

Demonetization in India (2016)

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Abstract: *The government of India has demonetized the Rs.500 and Rs.1000 banknotes on November 8,2016 with the purpose of reducing black money and counterfeit currency and terror funding and to go for a formal economy. In this sense, the paper aims to see the reasons, issues, challenges, implementation and impacts of demonetization on Indian economy.*

Keywords: Demonetization, black money, counterfeit currency & terror funding.

Objectives of Study

- To study the concept of Demonetization.
- To study the reasons for Demonetization.
- To study the process of implementation of Demonetization.
- To study the challenges for Demonetization.
- To study the impacts of Demonetization.

Research Methodology

The Research Paper includes the primary and secondary data of RESERVE BANK OF INDIA (RBI) and CENTRAL STATISTICAL ORGANISATION (CSO) in relation to Demonetization. The period which has been taken for this research was from 2015 to 2018.

1. Introduction

Demonetization of a currency simply means that when a value of coin or paper currency loses its legal existence or legal tender status in a country or in an economy.

In other words, it simply means withdrawing few currency notes or coins from economy so as to replace them with a new currency notes or coin.

The larger purpose to make or to go for Demonetization is to reduce black money from the economy and to make the non tax compliant society to a tax compliant society and counterfeit cash to fund terrorism.

So, on a fine morning i.e. 8th November, 2016 the Narendra Modi Government had announced the demonetization of Rs.5,00 and Rs. 1,000 bank notes in India and introduced the new notes of Rs .5,00 and Rs.2,000 in the economy and removes Rs.1,000 banknotes from the economy.

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As Indian economy is a vulnerable system to the impact of illegal activities like black money, corruption & financial crimes etc. Also, the incidence of false banknotes in the

country has increased and due to similarity of these fake notes with original ones, gives birth to many illegal activities like terror funding, smuggling and drug trafficking and also acts as source of corruption.

In order to reduce the risk faced by society in the face of informal economy, it is necessary to eradicate black money and remove counterfeit currency in the economy. So, on a fine morning i.e. 8th November, 2016 the Narendra Modi Government had announced the demonetization of Rs.5,00 and Rs. 1,000 bank notes in India and introduced the new notes of Rs .5,00 and Rs.2,000 in the economy and removes Rs.1,000 banknotes from the economy. In this sense, it was a strategy to eradicate black money, minimize corruption, terror funding, smuggling and drug trafficking and to make the non tax compliant society into tax compliant society and a formal economy.

2. History of Demonetization in India

The demonetization was announced two times in the past i.e. in 1946 and 1978.

In 1946, currency notes of Rs.1000 & Rs.10,000 were removed from the country as the currency was of such higher denomination. But these notes were reintroduced in 1954 with an additional introduction of Rs.5000 notes.

In 1978, the Prime Minister Morarji Desai announced the demonetization of Rs.1000, Rs.5,000 and Rs.10,000 in the country. The aim of demonetization was to curb the black money in the economy.

3. Reasons for Demonetization (2016)

There are major four reasons due to which the Government Of India had announced Demonetization in 2016,

- Black Money
- Non Tax Compliant Society
- Counterfeit Currency
- Terror Funding

a) Black Money

The main motive for demonetization was to curb black money in India i.e. income which had not been reported and untaxed, or income earned through illegal activities, corruption etc. So, there was around Rs. 15,418 lakh crore banknotes in India, of which the Government Of India were

aimed to replace them with new currency notes and curb black money.

b) Non Tax Compliant Society

The non tax compliance is range of activities that are illegal and unfavorable and unethical in the eyes of law and to government's tax system. This includes tax evasion and sometimes tax avoidance in the form of falsification of accounts, omission of material facts ,delay in filing returns and avoid taxes.

So the demonetization is undertaken in order to make the non tax compliant society into a tax compliant society as there was only Rs 7 lakh crore direct tax collection in the year 2014-2015 and only Rs 7.5 lakh crore in the year 2015-2016.

c) Counterfeit Currency

Fake Indian Currency Notes (FICN) means counterfeit currency notes which are circulated in India or in Indian economy. These fake notes are mainly used for terror related activities. These fake money are also for many other illegal activities. In order to remove this problem, several central and state agencies joined together and Ministry Of Home Affairs constituted a Fake Indian Currency Notes Co-Ordination Centre (FCORD) to curb this menace and also Government decided to announce Demonetization.

