

# Socio-Economic Implications of Demonetization: Some Ground Realities

## Abstract

Demonetisation is the act of stripping a currency unit of its status as legal tender. Demonetisation is normally undertaken to curb the menace of black money and corruption. Keeping this in mind the worthy prime minister of India on 8<sup>th</sup> of November 2016 took the nation by surprise and announced that the notes of denomination of Rs. 500 and Rs. 1000 cease to be legal tender w.e.f. midnight. Making these notes invalid was a major assault on black money, fake currency, corruption and terror funding. While the Government's move aimed at eradicating the scourge of black money and corruption and nudging the Indians towards a cashless economy, it has caused hardships to a major chunk of Indians in the short to medium term. There are doubts if the move will stop the generation of new black money and corruption. It is against this backdrop that this paper attempts to discuss a few economic and social effects of demonetization.

**Keywords:** Demonetisation, Legal Tender, Corruption, Black Money, Cashless Economy.

## Introduction

Demonetization of currency is a radical monetary step stripping a currency unit of its status as legal tender. Demonetization is normally undertaken to curb the menace of black money and corruption. Keeping this in mind the worthy prime minister of India on 8<sup>th</sup> of November 2016 took the nation by surprise and announced that the notes of denomination of Rs. 500 and Rs. 1000 cease to be legal tender w.e.f. midnight. Making these notes invalid was a major assault on black money, fake currency, corruption and terror funding. While the Government's move aimed at eradicating the scourge of black money and corruption and nudging the Indians towards a licit, taxable and cashless economy, it caused many hardships to a major chunk of Indians in the short to medium term. Similar exercise of demonetization was undertaken twice in the past in India. First instance was in 1946 when notes of Rs 1000 and 10000 denomination were discontinued. Eight years later in 1954 new notes of higher denomination of Rs 1000, 5000 and 10000 were introduced only to be demonetized in 1978 by the then Morarji Desai government. However, both the times the experiment with demonetization was a failure. The difference between the past and present process is that while earlier only 15% of total currency in circulation was demonetized whereas this time 86% currency was wiped out of the system. Secondly, the middle class in 1978 was sparse and lived within the modest income bracket having almost no access to high denomination currency notes. Much of the currency notes of Rs 1000 and above were then stacked by the wealthy section of the society. In contrast today the situation is entirely different as the demonetized currency is available with almost all the sections of society even with the poor.

This step of the Government led to short term disruption in the economy causing inconvenience to one and all as supply of new currency notes was far short of requirement manifesting a flaw in the planning of the Government. There was a glaring mismatch between the demand and supply of the new currency. Cash crunch in the economy drastically reduced the purchasing power of the consumer resulting in lower demand of all the goods and services

The slowdown in the economic activity had largely affected the poor and the lower middle class by robbing the livelihood of daily wage earners. The repercussions of this move have been acutely felt by the farmers, milk producers, fisher folks and the like employed in the informal



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sector and other vulnerable sections of the society. Broadly the effect of demonetization had been felt across India on all the sectors of economy. This paper is an attempt to discuss few economic and social effects of demonetization.

#### **Aim of the Study**

Demonetisation of the year 2016 was an ambitious step of the Modi government which led to disruptions in the life of almost all the Indian public especially the middle and lower class, The present paper is an attempt to study the social and economic effects of the move.

#### **Economic Effects**

Demonetisation resulted in the significant disruption of the economy and threatened economic output as it hit consumption, production and trade. It had an expected negative impact on the economy in the short-run, but the expected adverse effects are expected to disperse in the medium to long run. This section of the paper discusses the economic effects of demonetization.

