ECONSPEAK: A Journal of Advances in Management IT & Social Sciences,
Vol. 8, Issue 7, July 2018 Impact Factor 5.132 ISSN: (2231-4571)
www.skirec.org Email Id: skirec.org@gmail.com

An Analysis of Cash, Corruption & Demonetization in India

Dr. Rajesh Kumar
PhD. in Economics
T. M. Bhagalpur University, Bhagalpur, Bihar

ABSTRACT

Indian economy is the fastest growing economy and one of the bright spot among emerging markets in the world. It is one of the bright spots of attracting investment from all over the world. However, the growth black money, increasing in terror funding and counterfeit currency led to growth of parallel economy. Tax evasion is also rapidly growing in the country. In this context, the government has taken the decision of demagnetization of higher value currency. Therefore, the present study has undertaken to analyze the impact of demonetization on tax revenue. The study was based on secondary data collected from various journals and reports. The results of the study indicated that the study the revenue of the government has been increasing after the demonetization of high value notes in the country. More importantly, economy is shifting from informal to formal and more cash economy to less cash economy. However, it is not enough to justify the demonetization because the demonetization of high value currency led to the loss of employment opportunities in informal economy, reverse migration, reduces the private consumption expenditure, insufficient cash in the earlier months of demonetization further dent the economy. In spite of all these constraints, the demonetization has some extent succeeded to clean the economy.

Keywords- Demonetization, Denomination, Compliant and Activities

1.**Introduction** Indian economy is the fastest growing economy and one of the bright spot among emerging markets in the world. Economy has moved on a high growth path and hence India‟s current account deficit declined from about 1percent of Gross Domestic Product (GDP) last year to 0.3 percent of GDP in the first half of 2016-17. Foreign Direct Investment (FDI) grew 36 percent in 2016-17 over 2015-16, despite 5 percent reduction in global FDI inflows. Foreign exchange reserves have reached 361 billion US Dollars as on 20th January, 2017 (Budget, 2017-18). Despite rapid overall growth, there is striking evidence of divergence or widening gaps in income and consumption. Moreover the growth has led to parallel economy, based on the black money or unaccounted money, is a big menace to the Indian economy. It is also a cause of big loss in the tax- revenues for the government. As such, it needs to be curbed. Black money elimination would benefit the whole economy in several ways. Thus the government of India has taken a bold decision of demonetization which has been a radical, unprecedented step with short term costs and long term benefits. Demonetization, coupled with Goods and Service Tax (GST), in the days to come might be ensured much larger revenues as far as states and the central government are concerned and expand the size of the formal economy of the country. Besides, India is largely a tax non-compliant society. The central and the states government struggled with their revenues to run the system which created an unfair enrichment in favour of the evader. The government, therefore, decided to demonetize the high denomination currency (Jaitley, 2017). The effect of demonetization on government finances was divided into three categories; the impact through RBI‟s finances, the impact through taxes and the impact through credit available to finance deficits (Tax Research Team, 2016). In this

background, an attempt has been made to analyze the impact of demonetization of high value currency on tax revenue of the government.

Review of literature

The review of literature related to the study helps one to understand the objectives, methodology and findings of the different research studies. Therefore, the review of literature has undertaken in the following section;

India has carried out demonetization exercises twice before, in 1946 and1978.In Jan 1978 episode, currency worth INR 1.46 billion (1.7% of total notes in circulation was demonetized. Of this INR 1.0 billion (or 68%) was tendered back. In 1978 the value of demonetization was very small (only 0.1% of GDP). However, the 2016 demonetization efforts cover 86 percent of the total currency in circulation (11% of GDP) (Manohar Chaudhry and Associates, Chartered Accountants).

Demonetization was made between 1850 and 1857 in France. Demonetization of high value currency exercise did twice in 1946 and 1978 in India. The move was enacted under the High Denomination Bank Note (Demonetization) Act, 1978. Under the law, the Indian government demonetized all "high denomination bank notes" of Rs 1,000, Rs 5,000 and Rs 10,000 notes which was quite substantial at that point of time ceased to be legal tender after January 16, 1978. People who possessed these notes were given till January 24 the same year and a week"s time and also to exchange any high denomination bank notes. The main difference between then and now was that currency of higher denomination was barely in circulation, whereas now 86 percent of notes consist of Rs 500 and Rs 1000 in circulation. At the same time, the demonetization has the potential to generate long-term benefits in form of reduced corruption, greater digitalization of the economy, increased flows of financial savings, and greater formalization of the economy, all of which could eventually lead to higher GDP growth, better tax compliance and greater tax revenues (Economic Survey, 2016-17).