The data and statistics shown by RBI Report 2017-2018 says that the number of counterfeit Rs.1000 notes rose to 1,43,099 pieces in 2015-2016 from 1,31,190 pieces in the year 2014-2015 and while the trend of Rs.500 was 2,73,923 in year 2014-2015 and 2,61,695 in the year 2015-2016.

Denomination wise Counterfeit Notes Detected in the Banking System

Denomination	2014-2015			2015-2016		
	Number of Counterfeit Notes	Notes in Circulation	FICN as a Proportion Of NIC	Number of Counterfeit Notes	Notes in Circulation	FICN As a Proportion Of NIC
2 and 5	0	11,672 Million	0	2	11,626 Million	0
10	268	30,304 Million	.00000001	134	32,015 Million	0
20	106	4,360 Million	.00000002	96	4,924 Million	0
50	7,160	3,487 Million	.00000205	6,453	3,890 Million	.0000017
100	181,799	15,026 Million	.00001210	221,447	15,778 Million	.0000140
500	273,923	13,128 Million	.00002087	261,696	15,707 Million	.0000167
1000	131,190	5,612 Million	.00002338	143,099	6,326 Million	.0000226
TOTAL	594,446	83,579 Million	.00000711	632,926	90,266 Million	.0000070

Source: RBI

d) Terror Funding

The counterfeit currency and fake Indian currency notes are used as a medium to support and promote terrorism in India. There was an emergence of funding for arms smuggling and terrorists in India. There were many incidents of stone pelting in Jammu & Kashmir and many terror attacks also. The criminals take Rs.500 for stone pelting and Rs.1000 for other terror attacks. As per the data, the stone pelting incidents were increasing day by day, in this sense the stone pelting incidents were highest in July, 2016 with stone pelting incidents of 1133.

Stone Pelting Incidents In Jammu & Kashmir

Month	Stone Pelting Incidents
April, 2016	97
May, 2016	38
June, 2016	63
July, 2016	1133
August, 2016	825
September, 2016	687
October, 2016	245

So these are the major reasons due to which the Government Of India has decided to demonetize the Rs.500 and Rs.1000 banknotes in the country and to go for an formal economy.

4. How demonetization was implemented in India (2016)

The demonetization was announced on 8th November, 2016. When demonetization was announced, there was not much information available to the public. It was sudden and

unexpected. The new currency notes are quite different in terms of its size, colour, looks and design.

The plan of demonetization was started in February, 2016. The RBI had presented to Government an analytical notes about the merits and demerits of this idea, the impact, challenges, consequences associated with it and alternatives ideas and necessary preparation for its implementation. There were several rounds were conducted on ideas, pros and cons etc, again and again regarding this move and regarding its implementation.

In May 2016, the Reserve Bank Of India has started the printing of new currency notes and confirmed the design of Rs.2000 banknotes in August, 2016.

The new banknotes were started printing in October, 2016. RBI has spent around Rs.3,500 crore to print new banknotes in 2016-2017 (July to June). Also incurred various cost in collection, storage and movement of banknotes across the country. RBI has new series notes of more than Rs.23 billion pieces of new series notes,(i.e. 2 billion pieces of Rs.2000 notes to replace with existing 4 billion notes of Rs.1000 and 21 billion pieces of new series notes of Rs.500), have been printed and accumulate by the time the programme commenced.

On 8th November, 2016 demonetization was effected through 3 notifications:

- 1) The Ministry Of Finance issued Gazette Notification by which Rs.500 and Rs.1000 banknotes ceased to be legal tender from 9th November, 2016.

- 2) MOF issued Gazette Notification regarding denomination of new currency notes.
- 3) The RBI in its Notification no.2625 informed about the new currency notes and about the process of exchanging banknotes.

The Union cabinet was informed about the demonetization on 8th Novemeber, 2016 by the Prime Minister, Narendra Modi. After the meeting, Narendra Modi announced the demonetization in an unscheduled live national televised address at 8:15 P.M. and declared the old Rs.500 and Rs.1000 banknotes to be invalid and also announced the issuance of new currency notes of Rs.500 and Rs.2000 banknotes of Mahatma Gandhi New Series Notes.

