



AN ASSESSMENT OF DEMONETIZATION

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Abstract:

Demonetization is the process of replacing the current currency from the economy with the new one. It is the step taken by the national Government generally to wipe out corruption and black money. This study is an attempt to assess the efficiency of demonetization introduced by union government. Demonetisation which was announced on November 8, 2016 was meant to address corruption, black money, counterfeit currency and terror funding. This analysis shows that demonetisation impacted many sectors of the economy in different degrees; however, in the affected sectors, the undesirable impact was temporary and felt mainly in November and December 2016. Currency compress due to demonetisation along with seasonal factors had brought food inflation considerably down but has not had much impact on inflation excluding food and fuel. A rush in deposits led to a sharp growth in the consolidated balance sheet of scheduled commercial banks and shaped large surplus liquidity conditions. Reserve Bank of India managed these through a mix of conventional and unconventional policy measures. There had not been any significant impact on the external sector. There had been a spike in the number of accounts under the Pradhan Mantri Jan Dhan Yojana and the deposits in such accounts had also surged. An important consequence of demonetisation had been the sharp increase in the use of digital transactions.

Key Words: Demonetization, Corruption, Black Money, Counterfeit Currency & Digital Transactions Etc

Introduction:

Demonetization is the process in which the current currency is replaced with the new one. Generally this is introduced to wipe out black money and corruption, to check counterfeit currency and to promote digital transaction. Not only India but Nigeria, Ghana, Soviet union, Myanmar and North Korea have also gone through process of Demonetization in the past decades.

History of Demonetization in India:

India has gone through the process of demonetization three times. In 1946, In 1978 and now currently in 2016 India went through demonetization. In 1946 notes of rupees 1000 and rupees 10000 were withdrawn from circulation. Janta party coalition government again demonetized notes of rupees 1000, 5000 and 10000 in 1978. And now current Modi regime demonetized notes of rupees 500 and 1000 in 2016. Government introduced new notes of rupees 500 and rupees 2000 to replace demonetized notes.

Rationale behind Demonetization in India:

On 8th of Nov 2016 prime minister of India decided to demonetise high value currency notes of 1000 and 500. Such notes constituted nearly 87 percent of the value of total currency in the circulation. The decision was taken by the government of India to eliminate corruption and black money, counterfeit currency and terror finance. The decision was also guided by the endeavour of reaping its huge potential medium-term profits in the shape of reduced corruption, superior digitisation of the economy, augmented flow of financial savings and bigger formalisation of the economy. There was also an aim that this would lead to higher GDP growth and larger tax revenues in the long run.

Rs 500 and Rs 1,000 banknotes in circulation						
Denomination (Rs)	Volume (crore pieces)			Value (Rs lakh crore)		
	Mar-14	Mar-15	Mar-16	Mar-14	Mar-15	Mar-16
500	1141	1313	1571	5.7	6.6	7.9
(% share)	14.7	15.7	17.4	44.4	45.9	47.8
1,000	508	561	633	5.1	5.6	6.3
(% share)	6.6	6.7	7.0	39.6	39.3	38.5
500 and 1000 together	1649	1874	2203	10.8	12.2	14.2
(% share)	21.3	22.4	24.4	84.1	85.2	86.4
Total of all notes	7733	8358	9027	12.8	14.3	16.4
Source: RBI						

Effects of Demonetization: An analysis Growth

It was very much expected that gross value added would be impacted by the liquidity shock that is due to limited access to currency as a medium of exchange. There was a decline in demand due to shortage of cash to make payments and production activities were also disrupted due to unavailability of cash in unorganised sector were payments are mostly paid in Cash. This ultimately led to fall in consumption demand. The wealth effect was another medium through which demonetisation impacted economic activities. Vitaly, Quarter third growth (at 6.6 per cent) was only slightly lower than that recorded in quarter two (6.7 per cent), thus suggesting that demonetisation had only a meek brunt on growth in Q3 of 2016-17.

Inflation:

The food inflation was stemmed moderately due to demonetisation though inflation excluding food and fuel remained unaffected. Food inflation decreased from 3.7 per cent in October 2016 to 2.6 per cent in November, to 2.0 per cent in December and then to 1.3 per cent in January 2017. This was largely on account of vegetables and pulses. Vegetable prices decreased by 6.2 per cent on a month-on-month basis in November 2016 and then by 11.7 per cent in December 2016.

Effect on Financial Sector:

Change in Currency Demand:

There had been a noteworthy change in the income elasticity of currency demand in the post-demonetisation period to 0.9 from more than 1 in the pre demonetisation period, showing a reduction in cash intensity in retail transactions.

Uncovering of Suspicious Transactions:

The amount of abnormal cash deposits in exceptional types of accounts (such as the Basic Saving Bank Deposit, PMJDY, Kisan Credit Card (KCC), loan accounts and the like) was approximate in the range of `1.6-1.7 trillion.

Improved Monetary Transmission:

In a situation of a rush in low-cost current account and saving account (CASA) deposits, banks had announced a huge cut in their marginal cost of funds based lending rates (MCLR) with a 100 basis points (bps) reduction in the 1-year MCLR.

Other Impacts:

Increase in tax net: nearly 18 lakh additional tax payers have been added in the tax net since prime minister introduced the demonetization.

Conclusion:

Demonetization was brought with a noble aim to eliminate corruption, black money, counterfeit currency and terrorism. The silent aims were to increase digital transactions and increase in tax bracket. RBI said that almost all of the banned 500- and 1,000-rupee notes were deposited or exchanged in its annual report. This means that to discover the black money investigating authorities has a task cut out in their hands. So corruption and black money elimination goal has not been achieved to the extent it desired of the dividends of RBI had also fallen by around 53 percent year after demonetization. But not all is lost, The demonetization has had secondary advantages of encouraging higher due diligence, spread of tax base and the boosting of digital payments.

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