

**COMMENTARY**

**DEMONETISATION AND SOCIAL CHANGE:  
AN INTROSPECTIVE VIEW**

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On November 8, 2016, the country witnessed unprecedented changes, disruptions and chaos in the society and the economy, when the present Union Government banned the two largest denomination notes Rs.500 and Rs.1000. Following the ban, these notes were demonetized and ceased to be legal tender with immediate effect. These notes accounted for about 86 per cent of currency in circulation which were to be deposited in the banks by 30th December, 2016. This happened in a situation where 78 per cent of financial transactions are done in cash. Along with it, restrictions were also imposed on cash withdrawal which limited the convertibility of domestic money and bank deposits.

The prime reason for demonetisation can be referred to the promise made by the government to curb corruption which in Indian case has become so much deep rooted that needed to be stamped out for the benefit of the economy and the people. During the three years of the present government, a series of efforts were made to curb the black money. Among the efforts mention may be made of the creation of the Special Investigative Team (SIT) in the 2014 budget; The Black Money and Imposition of Tax Act, 2015; Benami Transaction Act 2016; changes in the tax treaties with Mauritius, Cyprus, Singapore; and the Income Disclosure Scheme. However, these efforts could not be proved very much effective to stamp out the black money, i.e., - very little black money was caught. Consequently, in the eye of the government, demonetisation was supposed to be a panacea to penalise the illicit activities which were the roots of creation of black money. The government's main plea in regard to demonetisation was that this action may facilitate in curbing corruption; counterfeiting; the use of high denomination notes for terrorists activities; and especially the accumulation of 'black money', generated by income that has not been declared to the tax authorities (Economic Survey, 2017). The resultant effect was that in an overnight, people found themselves helpless for basic transactions for meeting their day-to-day requirements. Retail businesses, by and large, came to a standstill because people hoarded the little cash they had for food and other necessary items.

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Apparently, since the pronouncement of demonetisation there has been intense debate over the rationale of demonetisation particularly in a situation when Indian economy is stable. Perhaps India is the first country which took the measure of demonetisation to curb corruption in a normal economic situation. In many countries such measure was taken up when there has been untoward situation like hyperinflation, political upheavals, wars, etc. However, the rationale or say, appropriateness of demonetisation can be better understood with a theoretical prescription. For example, in the early 1940s there was a discussion among the economists that what should be the best engine of economic development of the third world countries - Agriculture? Industry? Trade? There appeared to be divergent views but integration of agriculture and industry was well accepted in accelerating the process of economic growth (Prasad, 2000). Likewise, in the context of demonetisation, the question is of what comes first, development or growth. There is general presumption that the institutions grow stronger as a nation grows richer and the nation becomes rich when formalization takes place and corruption falls. A rich nation means having expectation of high economic growth. In the present development scenario, the percolation of this benefit is a prerequisite to the development of the country and the people as well. It is not a logical proposition that only with the means of purging black money the objectives of economic development could be fulfilled. It could be well understood with the economic meaning of development for which the country has been struggling since Independence.

Much earlier, Dudley Seers (1969) has tried to tackle the basic question of the meaning of development in his following words: "The questions to ask about a country's development are therefore: What has been happening to poverty? What has been happening to unemployment? What has been happening to inequality? If all three of these have declined from high levels, then beyond doubt this has been period of development of the country concerned. If one or two of these central problems have been growing worse, especially if all three have, it would be strange to call the result 'development' even if per capita income doubled" (Seers, 1969, p.7). From this statement it becomes clear that mere high economic growth is not sufficient to achieve the goals of development rather it may be a necessary condition. The reality is that despite the high economic growth which the country achieved since the pronouncement of economic liberalization policies, all these central problems are persisting in the country. A trend analysis of poverty shows that there has been reduction in poverty particularly after India's rapid economic growth rate since 1991. This is appreciable but even today one quarter of

