

# Contemporary Economic Issues in India

Volume -1

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DAVANGERE

UNIVERSITY

Jnanagangotri, Chitradurga  
Department of Economics

## *Contemporary Economic Issues in India*

(Volume-I)

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***Contemporary Economic Issues in India***

**(Volume-I)**

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# A STUDY ON SOCIO ECONOMIC EFFECT OF DEMONETIZATION IN INDIA

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## ABSTRACT

*India has amongst the highest level of currencies in circulation at 12.1% of GDP. Cash on hand is an estimated at around 3.2% of household assets, higher than investment in equities, or roughly around \$ 220 billion. Of this cash, 87% is in the form of Rs 500 and Rs 1,000 notes or roughly Rs 14 Lakh crore (\$190 billion). Demonetization is a process by which a series of currency will not be legal tender. The series of currency will not be acceptable as valid currency. The demonetization was done in Nov 2016 in as an effort to stop counterfeiting of the current currency notes allegedly used for funding terrorism, as well as a crackdown on black money in the country. Demonetization is a generations' memorable experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. Demonetization affects the economy through the liquidity side. Its effect will be a telling one because nearly 86% of currency value in circulation was withdrawn without replacing bulk of it. As a result of the withdrawal of Rs 500 and Rs 1000 notes, there occurred huge gap in the currency composition as after Rs 100; Rs 2000 is the only denomination*

**Key Words-** *Demonetizations of Currency Notes, Social impact and Economic impact*

## Introduction

On November 8, 2017 Indian Prime Minister Mr. Narendra Modi took a historic decision by announcing that the high-denomination notes (Rs 500 and Rs 1,000) then in circulation would cease to be legal tender. With demonetization effort 86% of India's currency was nullified that aimed to wash the stock of 'black market's cash supply' and counterfeit notes out of the economy and convert it into the licit, banked and taxable, part of the economy. To reduce the impact of sudden commercial collapse, a 50 day period ensued where the population could (ideally) exchange their canceled cash for newly designed 500 and 2,000 rupee notes or deposit them into bank accounts. This move is expected to cleanse the formal economic system and discard black money from the same. The reasons of it are as under: To tackle black money in the economy; To lower the cash circulation in the country which is directly related to corruption in our country; To eliminate fake currency and dishonest funds which have been used by terror groups to fund terrorism in India

The sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. Rs 1,000 and higher denomination notes were first demonetized in January 1946 and again in 1978. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data. Rs 1,000 and Rs 10,000 bank notes were in circulation prior to January 1946. Higher denomination banknotes of Rs 1,000, Rs 5,000



and Rs 10,000 were reintroduced in 1954 and all of them were demonetized in January 1978.

### **Objectives of the Study:**

- A. To study the importance of Demonetization
- B. To analyze the impact of Demonetization on Social sector.
- C. To analyze the impact of Demonetization on economic sector.

### **Methodology or Data Source:**

This paper is based on secondary information collected from different sources such as books, journal articles, reports of various government organization and commission, articles, newspapers etc.

### **Importance of Demonetization:**

The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks. As this was a major economic movement so most of the Current citizen was not aware of the after effects and they did not have any knowledge to what to do what the money. The demonetization is very important to everyone. Everyone got affected by this he/she might be a business man, salaried, housewife, students, working professionals, politicians etc. Financial corruption shatters down the economic, social as well as the political stability of a country. As per reports, the financial corruption major involved the currency notes of bigger denominations. Hence, the outcome of demonetization of Rs 500 and 1000 currency notes is expected to put an end to such practices. In the last few years, terrorists from the neighboring countries had been consistent to wreck the financial stability of India by introducing fake currency notes to the market. These evil forces mainly used to forge the currency notes of Rs. 500 and Rs. 1000 and the introduction of the new series currency notes have put an end to such practices. As per the reports generated in last one month's time after demonetization, the peril of fake currency note has been overcome. This had strengthened the economy of the country.

### **A move towards a cashless economic framework:**

Cash transactions were another tool for unscrupulous parties to refrain from paying the necessary taxes and duties. The call for demonetization will make the Indian economy to embrace the plastic money to a higher extent. This will bring more transactions in the market under the supervision of the government.

According to an estimate by State Bank of India, out of Rs 12 Lakh crores in the cash economy, Rs 3 Lakh crores may never come back into the system. So, this will be the monetary surplus in the Reserve Bank of India. Out of the Rs 12 Lakh crores that comes in, the government should get substantial tax revenue of about Rs 2 Lakh crores. This should have far-reaching consequences on the Indian growth story. But if Rs 5 Lakh cores come into the banking system, because of the fractional reserves basis, this Rs 5 lakh crores can become Rs 20 Lakh crores. Let us assume Rs 100 is deposited in a bank. About one quarter of the amount will be invested in government bonds and reserves. The remaining 75 per cent will be available for lending. This 75 per cent gets into the banking system. Our study



estimate is, that at a minimum, the banking system multiplies the money in the system by three or four times. Money creations by banks will increase prosperity. The black or the cash economy therefore is inefficient in using money this way.

### **Social Impact:**

The information on demonetization was released suddenly and the worst affected was the common man. The social impact was drastic with marriages facing severe issues with cash transactions in marriages coming to a standstill. People conducting marriages must produce the marriage invitation to withdraw 2, 50,000 and above. This has caused great hassles among the public.

The impact on the health care sector was huge with most of the hospitals refused to accept the old currency. The issue was faced by the Union Minister Mr. Sidharamaiah in Bengaluru when the hospital administration refused to accept the old currency to retrieve his brother's dead body. The common man faced severe issues transacting in the hospitals with old currencies and several cases of death have been registered for not attending the patients due to demonetization.

During the demonetization long que of 1 to 2 kilometer was seen in several parts. Despite of that it was not guarantee the one will get money from the ATM or bank. Some people start moving to the bank from the last night. There was a severe shortage of cash. The demonetization has a positive impact on the common people that now they the use of digital currencies got increased. So the people no need to carry physical currencies to any places which also reduced the crime rate. The price of some of the important commodities got decreased.

### **Economic Impact**

Demonetization is viewed as a measure of sterilizing the money. RBI plays the pivotal role in this demonetization drive. All the banking experts welcome this demonetization measure. Considering the banking sector, both public and private sector banks are facing the severe issue of Non-Performing Assets (NPA) or Bad loans to the tune of 10 lac crore including the stressed assets according to RBI sources. This demonetization measure will help banks to recover some bad loans and improve their financial position.

Considering the entire economy of India as a whole, demonetization will make most of the transactions to be done through the formal banking sector. This will increase the transparency with people and corporate paying tax properly. Income Tax department has reported that only 4 percent of the individuals pay income tax while this figure has to be increased to 28 percent. The demonetization will help achieve this target of the Income tax department.

The RBI has CPI growth targets to adhere to while deciding its monetary policy stance. By January 2016, it was supposed to keep inflation below a target of 6%, which it was able to do. Its next target is to keep inflation at or below the 5% mark by March 2017.

## Conclusion

The impact of demonetization was felt more in the social sector and the worst affected was also the poor and the common people. Salaried class is not still able to withdraw their salaries from the banks and ATMs as a result of cash deficit. Prime Minister Modi has encouraged doing financial transactions using mobile and other electronic means. It is clearly evident that India is moving towards cash less economy. This will curb the black money to a great extent but educating the masses on the mobile based money transaction is a huge challenge. Finally as a relief to poor people, GOI has announced that black money retrieved from the demonetization measure will be deposited for four years without interest on Kalyan Yojana to benefit the poor in marriage. This will create a positive impact on the social sector in the long run.

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