Sabnavis et, all., (2016) were examined the economic consequences of demonetization of 500 and 1000 Rupee Notes. The study indicated that the GDP of the country was declined due to reduction in the consumption demand and however with the recent rise in festival demand is expected to offset this fall in overall impact. The demonetization of high value currency leads to more amounts being deposited in savings and current accounts of commercial banks. This in turn enhances the liquidity position of the banks, which can be utilized further for lending purposes. Finally, the cash crunch encourages the people to switch over from the more cash transactions to alternative forms of payment which would contribute to surge in demand. Digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), etc have been substantially increasing the demand.

HDFC Bank Investment Advisory Group (2016) was assessed the demonetization and its impact on Indian economy. The results of the study indicated that the immediate effect of reduced ability of the unorganized sector to deal in cash would impact the demand. Consumption items which had large element of cash dealing involved had shown the lower demand.

Real estate and allied sectors could be indicated short term to medium term negative impact. In the long run, the demonetization extinguishing of the major proportion of unaccounted currency would reduce from the liabilities of the government. The demonetization move was led to better tax compliance; raise the tax to GDP ratio, improved tax collection and lower borrowing and better fiscal management. Further the demonetization has made enough headroom to reduce the income tax rates, which can lead to higher disposable income with people and can improve consumption demand in the medium to long term.

Murty was examined the macroeconomic effects of demonetization in India and policy simulations using a macro econometric model for India. The study reported that the overall, due to 5 percent reduction in reserve money supply accompanied with rise in deposits and increase in direct tax collection, together called here as demonetization, real aggregate demand will increase by 2 percent and real GDP in the economy will rise by 0.5percent, despite a 5.5 percent decline in nominal output. This growth in real GDP is facilitated by rise in real private investment by 1.3 percent.

The government has implemented a major change in the economic environment by demonetizing the high value currency notes of Rs 500 and Rs 1000 denomination. These ceased to be legal tender from the midnight of 8th of November 2016. People have been given up to December 30, 2016 to exchange the notes held by them. Tax Research Team (2016) reported that the demonetization, by removing 86 per cent of the currency in circulation, has resulted in a very severe contraction in money supply in the economy. The impact of the shock in the medium term is a function of how much of the currency would be replaced at the end of the replacement process and the extent to which currency in circulation was extinguished. However, the facts are not available to anybody.

Chand and Jaspal showed that the growth story of agriculture is in-tact as demonetization is found to cause small and insignificant effect on growth of output as well as farmers‟ income. Agriculture, which is largest informal sector of Indian economy, has shown strong resilience to effect of demonetization. Further, hand book of Statistics on Indian Economy for 2016-17, released by the Reserve Bank of India (RBI), central government's tax revenue increased to Rs 10.88 lakh crore in 2016-17 from Rs 8.15 lakh crore in 2013-14. According to the latest release by the finance ministry, gross direct tax collections (before adjusting for refunds) in 2017-18 have increased by to Rs.11.44 lakh crore. Refunds of Rs.1.49 lakh crore have been issued during 2017-18 (India Today, 5-4- 2018). Adjusting the figures, Finance Minister Arun Jaitley stated that the direct tax collections were 18 per cent higher than previous year. The data reveal the efficiency of tax department and rise in number of honest tax payers. This historical revenue receipt is a factual testimony of accountable governance.

The above review of literature highlighted the mixed results of high value currency demonetization effects on tax revenue. A good number of studies revealed that the demonetization significantly contributed to the improvement of tax revenue, increase in GDP in the long run. However, the equal number of studies reported that the reduction in consumption demand adversely affected the gross domestic product. Therefore, it was quite clear that there is a dearth of studies in the assessment of effects of demonetization on tax revenue of the country. In this context an attempt has been made to assess the effect of demonetization on tax revenue with the following objectives.

3.Objectives of the study

The study is based on the following specific objectives;

- ✔ To know the concept of demonetization
- ✔ To examine the tax compliance of the government
- ✔ To suggest some measures to improve the efficiency of demonetization.

4. Methodology of the study

Secondary data were, required to examine the research topic, collected from the research articles published in the journals, economic survey 2016-2017, budget 2017-2018 and research articles published in the news papers. Therefore, the study was based on the secondary data and the scope of the study is limited to effect of demonetization on the tax revenue of the government.