Indian population lives below the poverty line. According to Annual Report of Reserve Bank of India 2012, 21.92 per cent of total population lived below the poverty line. As such, poverty eradication is still a major issue. In a recently prepared document by the Niti Aayog on sustainable development goals (SDGs) there has been emphasis on ‘no poverty’ by 2030. Likewise, the problem of unemployment has become more worse as being indicated in the declining trend in the employment elasticity meaning that employment is not being generated in proportion to the increase in output. It needs to be understood that the income based poverty can be eliminated only with giving the opportunities for the employment and income generation to the poor people. The estimates from NSSO and CSO data suggest that between 2004-12, India’s new net cumulative job growth swelled by only 3 per cent (or 15 million net new jobs) when the country’s economy expanded. Recently, NITI Aayog, Vice Chairman, Arvind Panagariya has said that despite the expectation of 7.5 per cent growth rate during the current financial year the creation of “good jobs” is a big challenge for the country. So, the country is in dire need of development rather than merely growth otherwise it would be called jobless growth.

No doubt, black money is a key to corruption and if India is to eradicate corruption, it must first do away with widespread black money. This sounds well because assumption is that wiping out the black money may have profound impact on the economic development of the country which may also pave the way for social change. While analyzing the impact of demonetisation on social change let us first examine the nature and magnitude of economic effects of demonetisation both in short and long run.

The effects of demonetisation are beautifully summarised in the Economic Survey Report (2016-17). These are presented below in table 1.

**Table-1. Impact of Demonetisation**

Sector	Impact	
	Short Run	Long Run
<i>Money/Interest Rate</i>	Cash declined sharply	Cash will recover but settle at a lower level
	Bank deposits increased sharply	Deposit will decline, but probably settle at a slightly higher level
	RBI's balance sheet largely unchanged: return of currency reduced the central bank's cash liabilities but increased its deposit liabilities to commercial bank	RBI's balance sheet will shrink, after the deadline for redeeming outstanding notes
	Interest rate on deposits, loans, and government securities declined; implicit rate on cash increased	Loan rates could fall further, if much of deposit increase prove durable

Financial System Savings	Increased	Increase, to the extent that the cash deposit ratio falls permanently
<i>Coorruption (underlying illicit activities)</i>		Could decline, if incentives for compliance improve
<i>Unaccounted income/black money (underlying activity may or may not be illicit)</i>	Stock of black money fell, as some holders came into the tax net	Formalization should reduce the <i>flow</i> of unaccounted income
<i>Private Wealth</i>	Private sector wealth declined, since some high denomination were not returned and real estate prices fall	Wealth could fall further, if real estate prices continue to decline
<i>Public Sector Wealth</i>	No effect	Government/RBI's wealth will increase when unreturned cash is extinguished, reducing liabilities
<i>Formalization/digitalisation</i>	Digital transactions among new users (RuPay/AEPS) increased sharply; existing users' transactions increased in line with historical trend	Some return to cash as supply normalises, but the now-launched digital revolution will continue
<i>Real estate</i>	Prices declined, as wealth fell while cash shortages impeded transactions	Prices could fall further as investing undeclared income in real estate becomes more difficult; but tax component could rise, especially if GST imposed on real estate (imposed)
<i>Broader economy</i>	Job losses, decline in farm incomes, social disruption, especially in cash-intensive sectors	Should gradually stabilize as the economy remonetised
<i>GDP</i>	Growth slowed, as demonetisation reduced demand (cash, private wealth), supply (reduced liquidity and working capital, and disrupted supply chains), and increased uncertainty	Could be beneficial in the long run if formalization increases and corruption falls
	Cash-intensive sectors (agriculture, real sector, jewellery) were affected more	Informal output could decline but recorded GDP would increase as the economy becomes more formalized
	Recorded GDP will understate impact on informal sector because informal manufacturing is estimated using informal sector indicators (Index of Industrial Production). But over time as the economy becomes more formalized the underestimation will decline	
	Recorded GDP would also be overstated because banking sector value added is based ( <i>inter alia</i> ) on deposits which have surged temporarily	
<i>Tax collection</i>	Income taxes rose because of increased disclosure	Indirect and corporate taxes could decline, to the extent growth slows