The RBI has stipulated that the banknotes should be deposited with the banks within 50 days upto 30th Decemebr, 2016. The Government also announced that those who have more than Rs.2,50,000 cash in hand , then they have to pay @30% tax on such amount. Also, informed that international airports, fuel pumps, government hospitals, railway and airline booking counters, medical stores and ration stores are allowed to accept the old demonetized banknotes till 2nd December, 2016.

The bank also limit Rs.4000 per person from 8th to 13th November, 2016 & Rs.4.500 from 14th to 17th November, 2016 and Rs.2000 from 18th to 25th November, 2016. Also, the cash withdrawal limit was restricted to Rs.10.000 per day and Rs.20,000 per week from 10th to 13th November, 2016. Later on this was extended to Rs. 24,000 per week from 14th November, 2016.

A limit on withdrawals from ATMs was imposed from Rs.2000 per day till 14th November, 2016 and Rs.2500 per day until 31st December, 2016.

5. Challenges For Demonetization

- 1) The demonetization announced on 8th November, 2016 was sudden and unexpected. So there was scarcity of cash in the banks due to which demonetization creates confusion, problem for public in depositing or exchanging them with new ones and also led to long queues outside banks and ATMs.
- 2) There was non-availability of currency change as Rs.2000 banknotes was of high denomination and so many individuals were getting difficulties in getting change of Rs.2000.
- 3) The demonetization was a bad hit for those individual who need urgent medical treatment and need cash for surgeries and medicines etc.

- 4) The demonetization badly affected those people who were having marriages in their families and they are allowed cash withdrawal of Rs.2.5 lakhs only.
- 5) The general public also facing problems as they are not able to buy daily necessities product because of shortage of cash.
- 6) Farmers started incurring losses as there was scarcity of cash and thus prices of their products have fallen.
- 7) The demonetization was bad hit for daily wagers and laborers as they are not able to get there payments and wages on time
- 8) There was emergence of online transactions but those who are illiterate and of old age were not able to make use of smart phones and laptops.
- 9) The foreign tourists who were enjoying there holidays were badly hit due to this movement as due to demonetization they were not able to make transactions through older currency notes.
- 10)The demand for land holding drives the property costs in the country.
- 11)The huge number of traders have started incurring losses due to non availability of cash in the market.

6. Impacts of Demonetization

The demonetization has brought many changes in the economy and impacts the Indian economy and especially the issues for which it has been undertaken by the Government Of India.

a) Black Money

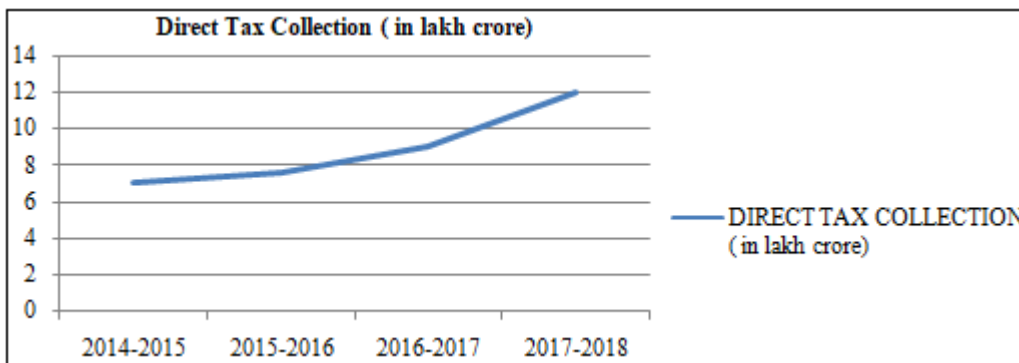
The government has estimated that around Rs.5 lakh crore would be removed from circulation permanently. But, according to RBI report for the year 2017-2018, more than 97% of Rs.500 and Rs.1000 banknotes i.e. around 15, 311 lakh crore out of 15, 418 lakh crore have been recovered and deposited with the banks. Only a little amount of banknotes have not been recovered and deposited with the banks.

b) Tax Compliant Society

There is an increase in direct tax collection by 25% i.e. around 12 lakh crore in year 2017-2018 as compared to previous year 2016-2017 from 9 lakh crore.

