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**Demonetization in Indian: An Analysis**

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## Demonetization in Indian: An Analysis

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### Introduction:

Honorable Prime Minister of India, Narendra Modi was made announcement of demonetization of large currency in an unscheduled live televised address on 8 November 2016. In his announcement, he declared that use of all ₹ 500 and ₹ 1,000 banknotes would be invalid after midnight of that day, the two biggest denomination notes and announced the issuance of new ₹ 500 and ₹ 2000 banknotes in exchange for the old banknotes. The goal of government behind demonetization decision was to eradicate counterfeit currency, fight tax evasion, eliminate black money gotten from money laundering and terrorist financing activities, and promote a cashless economy. Honorable Prime Minister was appeal to people for adjust with inadequate currency till next fifty days and people was given positive response to Modi's announcement. But people or bank customer from same queue was given their negative reactions after 50 days of demonetization. It is proper time to assess the impact of demonetization on socio-economic and political condition of India.

### Objectives of the Present Study:

Following are the main objectives of the present study.

1. To study the history of demonetization in India.
2. To study the volume of demonetized currency in the economy.
3. To assess the impact of demonetization on Indian economy.

### Research Methodology and Database:

The present study is based on secondary data collected from various sources such as RBI reports and notifications, government announcements, journals and related websites.

### Concept of Demonetization:

Demonetization is the legal act of rendering existing currency notes invalid, and replacing them by new currency notes of same or different denominations. It is a shock therapy intended to destroy accumulated illegal cash and restore the faith of honest taxpaying citizen. Demonetization is the act of stripping a currency unit of its status as legal tender. It is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit.

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## **Demonetization History of World**

World have mixed experience of demonetization, some countries including India have positive and acceptable response from their economies. The countries like Ghana, Soviet Union have negative and adverse impact of demonetization on their economies.

In order to monitor money laundering and corruption, Ghana and Nigeria governments were decided to demonetise their currency notes in 1982 and 1984 respectively. The change was not welcomed warmly, creating chaos in both the countries and finally resulted in a move back to physical assets and foreign currency. Economy of Nigeria was collapsed after demonetization move that did not go as planned. The military government of then President Muhammadu Buhari introduced different coloured notes to invalidate their old currency in order to crack down black money. Military government of Myanmar was demonetized their 80% currency to curb black money in 1987, but the move resulted in a lot of protests and the country witnessed several killings. In 1991, Mikhail Gorbachev (Soviet Union), demonetized the higher denominations of ruble bills, the 50s and 100s. The move did not go well and resulted in takeover of Mikhail's leadership within eight months of the plan. In 2010, economy of North Korea faced demonetization of their currency in, which led to major economy breakdown with people left to starve for basics. Zimbabwe once had hundred trillion dollar note, which was demonetized and was exchanged in a mocking way dropping trillion dollars to \$0.5 dollar. 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 three-month process involved expunging the Zimbabwean dollar from the country's financial system and solidifying the US dollar, Botswana pula, and South African rand as the country's legal tender in a bid to stabilize the economy.

Another example of demonetization occurred when the nations of the European Monetary Union adopted the euro in 2002. In order to switch to the euro, authorities first fixed exchange rates for the varied national currencies into Euros. When the Euro was introduced, the old national currencies were demonetized. However, the old currencies remained convertible into Euros for a while so that a smooth transition through demonetization would be assured. But USA and other top countries never tired to demonetizes their currency.

### **Demonetization in India:**

The Indian rupee (INR) is the official currency of the Republic of India. The RBI manages currency in India and derives its role in currency management on the basis of the RBI Act, 1934. The rupee is named after the silver coin, rupiya, first issued by Sultan Sher Shah Suri in the 16th century and later continued by the Mughal Empire. In 2010, a new symbol '₹' was officially adopted. The first series of coins with the new rupee symbol started in circulation on 8 July 2011.

The sudden move to demonetize Rs 500 and Rs 1,000 currency notes is not new. According to RBI data the highest denomination note ever printed by the RBI was the Rs. 1000

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and Rs 10,000 note in 1938 and all these higher denomination notes were first demonetized in 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. The Rs 500 note came into circulation in October 1987 and Rs 1,000 note made a comeback in November 2000. The move was then justified as attempt to contain the volume of banknotes in circulation due to inflation.

