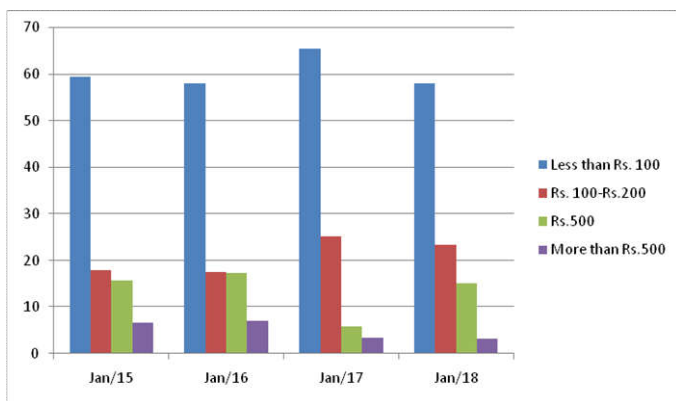
banking system. It was already known that most demonetised currency had come back to the banking system. Slightly more than one-third of the total currency in circulation was in denominations greater than Rs. 500 at the end of March 2018, which is nearly the same as the corresponding pending values in March 2015 and 2016, the last two years before Demonetization. However things have changed drastically in terms of volume. The share of currency both in value and volume terms has increased compared to what it was before Demonetization. A person conducting a retail cash transaction above Rs. 500 in the pre-Demonetization period would have needed a lesser amount in change than he/she would in the post Demonetization world. The reason being, a person will now have to get a Rs. 2,000 note.

Table 1. Volume (Million Pieces)

Year	Less than Rs. 100	Rs. 100-Rs.200	Rs.500	More than Rs.500
March 2015	59.6	18	15.7	6.7
March 2016	58.1	17.5	17.4	7.0
March 2017	65.6	25.2	5.9	3.4
March 2018	58.0	23.5	15.1	3.3

Daily HT, August 31, 2018 p.12 (Number Theory)

Volume (Million Pieces)



Growth in number of tax returns and income shows in ITRs in the upto Rs. 5 lakh annual non-salary income category suffered a big deceleration.

Table 2. Income Growth of Non-Salary earners with income upto Rs.5lakh slowed down significantly the year of Demonetization (Growth Percentage YOY)

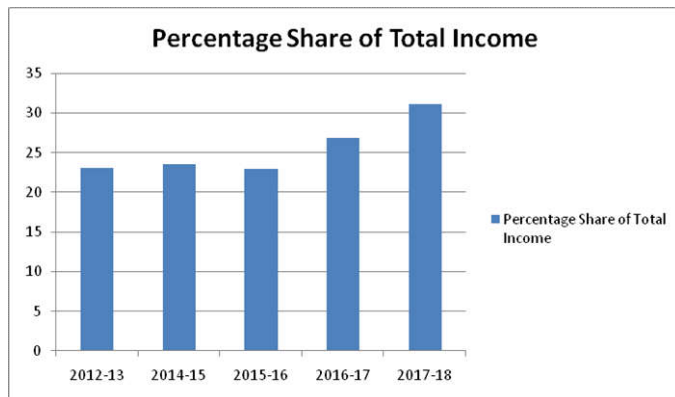
Year	Up to Rs. 5 lakh	5 lakh-10 lakh	10 lakh-25 lakh	25 lakh-50 Lakh	50 lakh-1 crore	1 Crore and more
2013-14	11	21	32	15	Negative	7
2014-15	12	18	17	15	Negative	6
2015-16	28	20	9	13	44	33
2016-17	10	52	44	40	22	24

Table 3. Percentage Share of Total Income reported in ITR in Gross Value Added

Year	Percentage Share of Total Income
2012-13	23
2014-15	23.5
2015-16	22.9
2016-17	26.8
2017-18	31.1

Daily HT, October 24, 2018 p.+1 (Number Theory)

Thus note ban helped to formalise economy but it led to a slowdown in small business' income growth.



Impact on Villages

Two years after Demonetization was announced the big impact seems to have been on rural India in two ways:

The relative erosion of rural agriculture wages and the fall in bargaining power of farmers in receiving at attractive price for their produce. Farmers and rural workers are unhappy. Two set of statistics ratio of agricultural and new agricultural wages and difference between rural and urban food and non-food inflation support this. This has contributed to farm distress.