Income Tax Filings

Year	Income Tax Return	New Return Filers	Corporate Returns
2015-2016	4.7 cr	66.2 L	7.5 L
2016-2017	5.5 cr	85.5 L	8 L
2017-2018	7.0 cr	1 cr	9.3 L



There is an increase in income tax filings (above given table) by 21% i.e. from 5.5 crore in the year 2016-2017 to 7 crore in the year 2017-2018. There is an increase in corporate returns by 17% i.e. from 8 lakhs in year 2016-2017 to 9.3 lakhs in year 2017-2018. Also voluntary tax payments under Advance tax payments increased by 23% in the year 2017-2018.

c) Counterfeit Currency

Denomination wise counterfeit notes detected in banking system

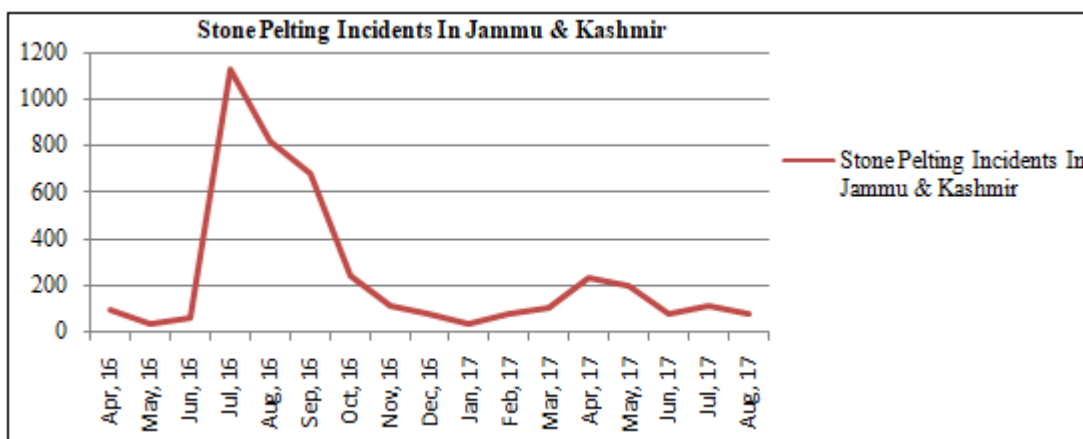
Denomination	2015-2016	2016-2017	2017-2018
2 and 5	2	80	1
10	134	523	287
20	96	324	437
50	6,453	9,222	23,447
100	221,447	177,195	239,182
200	-	-	79
500(MG series)	261,695	317,567	127,918
500 (New design)	-	199	9,892
1000	143,099	256,324	103,611
2000	-	638	17,929
TOTAL	632,926	762,072	522,783

Source: RBI

After the demonetization the counterfeit currency was badly hit and there is a fall in these fake and illegal Indian currency notes. There is a fall in counterfeit notes of Rs.500 from 3,17,567 in year 2016-2017 to 1,27,918 in year 2017-2018 and counterfeit notes of Rs.1000 from 2,56,324 in year 2016-2017 to 1,03,611 in year 2017-2018. But the counterfeit notes of Rs.500 (Mahatma Gandhi New series note) increased from 199(2016-2017) to 9,892(2017-2018) and of Rs. 2000 notes increased from 638(2016-2017) to 17,929(2017-2018).

d) Terror Funding

The demonetization leads to fall in terror funding as there are less fake notes and less counterfeit notes. So as a result the stone pelting incidents fall to 73 in November, 2016 and 36 in December, 2016 and also demonetization leads to fall in many other terror attacks in India due to non availability of cash or the demonetized notes has lost their legal tender.



As the above diagram represents that the stone pelting incidents were higher prior to demonetization and after demonetization these incidents started falling due to scarcity of cash, no more fake notes of Rs.500 and Rs.1000 and also the Rs.500 and Rs.1000 have lost their legal existence and significance.