5. Results and discussion

The results of the study presented in the following section

6. Concept of Demonetization

Before 1931, gold and silver coins were universally accepted as medium of exchange in the world. Due to the shortage of gold, First World War (1914-18) and Germany‟s reluctance to repay the war debt led to the breakdown of gold standard. During second decade of the twentieth century, the smell of demonetization was appeared in the international monetary system. Demonization indicates the withdrawal of gold and silver coins from the circulation before 1931. Hence it is important to know the concept of demonetization as under;

Demonetization is an 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. The silver coins drives out the gold coins from circulation (Bad money drives out the good money by Gresham). Likewise in India, the high value currency notes often disappeared from the circulation and hence Reserve Bank of India repeatedly issues higher value currency more and more to meet the needs of the economy. A few economic activities fall outside of the country's rules and regulations regarding commerce and industry. These activities are either legal or illegal depending on what goods and services considered as black economy. Therefore the government of India on November 8, 2016, the announced a historic measure, with profound implications for the economy. The two largest denomination notes, Rs 500 and Rs 1000, were “demonetized” with immediate effect, ceasing to be legal tender except for a few specified purposes. As a result of demonetization of high value currency, 86 percent of the cash in circulation was thereby rendered invalid.

The demonetization was not new in India and even in the world. There are several countries embraced the demonetization for solving the problem of hyper inflation, corruption, counterfeit currency, terror funding and more importantly to tackle the black money. Hence, the Government of India decided to withdraw the high value currency from the circulation on 8th

November 2017. The process of demonetization was also found in several countries across the world with the main objective of removing the black money from the economy. Data related to the demonetization was collected and summarized in the table 1.

Table 1.Cross-Country Instances of Demonetization

Sr. No.	Country	Year	Rationale	Effects
1	Ghana	1982	Excess liquidity and inflation	Loss of confidence in the banking system
2	Myanmar	1985	Need to fight black marketing	Public protests
3	Myanmar	1987		Hurry to buy and stock goods pushed inflation up
4	Brazil	1990	Fight hyperinflation	Contraction of output; price moderation only very gradual due to uncontrolled reinjection of liquidity
5	Brazil	1993	Fight hyperinflation	Economy stabilized gradually
6	Soviet Union	1991	Fight organized crime and address money overhang	Loss of public confidence, hyperinflation, cash drying up, job losses
7	Russia	1993	Need to complete exchange of old bank notes and control inflation	Did not strengthen ruble; problems for neighbouring currencies Iraq 1993 25 dinar notes replaced by new locally
8	Iraq	1993	Southern Iraq, being unable to cope with UN sanctions and print money abroad, printed it locally to finance the fiscal deficits.	Uncontrolled printing caused inflation to soar
9	North Korea	2009	To crack down black currency market and fight inflation	Activities halted for a week; public panic; won depreciated in black market; protests.
10	Cyprus	2013	Weakened banking system after Greece defaulted on its debts	Banking system gradually regained its footing
11	Greece	2015	Fiscal and banking Crisis.	Banks reopened in July 2015 but capital controls remained.
12	Venezuela	2016	To fight inflation and profiteering	Public unrest
13	India	2016	To fight against black money, counterfeit currency and terror funding.	Public fully supported the government move.

Source: Government of India, Economic Survey 2016-17

During 1982s, Ghana was taken the decision of demonetization of its currency with the objective of control the hyper inflation however it was not succeed due to loss of public confidence in baking system. Similarly, Myanmar was also carried out demonetization twice in 1985 and 1987 aiming at the curbing of black marketing. Hyper inflation and strong public protest guided to fail the demonetization process. In 1990 and 1993 Brazil was undertaken demonetization process to fight against the hyper inflation. Brazil has come out of output contraction and also achieved success gradually in stabilizing the economy. At different periods, Soviet Union, Russia, North Korea, Iraq and Greece have followed the demonetization to curb the hyper inflation and black money market in their economies. Public unrest and strong protest yielded no better results in their economies. Cyprus was gradually succeeded to regain in banking system due to demonetization of currency. Venezuela announced the demonetization with the objective of tackling the hyper inflation and profiteering however it was not succeeded due to strong public resistance in the country. In India, the government has succeeded to convince the people of the country through the specific objectives of demonetization such as terror funding, counterfeit currency and black money. Hence the citizens of the country whole heartedly supported the government move towards the demonetization.