Table 4. Relative Erosion of Agriculture Wages

Date	Ratio
September 2003	.77
December 2013	.89
January 2018	.86

Food Inflation comes down sharply. But non –food inflation did not fall.

Table 5. CPI Food Annual Growth in Percentage

Date	Urban	Rural
March 2012	4.29	5.17
December 2013	15.24	14.46
December 2016	1.74	3.31
June 2017	.47	.20
September 2018	.24	1.79

Table 6. Non- Food Inflation Annual Growth in Percentage

Date	Urban	Rural
March 2012	9.54	11.50
December 2016	3.55	5.47
September 2018	6.12	5.88

Source- Daily HT, Nov. 07, 2018, p15 (Number Theory)

The bargaining power of farmers has almost low, but Demonetization amplified it. Medium of small and medium businesses smashed and entire informal sector devastated.

Objective–2

Demonetization did not put an end to generate or use of black money and also did not put an end to fake currency. On the contrary counterfeits have successfully counterfeited the new Rs. 2,000 and new Rs. 500 notes. This step did not render any currency notes worth less and the govt. did not reap a bonanza of Rs. 3 lakh to Rs. 4lakh Crore. All the demonetised notes-actually 99.3 percent were returned to the RBI. Practically every Single currency note was officially exchanged at bank

counters. Thus the objectives behind this move could not be fulfilled.

Objective-3

The economic survey 2016-17, acknowledged that Demonetization had influenced the economy in short run and caused inconvenience, especially to those in the informal and cash intensive sectors of the economy, which have lost both income and employment. The long term benefit as expected are reduced corruption, greater digitisation of the economy, increased flow of financial savings and greater formalisation of economy etc. a yet to be seen. The Gross non – performing assets and that bad debt of public sector banks in particular are very serious issues. No doubt, the number of returns filed and tax being collected has gone up. But direct tax to GDP ratio has hardly increased compared to pre-demonetised period. Inflation growth in Oct. 2018, was 3.31 percent, the lowest since Nov. 2017 and negative food inflation may further worsen agrarian distress. A moderate price rise is always considered as a good news for an expanding economy where investment, output and employment are needed an increasing trend. According to Prof. Arun Kumar (Author of Demonetization and Black economy), the black economy is more than 60 percent of GDP and 10 percent of it had income into tax net, otherwise it would have yielded 2 percent of GDP as addition to Tax collection –(Quoted Arun Kumar – With due respect, Finance minister , Daily Indian Express, November 12. 2018, p.7) Monetary and Fiscal authorities have to manage the affairs effectively. Economic variables are to set in coordination with each other by policy makers and planners.

Conclusion

The statistics released on October 22, 2018, give details about the number of ITR filings and income shown in ITRS by income categories. Hindustan Times (Dated 24-10-2018 p+10) created two broad categories of salary and non salary income. The income inequality pattern has a stark difference among the salaried and non salaried income class. 80percent of total income reported in the former in 2016-17 was from the up to Rs. 25 lakh category, while this share was just 39 percent for non-salaried income. The share of Salaried and non-categories was almost similar in the up to Rs.5 lakh category. 2016-17 was the year of implementation of seventh pay commission recommendations.

It was really difficult to conceal income among the salaried. It clearly shows that Demonetization led to a slow down of small businesses' income growth. Nigeria has a low cash GDP ratio but a big black economy and Japan has a high cash GDP ratio but a small black economy, hence digitalisation does not necessarily check black income generation. Here we may conclude in the words of Prof. Kumar, Author of Demonetization and the Black Economy ' , formalisation does not help the reduce the black economy since the informal sector hardly generates any black incomes. Most incomes in this sector are generally below the taxable limits which is rather high in India at three times the per capita income. (Daily Indian Express November 12, 2018 P.7). Former chief economic advisor Arvind Subarmanian in his forth coming book has called demonetization a massive draconian, mentary shock.... and also bats for the RBI deploying part of excess capital of Rs. 4.5-7 trillion in recapitalising public sector banks. (Daily Hindustan Times, 30th November 2012, p.+1)

Endnotes

1. Daily HT, August 31, 2018, P -12 (Number Theory)
2. Daily HT, October 24,2018, P -+1 (Number Theory)
3. Daily HT, Nov. 07, 2018, P -15 (Number Theory)
4. Daily Indian Express November 12, 2018, P-7
5. Daily Hindustan Times, 30th November 2012, P - +1

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