Impacts of Demonetization on Different Sectors of Economy

Industry Sector –

There was an decrease in purchasing managing index (PMI) from 54.4 in October, 2016 to 52.3 in November, 2016 and 49.6 in December, 2016 and 50.4 in January, 2017.

Sectorial Indicators(y-o-y growth %)

Industry	Apr-Oct, 16	Oct, 16	Nov, 16	Dec, 16	Jan, 17	Feb, 17
PMI	52	54.4	52.3	49.6	50.4	50.7
IIP	-0.3	-1.9	5.7	-0.1	2.7	-
Mining	-0.2	-0.9	3.7	5.5	5.3	-
Coal	0.7	-1.6	6.4	4.4	4.8	-
Crude Oil	-3.3	-3.2	-5.4	-0.8	1.3	-
Natural gas	-0.4	-1.4	-1.7	0	11.9	-
Manufacturing	-1	-2.4	5.5	-1.7	2.3	-
Electricity	4.5	1.1	8.9	6.3	3.9	-

Source: RBI & CSO

The electricity shoot up by 8.9% and 6.3% which was higher than the growth of 4.5% in Apr-Oct, 2016 and decreased to 3.9% in January, 2017. The coal production shoot up by 6.4% in November, 2016 and decreased to 4.8% in January, 2017. The natural gas production also increased to 11.9% in January, 2017 from -1.7% in November, 2016. Also there was an increase in mining production and in crude oil production. The manufacturing shoot up by 5.5% in November, 2016 from -2.4 in October, 2016 and fall to -1.7% in December, 2017.

Service Sector

There was a fall in automobile sales from 8.1% in October, 2016 to -5.5% in November, 2016 and further fall to -18.7% in December, 2016. The three wheelers sales was also fall from 4.4 in October, 2016 to -25.9 in November, 2016 and two wheelers sales falls from 8.7 in October, 2016 to -5.9 in November, 2016.

Sectorial Indicators(y-o-y growth %)

Services	Apr-Oct 16	Oct 16	Nov 16	Dec 16	Jan 17	Feb 17
PMI services	52.6	54.5	46.7	46.8	48.7	50.3
Automobile sales	15	8.1	-5.5	-18.7	-4.7	0.9
C.V.Sales	6.9	11.9	-11.6	-5.1	-0.7	7.3
P.V.Sales	11	4.5	1.8	-1.4	14.4	9
Three wheelers	11.8	4.4	-25.9	-36.2	-28.2	-21.4
Two wheelers	16	8.7	-5.9	-22	-7.4	0
Cargo handled	6.3	13.2	10.2	12.9	3.6	-
Railway freight traffic	-1.7	-2.6	5.5	-0.1	0.3	-
Tourists arrivals	10.8	10.4	9.2	13.6	16.4	-
Cement production	4.8	6.2	0.5	-8.7	-13.3	-
Steel production	2.7	0.3	5	5.3	3.1	-
Domestic cargo traffic	7.5	10.6	-0.6	7.5	10.1	-
International cargo traffic	9.2	15.6	15.4	12.6	16	-
International	9.1	7.4	7.7	7.7	8.8	-

passenger traffic						
Domestic passenger traffic	22.5	23.6	22	23.9	25.6	-
Bank deposits	6.4	9.3	15.7	14.9	13.5	-
Insurance premium	31.1	22.4	72.1	21.1	32.1	-
Merchandise exports	0.2	9	2.4	5.5	4.3	-
Merchandise imports	-9.8	8.3	9.4	0.1	10.7	-

Source: RBI & CSO

The tourists arrival fall in November, 2016 to 9.2 from 10.4 in October, 2016 and further increased to 13.6 in December, 2016. The steel production increased to 5% in November, 2016 from 0.3% in October, 2016 and then increased to 5.3% in December, 2016 and then fall to 3.1% in January, 2017. The cement production falls to 0.5% in November, 2016 from 6.2% in October, 2016. Also there is an shoot up in insurance premium from 22.4% in October, 2016 to 72.1% in Nov, 2016 but further fall to 21.1% in December, 2016 and 32.1% in January, 2017. The bank deposits increased to 15.7% in November, 2016 from 9.3% in October, 2016 and further more to 14.9% in December, 2016 and 13.5 % in January, 2017.