#### **Liquidity Crunch**

This impact can be considered as short term-term impact. Liquidity shock means people were not able to get sufficient volume of popular denomination notes especially Rs 500. This currency unit is the favorable denomination in daily life. It constituted nearly 49% of the previous currency supply in terms of value. Less liquidity with the public and firms is likely to slow down economic activity and hamper the Make-In-India initiative which has a lot of start-ups which presently face the shortage of cash. The liquidity crunch will also delay the outstanding investment projects and may actually lead to an increase in NPA's as small and medium-sized enterprises will not be in a position to repay bank loans. The unorganized sector in India, on the other hand employs workers and the mode of payment is cash. A liquidity crunch in such a system could compromise the employment and livelihood of the weaker sections of the society as well. This shortage of cash is expected to remain for a couple of months. However, the employment scenario, no matter how bleak it may be in the short-run will definitely improve down the line. All these indicate that currency crunch will remain in the economy for the next couple of months.

#### **Setback to the Economy as a Whole**

In a bid to clampdown on black money 86 percent of the cash was declared illegal tender paralyzing all economic activity by creating an immediate cash crunch in the economy. Reduction in cash flow resulted in bringing down the demand for goods and services which in turn reduced the propensity to consume of a large section of the population. With the backward working of the multiplier hence coming into operation a fall in investment leading to a fall in GDP is inevitable. With trade, tourism, construction activity all coming to a standstill for want of cash the GDP in the economy is set to decelerate significantly. In overall terms third quarter GDP will be affected badly and the figures for the fourth quarter look gloomy too. Shortly after demonetization Goldman Sachs slashed its growth

estimates of the Indian economy for the year by 1.6 percent. IMF has also pegged down the estimated growth rate by half a percent for the current fiscal year. However the GDP data of third quarter came as a big surprise beating all the estimates. Post-demonetisation the growth recorded was at 7 percent. According to official statistics the impact of demonetization was marginal. Only the services sector slowed down whereas in all the other sectors growth accelerated. The reason for this is that the official GDP statistics are significantly underestimating the growth impact of demonetization. Professor Prabhat Patnaik one of the topmost Indian economists, has revealed that the Government of India's Statistical Organisation(CSO), while announcing 7 percent GDP growth for the third quarter of 2016-17 did this by revising downwards the base upon which this growth-rate is calculated. He said that it was a clear case of doctoring of statistics on the part of the CSO at the behest of the government and this manipulation automatically led to a surprise jump in the growth rate from 6.2 percent to 7 percent. Moreover the official estimates are largely based on organised data and the negative growth effect on the unorganized sector has been largely ignored. In other words informal and other cash based economy hardly contributes to GDP and these were the two sectors which suffered the most. These statistics are for period September to December which includes the high spending festive season.

#### **Impact on Agriculture Sector**

Rural India engaged in agriculture felt the shortage of cash much more acutely. Indian agriculture sector heavily dependent on cash and has been adversely affected. Due to scarcity of new notes the farmers had insufficient cash to purchase seeds, fertilizers, pesticides, etc. for the sowing of rabi crop. Analysts are doubtful or a bumper rabi crop this year as farmers have not been very enthusiastic in sowing the second round of cropping this year. The farmers also suffered as due to non-availability of cash they had to buy fertilizers, pesticides, etc. on credit. They were exploited as they had to pay more on account of paying later. Cash stripped rural families have been reported to be forfeiting food, fertilizer, and kerosene consumption and also deferring the payment of bills for education and health- let alone for marriages or income-elastic items from the market. The farmers who reaped a bumper crop and hoped to get good returns suffered the most as wholesale vegetable prices crashed due to scrapping of high value banknotes. Some farmers in AP could not even recover their transportation costs due to low price and dumped the vegetables in the market yard. Onion farmers were forced to sell their crop for as low as Re. 1 per Kg. These issues are however of a short term nature and will get better with time leaving a scar on the hearts of those who suffered without any fault.

#### **Impact on Black Money**

Demonetization of 86 percent of the currency in circulation was undertaken with the main objective of curbing black money. In India only about 5-6 percent of undisclosed income is held in cash, the rest being invested in jewellery, land, real estate etc.