	Payments to local bodies and discoms increased because demonetized notes remained legal tender for tax payments/ clearances of arrears	Over long run, taxes should increase as formalization expands and compliance improves
<i>Uncertainty/ Credibility</i>	Uncertainty increased, as firms and households were unsure of the economic impact and implications for future policy. Investment decisions and durable goods purchases postponed	Credibility will be strengthened if demonetisation is accompanied by complementary measures. Early and full remonetisation essential. Tax arbitrariness and harassment could attenuate credibility

Source: Economic Survey 2016-17, Government of India, pp.59-60.

It can be noted that there has been mixed picture of its effect but in most of the situations long run effects are positive indicating that GDP will improve and stabilize. There has also been expectation that with the help of demonetisation, corruption will be rooted out which will be a boon to economic development of the country. This had the necessity as the continuous growing size of black money had become a huge problem and constraint to growth of the economy. This was on account of the fact that unaccounted - for cash or black money- keeps money out of banks when it could be lent to others helping the businesses grow and driving economic growth. Assault on black money also sharply reduces the tax evasions and more revenue in the hands of the government which in turn makes possibility of availability of more services to the public.

An in-depth analysis of short run effects of demonetisation as shown in table1 indicates that there are more costs than benefits. Many disquieting features have appeared after demonetisation which can be enumerated as: fall in GDP growth, income cuts, sentiment hurt, job cuts, production falls, demand fall and cash crunch. All these disquieting features have disrupted the economy which can be seen in the weaker growth affecting, by and large, all the sectors of the economy. Also, the government's expectations have not come true as being stated in the key objectives of demonetisation. For example, demonetisation as a means to stamping out black money and fake currency, increasing non-cash transactions and introduction of unplanned tax amnesty scheme could not match with the expectation. However, the government's assumption is that the short run costs may be minimised and the long run benefits may be maximized with the help of a number of follow-up action. These include: fast, demand-driven, remonetisation; further tax reforms, including bringing land and real estate into the GST, reducing the tax rates and stamp duties; and acting to allay anxieties about overzealous tax administration. It is hoped that these actions would overcome the problem of decline in GDP and consequently, growth will increase. The available statistics indicate that India's growth in

the first quarter of 2017 was 6.4 per cent, down from 7.9 per cent in the fiscal year 2015-16. The industrial output also declined to 3.1 per cent in April 2017 from 6.5 per cent during the previous year. Furthermore, in the first quarter of 2017 the construction sector actually shrank, by 3.7 per cent, over the previous quarter. However, it has been opined that an economy is a complex machine, and there is no way to be absolutely certain that the cause of all this is demonetisation. Even if this notion is accepted, the crisis which appeared within very short span of demonetisation cannot be negated. Just after the demonetisation many economists came forward to put their arguments that growth will slow down due to demonetisation.

Despite the short run costs the government has high expectation that demonetisation would have much more benefits in the long run than costs borne in the short run. Table 1 shows the various benefits which will emerge in the long run due to demonetisation. In nutshell, it can be said that demonetisation will benefit the economy in the long run by way of rate cuts, stopping counterfeiting and broadening the tax base. However, there are many assumptions to fructify these benefits. For instance, in regard to increase in GDP there are assumptions that formalization should take place and corruption will fall. So, the success of demonetisation will largely depend on how much the assumptions come true. Only in future it could be ascertained.

In the perspective of the effect of demonetisation on social change it is too early to explore. However, for analysis purpose especially in the perspective of demonetisation, social change may be referred to social progress which means that society moves forward by dialectical or evolutionary means. The dialectical means has greater relevance in the perspective of demonetisation and social change. In other words, along with many forces, economic forces in today's materialistic age have the notion of paradigmatic change in the socio-economic structure. For example, over the period, there is a shift way from feudalism to capitalism. On the other side, change is difficult because society prefers status quo; there is resistance to change. It has already been witnessed immediately after the pronouncement of demonetisation. There was visible chaos in the first weeks, even after months, and there has been evidence of immediate damage, though large, but not so large as being feared.