In a major step to check undeclared black money, the GOI on the 8 November 2016 announced demonetization of Rs 500 and Rs1000 banknotes with effect from the same day's midnight, making these notes invalid. The two biggest denomination notes accounted for 86% of the country's cash supply. Apart from combating black money, the stated purpose is also to check fake currency (used to finance terrorism) and corruption. A new redesigned series of Rs500 banknote, in addition to a new denomination of Rs 2000 banknote is in circulation since 10 November 2016.

The total currency in circulation as on end March 31, 2016 was Rs. 16,415 billion of which notes of Rs.1,000 denomination account for 38.6 % (Rs.6,326 billion) and Rs.500 account for 47.8% (Rs.7,854 billion). The importance of Rs.500 has been increasing over the years, from 4.1% on March 31, 1990 to 47.2% on March 31, 2016. Similarly, the share of Rs.1,000 note has increased from 1.7% in 2001 to 38% in 2016. The total amount of Rs. 500 and Rs. 1,000 notes amount to Rs. 14,180 billion as compared with India's national income of Rs.1,35,761 billion in 2015-16 or about 10.5 percent of GDP and 86 percent of total currency.

### **Impact of Demonetization on Indian Economy**

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.

Absence of intermediate denominations like Rs 500 and Rs 1000 will reduce the utility of Rs 2000. Effectively, this will make Rs 2000 less useful as a transaction currency though it can be a store value denomination.

Demonetization technically is 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, the exercise may produce following short term and long term consumption, investment, welfare and growth impacts on Indian economy. The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks. Following are the main impacts.

Liquidity shock means people are not able to get sufficient volume of popular denomination especially Rs 500. This currency unit is the favorable 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 the liquidity crunch. Current reports indicate that all security printing press can print only 2000 million units of RS 500 notes

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by the end of this year. Nearly 16000 million Rs 500 notes were in circulation as on end March 2016. Some portion of this was filled by the new Rs 2000 notes. Towards 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 four months.

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 firms to reduce labour cost and thus reduces income to the poor working class. When liquidity shortage strikes, it is consumption that is going to be adversely affected first. India risks its position of being the fastest growing largest economy- reduced consumption, income and investment etc. may reduce India's GDP growth as the liquidity impact itself may last three -four months.

Deposit in the short term may rise, but in the long term, its effect 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. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the savers when full-fledged new currency supply takes place. This means that new savings with banks is only transitory or short-term deposit. It is not necessary that demonetization will produce big savings in the banking system in the medium term. Most of the savings are obtained by biggie public sector banks like the SBI. They may reduce interest rate in the short or medium term. But they can't follow it in the long term.

Only a small portion of black money is actually stored in the form of cash. According to experts about 400 crore (0.028%) black money is existing in circulation. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. Hence the amount of black money countered by demonetization depends upon the amount of black money held in the form of cash and it will be smaller than expected. But more than anything else, demonetization has a big propaganda effect. People are now much convinced about the need to fight black income. Such a nationwide awareness and urge will encourage government to come out with even strong measures.

The real impact will be on counterfeit or fake currency as its circulation will be checked after this exercise. Demonetization 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.

Agriculture sector contributes 15% to India's total output there cash is the primary mode of transaction. Formal financing in many parts, especially Punjab, Uttar Pradesh, Odisha, Maharashtra, Gujarat and Kerala is significantly from cooperative banks, which are barred from exchange-deposit of demonetized currency. Notably, this is a time of kharif harvest and start of

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rabi sowing, partly explaining why this period is dubbed the 'busy season' from a standpoint of credit demand, the other being bunching of festivals and weddings. Agriculture is impacted through the input-output channels as well as price and output feedback effects. Sale, transport, marketing and distribution of ready produce to wholesale centres or mandis, is dominantly cash-dependent. Disruptions, breaks in the supply chains, feedback to farmers as sales fall, increased wastage of perishables, lower revenues that show up as trade dues instead of cash in hand and when credited into bank accounts with limited access affect the sector.

**Conclusion:** Purchasing power of people is reduced by 80 percent to 90 percent because of unplanned demonetization in the economy. Moreover, vegetable markets and agricultural marketing committees are now closed, share market is also collapsed. There are 1.34 lakhs bank branches and 2.15 lakhs ATMs are in India; everyday 11 crore populations are in queue if 500 people are in queue at a bank or an ATM. It decreased efficiency and working hours of common people in the country. Besides that, new note of Rs. 2000 is available with black money holders and terrorists. Country has loss of Rs. 15 thousand crores to 20 thousand crores which was spent for printing of Rs. 500 and Rs.1000 notes.

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