7. Impact of Demonetization on Tax Revenue

There are four ways to generate budgetary revenues: first, exploitation of state owned or controlled resources; second, taxation of assets and income or trade flows; third, forced loans on economic agents and finally, seigniorage, i.e. printing money (Ze Zhu and Barbara Krug, 2006). The government claimed that the demonetization was an effort to stop counterfeiting of the current banknotes allegedly used for funding terrorism, as well as a crack down on black money in the country. The move was described as an effort to reduce corruption, the use of drugs, and smuggling. The term demonetization has become much more than a household name since the old Rs 500 and Rs 1,000 notes were pulled out of circulation. While as per dictionary demonetization means "ending something (e.g. gold or silver) that is no longer the legal tender of a country", one needs to understand that there is much more than the literal meaning to the word. The information related to number of tax payers and total taxable income collected from different period has been summarized in the table 2. The total number of tax payers in the country was 538.0 lakhs in 2013-2014 whereas demonetization move increased the new individual tax payers to 80.7 lakhs in 2016-2017 compared to previous financial year 2015-2016 (63.5lakhs). Average income of individual tax payers increased to Rs 270000/- in 2016-2017 from Rs.250000/- 2013-2014. As aresult of demonetization and operation clean money; there is a substantial increase in the number of income tax returns (ITRs) field. The number of returns filed as on 05-08-2017 stands at 28292955 as against 22697843 filed during corresponding period of financial year 2016-2017 registering an increase of 24.7 percent compared to growth rate of 9.9 percent in the previous year. The growth in returns filed by individual is 25.3 percent with 27939083 returns having been received upto 05- 08-2017 as against 22292864 returns in the corresponding period of financial year 2016-2017. This clearly shows that substantial number of new tax payers have been brought into the tax net subsequent to demonetization (Surabhi, 2017). Thus it was observed from the table that the total number of persons filed the tax returns and tax payers substantially increased after the demonetization. Therefore it could be inferred that the demonetization of high value currency notes significantly increased the number of tax payers and returns filed in the country.

Sr. No.	Range of Gross Income (in Rs)	2013-2014	
		Number of Tax Payers (in Lakh)	Total Income (in Rs Lakh Crores)
1	0-250000	137.2	2.6
2	250001 to 500000	138.5	4.8
3	500001 to 1000000	65.4	4.4
4	1000001	24.1	6.7
5	Taxpayers who filed tax returns	365.1	18.4

6	Taxpayers who paid tax but didn‟t file returns	172.9	-
Grand Total		**538.0**	-

Table 2. Distribution of Individual Income Tax Payer for FY 2013-14
Source: Government of India, Economic Survey 2016-17
Government of India, Economic Survey 2017-18

Information related to tax revenue of the government from both direct and indirect taxes has been collected and summarized in the table 3. Data of 2015-16, 2016-2017 and revised estimates of 2016-17 presented in table. Revenue collected from corporation tax increased from Rs 453228 in 2015-14 to Rs 493923 in 2016-17 whereas revenue collected from the income tax showed the considerable increase from Rs. 287637 to Rs. 353 174 in the corresponding years. Therefore it could be inferred that the demonetization has significantly improved the tax collection from the direct taxes on the one hand and reduce the tax evasion on the other. The revenue collection from indirect taxes such as custom duties, union excise duties, service tax and tax on union territories also considerably increased between 2015-16 and 2016-2017. However, the revenue collection from wealth tax has not shown any substantial improvement in the similar years. Thus the effect of demonetization is also visible in the growth in direct tax collection, advance tax collection of personal income tax as on 5-08-2017 showed a growth of about 41.79 percent over the corresponding period in financial year 2016-2017. Personal income tax under Self-assessment Tax (SAT) grew at 34.25 percent over the corresponding period in financial year 2016- 2017 (Surabhi, 2017). Hence it was inferred that the demonetarization is succeeded to improve the revenue collection of the government compared to 2015-2016 financial year.

Sl. No.	Particulars	2015-2016 Actual	2016-2017 (Budget Estimates)	2016-2017 (Revised Estimates)
1	Corporation Tax	453228	493924	493923
2	Tax on Income	287637	353174	353174
3	Customs	210338	318669	387369
4	Union Excise Duties	288073	318669	387369
5	Service Tax	211414	231000	247500
6	Tax on Union Territories	3878	4121	4277
7	Wealth Tax	1080	-----	------
	Gross Tax Revenue	1455648	1630888	1703243

Table. 3: Receipts of Government under different Period (in Rs)
Source: Government of India, Economic Survey 2016-17

8. Suggestion

The demonetization has been widely acknowledged the all over the country and many economists praised the decision of the government. Therefore, the following suggestions were given for strengthening the demonetization.