In the present socio-economic structure of the country it seems to be very difficult choice to assess the benefits as being envisaged from the demonetisation. Likewise, in the perspective of social change, it becomes more difficult choice because it is directly concerned with the people's behaviour. The success of demonetisation

largely depends upon how much the people moves forward to formalization and less corrupt. It is well known fact that consumption in India is still largely cash-driven, and a move towards digital payments would require a likely gradual change in consumer habits. As indicated earlier, 78 per cent of financial transactions are done in cash. Moreover, the present socio-economic conditions are not very much conducive to cope with the digitalization process. Even if digitalization takes place it will go on very slowly and it may take longer period. For example, as per the Census 2011, 25.96 per cent of total population are illiterate. The statistics regarding occupational structure show that about two-third of total work force are engaged in agricultural sector. The employment structure indicates that about 91 per cent of total workforce is engaged in unorganized sector. The most revealing fact is that 75 per cent of India's 474 million workforce do not have legal contracts and 80 per cent do not get statutory benefits like PF & ESIC. These workers are exploited in various forms by the employers and in real sense, they represent themselves as 'have not's and being languishing in the alleyways of our system. Another revealing fact is that labour costs are booked as expenses (for avoiding tax) and only a fraction actually paid out to the rightful beneficiary. All the dealings are done in cash and it is very difficult to stop.

Now, after the demonetisation, all employees will have to be paid through banking channels. Obviously, once this formal system comes up, the employees benefit from social security and any future short or non-payments can be tracked and detected. Consequently, employees benefit and tax collection is facilitated. If such situation materializes, there would be significant change in the social system. Also, this social change would have far reaching impact on the way business would get done in the country. Here, the question comes about the labour reform in the country. This could be said here that the social change could be visualized if the process of legitimization of unorganized labour finds its place. This calls for labour reform in the new perspective.

Another important way for bringing social change through demonetisation is concerned with unorganized trade. The status of retail trade is that 90 per cent of retail's trade is unorganized. So, it needs to be organized bringing this into the mainstream of formalization. The formalization of retail trade will give the scope for formal means of finance and also brings them into the tax net. In the process of demonetisation they are forced to look for cashless forms of receiving payments. The large accessibility of the people to mobile phone will pave the way for social transformation.

It can be assumed that demonetisation will provide much scope for bringing the unorganized trade into mainstream. The facilities available for various options of payments and UPI will provide easy process of payments for consumers. This will bring about the radical change in the consumer behaviour having profound effect in social transformation.

Demonetisation may also affect the unproductive habit of the people in regard to their savings. There has been general perception that those who are rich may have bank account but a poor may not. A poor woman keeps her meagre savings at home, hidden in the roof or somewhere else. This practice of savings has also been noticed in the high and middle income groups. The rough estimates indicate that about 10 per cent of the national wealth is money not in circulation. Any effort to change this unproductive practice of savings cannot be stopped unless forced. Demonetisation if followed in its true perspective may force to a change in this unproductive habit but it is very hard to imagine. When the people will realize the benefit of keeping savings in the bank and go for day to day living through cashless modes, this may bring about change in their economic behaviour. This could lead to social change. One can hope that pains faced by the people may get over and there would be good response to changing the lives in a fruitful way.

Finally, it could be said that demonetisation is now a reality notwithstanding the fact that temporarily it has created crisis in the economy and the society. Any attempt to defy the demonetisation will defeat its purpose and even destroy its long run benefits. The Indian economy has its own strengths such as high rates of savings and investment and the crisis will pass. The moot question is how to maximize the long term benefits of demonetisation. This is a challenge as well as an opportunity. It could be hoped that demonetisation may prove as a catalyst for long-run changes in both the economy and the society. Indian polity will be more strengthened, economy will be in upward direction and society will be more cohesive.

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