

FIVE YEARS OF DEMONETIZATION

CONTEXT: On 8th November 2021, the Government celebrated 5th anniversary of Demonetization.

WHAT IS DEMONETIZATION?

Money is a medium of exchange. That currency or coin which is legally accepted as a medium of exchange is known as **Legal Tender Money**.

If the Central Bank of a country or a central government withdraws this legal support for legitimacy associated with a particular denomination, currency note or coin, then it is termed as **Demonetization**.

Demonetization done by the central bank of a country is a common phenomenon but demonetization done by the government of a country has been seen in India only thrice:

- In 1946- after British Government ended.
- Late 1970s- Morarji Desai withdraws Rs. 10,000 denominations.
- 8th November 2016- Rs. 500 and Rs. 1000 denomination.

However, the nature and purpose of the process of demonetization done in 2016 was different from the earlier ones.

Clause 26(2) of RBI Act 1934 authorizes even the central government to withdraw its guarantee from any denomination note.

AIM OF DEMONETIZATION IN INDIA

The officially declared objectives of demonetization were as follows:

- **To curb black money:** Indian economy was laden with black money and government want to neutralize its effects.
- **To curb corruption:** extra money lying inside the homes and other places should be come out.
- **To eliminate fake/counterfeit currency notes:** fake currency notes were in circulation and people were using it freely in the economic system.
- **To prevent terror financing:** Many intelligence reports suggested that Pakistan and China were financing terrorists through printing Indian fake currencies.

Other than the officially declared objectives of demonetization this process might fulfill some additional objectives. If the certain part of currency notes lying in the economy in the form of 500 rupee note and 1000 rupee note fails to come back to the RBI then the liability of the RBI will come down to the same extent.

SUCCESS OF DEMONETIZATION:

- **Demonetization encouraged Cash-less transactions:** when transactions are conducted in a cashless manner it becomes easier to track the movement of money from one hand to another.
- **Loan became cheaper:** the money lying at home or being hoarded doesn't contribute to the economy. However, after demonetization, the liquidity in the banking system increased making availability of loan cheaper. In longer run this will enhance consumption and investment.

- **Increased tax collection:** in the financial year 2017, The tax receipt of the government increased by 18%. Central Excise went up by 33.9%, Service Tax collection increased by 20.2%.
- **Increased tax base:** a sharp jump in filing of IT returns was witnessed. Advanced personal income tax collection increased by 41.7%
- **Tackling black money:** 1.8 million bank accounts were identified in which the cash deposit was not in line with the income shown by them in previous years. Thousands of shell corporations were identified which were used to launder black money.
- **Tackling organized crimes:** crimes like terrorism, sex trafficking, drug trafficking has shown sharp decline after demonetization due to cash crunch.

FAILURES OF DEMONETIZATION

- In India, **more than 86% of the total employment is in unorganized sector and MSMEs.** It is mainly cash driven sector. Sudden outflow of cash from the economy adversely affected this sector.
- Demonetization not only **affected the production** in the organized sector but also **affected the employment.**
- It had immediate impact over the GDP of the country. Demonetization caused a **reduction of 1.5% in the Indian GDP.**
- It had also resulted in sudden increase in **burden over the banking system.**
- A large section of the society is still not connected with the banking system which made **difficult for them to deposit the old currency.**
- The **RBI failed to ensure availability of sufficient cash** in the rural and interior part leading to extreme decline in liquidity.
- The cash in circulation is now higher than it was five years ago. We now have about **₹28.5 trillion in cash** floating around, compared to about **₹18 trillion at that time.**
- Introduction of the currency note with denomination of 2000 will encourage its hoarding in future. Hence even it should be demonetized as soon as possible.
- Objective of black money and fake currencies was not fulfilled as expected. Out of **15.41 lakh crore rupees, 15.31 lakh crore rupees came back to the RBI.**
- Number of casualties due to long queue and stampede cannot be counted in terms of monetary value.

ROLE OF AGENCIES DURING DEMONETIZATION

When the decision of such magnitude is taken, the government agencies should be well prepared beforehand. In this case, the responsibility was of RBI and Income Tax Department.

RBI had not made proper arrangements of such massive decision. There was a cash crunch in the economy. Currency notes of smaller denominations were not even available and the 2000 note was not easily breakable. Most of the ATMs were running out of cash. Bank employees were working day and night only because of sudden decision and lack of arrangements.

When people were depositing their extra lying cash in bank accounts, many account numbers have gone up but we didn't see any action or inquiry taken against them. Banks were keeping every record of the transactions but the Income Tax Department didn't take responsibility to initiate the inquiry against the holders.

COMBINED IMPACT OF DEMONETIZATION, GST AND COVID PANDEMIC

When demonetization took place, a sudden cash crunch was witnessed in the economy. The informal and MSME sector suffered the most of it because it is heavily cash dependent sector. Production came down and unemployment raised sharply.

After demonetization, introduction of Goods and Services Tax was another setback for this industry. The economic sectors which dependent on cash transactions were already in deep trouble. The GST brought the rest of the MSME sector, which is less cash dependent, into trouble as well.

The pandemic effect was kind of a bonus to the already dwindling economy. The informal sector had clearly not recovered and the pandemic added to the problem. The lockdown led to all businesses, formal and informal, being shut. Now, since the informal sector doesn't have a lot of reserves to be able to last out two months of lockdown, a lot of businesses closed down.

FUTURE LESSONS FROM DEMONETIZATION

Few lesson that can be learnt from the demonetization exercise are:

- Before taking any major decision, one should not miss the advice of Experts.
- Proper assessment of pros - cons needs to be done before taking any massive decision.
- Human Behaviour should be considered. In case of India, where people revolve around laws and regulations, decision has to be taken that should impact everyone. 99% currency returned back. This shows people found loopholes in the law and invested simultaneously.
- The government agencies should do proper homework before taking steps.

SOURCES:

- **INDIAN ECONOMY BY RAMESH SINGH**
- **INVESTOPEDIA**
- **MONEY CONTROL**
- **RBI WEBSITE**