Even if all of this is targeted by this measure it will not be an effective way to go at the existing stock of black money. Moreover, the generation of black money is a continuous process by evading taxes, regulations and indulging in criminal and illegal activities. Amassing of unaccounted-for wealth is ingrained in the psyche of the people and demonetization can not remove this greed. Incidence of black money is bound to swell up once the liquidity returns to normal. Demonetization alone may not be able to reduce the incidence of black money. India Ratings and Research has estimated that about Rs. 4 lakh crore worth of cash held in black money would be destroyed. This constitutes approximately 12percent of the black money in India, leaving 88percent to remain in the system. Actually, a small portion of black money is actually stored in the form of cash. 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. However it is not an easy task to cull out the black money from India's economy and the real players are tough to touch.

#### **Impact on Counterfeit Currency**

Demonetization as a cleaning exercise may produce several good things in the economy. This move however is a major setback to the counterfeit currency which is used by the various terrorist groups. Once and for all their funding through fake currency has been put to a halt and it may not be easy for them to fake the new currency in the near future. It will cripple their operation much more severely than any encounter in the recent past.

#### **Impact on Corruption**

Demonetization will not have any noticeable effect on corruption. This move is not the answer for a corruption free nation. Corrupt people will devise new ways to keep the ill-gotten wealth. Even when the nation was facing utter chaos with strict regulations put in place, India's shadow economy was able to unload their black money after laundering it sparkling white in the process. Corruption will continue unabated until and unless some stern steps are taken by the Government. However the money accumulated earlier in cash through corrupt means will come into circulation through this move. The opportunities for corruption which are available in a cash economy will continue unabated in future also as long as cash transactions are permitted. People will always find alternate ways to amass illegal wealth.

#### **Social Implications**

The impact of demonetization was felt more in the social sector and the worst effected were the women, the poor and the common man. This move disrupted the life of common people from all walks of life .The social impact was drastic as demonetization was announced suddenly. This section of the paper discusses the social effects of demonetization.

#### **Gender Impacts**

Demonetization has severely affected the savings of the fair gender by wiping out their emergency funds which they had accumulated over the years. These savings of the wife were always a pleasant surprise to the family in times of dire needs. The money saved by curtailing the household expenses was kept as a secret from the husbands. This small saving over a period of time was converted into convenient notes of Rs 500 and Rs 1000. The announcement rendering these notes illegal all of a sudden was a major setback to majority of women.

#### **Welfare Loss**

The impact of demonetization on society has not only been catastrophic but also highly unequal. Those with bank accounts and credit/debit cards faced mere inconvenience but those who were entirely dependent on cash found them rendered penniless overnight. In fact the common man who did not have any black money suffered the most. Thus, there welfare loss to the society especially to those who meet their transactions in cash.The daily wage earners, other laborers, 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 labor cost and thus reduces income to the poor working class.

#### **Social Unrest**

Because of the demonetization the general public suffered irreparable social setbacks.The sudden announcement of demonetization affected the social celebrations that most of the households treated as their cultural practices. Marriages and other social events had to be cancelled or postponed due to non availability of currency. Similarly, sudden social incidences that can be treated as integral part of cultural practices made the human life questionable during the period of non-availability currency in the market.

In certain cases that reported in media, demonetization resulted in worst situation in the society.

#### **Setback to Consumption Sector**

When liquidity shortage struck, it was consumption that was adversely affected. Consumer goods sales were reported to have dropped by one-third. Trucks were at a standstill. Farmers had difficulty buying seeds and fertilizer and selling crops and perishable produce. The fishing industry was close to collapse. Few villages had ATMs and having to trek into cities and wait in line for long time meant the loss of daily wages. Employment such as in case of rickshaw drivers, street vendors, domestic workers and daily labourers in the cities was badly hit. This loss in income led to low consumption of each and every commodity. The construction industry had been badly hit with significant wage implications for its casual workforce.

#### **Conclusion**

The following conclusions emerge from the preceding discussion.

1. Demonetization was undertaken to tackle black money, corruption, terror funding and

- counterfeiting- solving multiple problems with one stroke
2. It created chaos in the economy disrupting the lives of the people especially the deprived section of the society.
  3. Consumption decreased leading to a low level of investment and reduced estimates of GDP
  4. It has severely affected the small savings of the fair gender
  5. The common man who had nothing to do with black money suffered unnecessarily.
  6. Overall economic activities were 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.

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