Consumer Durable Segment

In consumer durable goods the washing machine growth robust at 113.1% in October, 2016 and drastically 34.4% in November, 2016.

Growth in Consumer Durable Segment

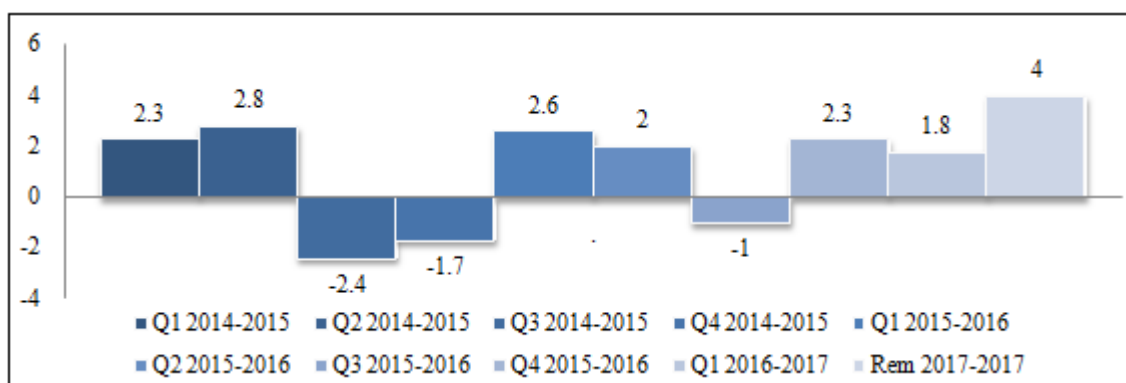
Category	October, 2016	November, 2016
Microwave	90.7	-51.5
Refrigerators	73.4	-40.3
Air Conditioner	4	-33.8
Washing Machines	113.1	-34.4
Flat Panel TV	99.4	-26.6

Source: RBI & CSO

As represented in table there was robust at microwave in October, 2016 of 90.7% and drastically -51.5 in November, 2016 and similarly the robust of air conditioners was of 4% in October, 2016 which fall to -33.8 in October, 2016.

Agriculture Sector –

As per statistics it is seen that the Agriculture growth was -1 in Q3 of 2015-2016 and 2.3 in Q4 of 2015-2016 and falls to 1.8 in 2016-2017 and further increased to 4 in year 2016-2017.



Digital Modes of Payments

Category		Oct, 16	Nov, 16	Dec, 16	Jan, 17	Feb, 17
NEFT	Volume	16.2	23.3	39	38	34.5
	Value	37.6	38.3	40.8	60.2	49.5
CTS	Volume	-1.1	23	58.4	52.7	20.2
	Value	2.9	8.6	13	19.3	0.8
IMPS	Volume	116.7	89.6	157.2	177.7	150.4
	Value	150.7	135.9	186.6	196.7	184.2
NACH	Volume	53	30	58.3	19.8	-0.9
	Value	89.8	76.3	116.7	22.8	54.2

Source: RBI

After the demonetization, electronic method of payments were low in the underlying weeks as individuals were occupied in saving/trading old cash. In December, 2016 the digital modes have started increasing drastically.

Pradhan Mantri Jan Dhan Yojana

Particulars	November 9, 2016	March 1, 2017
Public Sector Banks	203.6	222.9
Regional Rural Banks	43.1	46.4
Private Sector Banks	8.4	9
Schedule Commercial Banks	255.1	278.4

Source: www.pmjdy.gov.in

7. Conclusion

Demonetization have pros and cons both but as it is clear that it has more negative impacts in short run due to lack of cash or confusion or unexpected or sudden and as a result public was not much aware of it and faces various problems be it shortage of funds, long queues outside banks and ATMs.

The demonetization also leads to decline in the GDP of Indian economy as the economy slowdown during 2016-2017. But it helps to reduce fake currency notes and terror funding in the country and also fulfill the aim of formal economy.

Demonetization also have various negative impacts as it leads to decline in revenues of various sectors, companies like automobiles, steel production, tourist arrivals, insurance premiums and various other organization etc.

Also the circulation of currency has reduced after the demonetization but the deposits with the bank have increased. There has been an increase in digital modes of payment and moving towards digital India and cash less economy.