Before demonetization, the Government of Indian and the Reserve Bank should have made enough currency stock and hence much damage on unorganized sector could have been avoided in the country. Moreover, the private consumption demand would be sustained at higher level in the economy. Though demonetization is one of the important moves towards

formal economy, it is also equally important to take care of the informal economy which is largely contributed to employment and GDP of the country. Due to demonetization, thousands of laborers lost the jobs especially those engaged in unorganized sectors like construction works, household and cottage industries, petty traders etc. It is necessary to take care of all these industries by way of pumping enough money without much delay. Inadequate currency circulation in rural areas adversely affected the agriculture and farmers were not able to get the finance for the purchase of inputs which are needed to carry the agricultural operations. Therefore, the Government of Indian has to make the proper arrangement for enough currency circulation in rural areas which ensure the adequate finance to the farmers. Furthermore, the government should have been done the demonetization on only unseasonal time. This could have been avoided the adverse effects on agriculture.

9. Findings of the study

Indian economy is one of the emerging economies in the world however the magnitude of the formal economy relatively small compared to the other fastest growing developing economies in the world. Though the Indian economy has been witnessing the rapid growth, the informal economy is still the largest segment which has highly depended upon the cash. It is observed from the study that the demonetization encourages the people who engaged in informal economy to move towards the cashless transactions. It helps to achieve the objective of transparency in financial activities on the one hand and increases the number of tax payers on the other. Several countries across the world have taken the demonetization move for cleaning the economy but they have failed to achieve the objective however India is the only country succeeded in demonetization. It is also visible demonetization dented the black money.

Demonetization is a biggest decision of the government to withdraw the high value currency from the circulation in the country. This move helped the government to transform the economy from informal to formal economy. Such demonetization move significantly increased the number of tax payers in the country over the years. Further, the demonetization substantially increased the number of persons filed the tax returns and hence demonetization favourably affected tax payers and the revenue collection from different taxes. It was also observed from the study that the revenue collected from various taxes has been increasing after the demonetization. The government of India was able to collect enough revenue from direct and indirect taxes which is evident from the study.

10. Conclusion

Recently, Indian economy has been rapidly transforming into more tax revenue generating one and has also become successful to bring more number of new tax payers under the tax net in the

country. Before 2013-2014, the number of tax payers and revenue collected under different taxes was very meager which was appear from the study but the demonetization along with implement of appropriate policy reforms such doing business easily increase the revenue of the government. It is evident from the study that the revenue of the government has been increasing after the demonetization of high value notes in the country. More importantly, economy is shifting from informal to formal and more cash economy to less cash economy. However, it is not enough to justify the demonetization because the demonetization of high value currency led to the loss of employment opportunities in informal economy, reverse migration, reduces the private consumption expenditure, insufficient cash in the earlier months of demonetization further dent the economy. In spite of all these constraints, the demonetization has succeeded to clean the economy.

References

1. Arun Jaitley (2017) "GST, Demonetization Will Enhance India's Tax Revenues", Business Economy PTI Published January 27, 2017, 2:15 Pm IS Under certain circumstances people can exchange their currency at specified offices of RBI till March 31, 2017
2. HDFC Bank Investment Advisory Group (2016), "Demonetization and its impact", November 11, 2016 *Event Update*
3. Manohar Chowdhry and Associates G R Hari Chief Executive Partner Editorial Leadership Team, Demonetization
4. KN Murty "Macroeconomic Effects of Demonetization in India: Policy Simulations using a Macro Econometric Model for India", Professor (Retd.), School of Economics, University of Hyderabad Currently: Adjunct Faculty, CR Rao AIMSCS, HCU Campus, Hyderabad Email: knmurty@yahoo.com
5. Madan Sabnavis, Anushka and Mrudul Mishra,(2016), "Economic consequences of demonetization of 500 and 1000 Rupee Notes", Care Ratings Professional Risk Opinion November 09, 2016 I Economics: Policy View
6. http://timesofindia.indiatimes.com/city/chennai/Demonetisation-Madurai-Corporation-makes-record-tax-collection-on-a- single-day/articleshow/55374378.cms
7. Ramesh Chand and Jaspal Singh, "Agricultural Growth in the Aftermath of Demonetization", Member and Consultant, respectively, NITI Aayog.
8. Surabhi Ahluwalia, (2017), Commissioner of Income Tax, Media and Technical Official Spokesperson, CBDT. Government of India, Ministry of Finance, Department of Revenue, Central Board of Direct Taxes New Delhi, 07th August 2017, Press Release)
9. Tax Research Team (2016), "Demonetization: Impact on the Economy", No. 182 14-Nov-2016 National Institute of Public Finance and Policy New Delhi Working Paper No. 182
10. What is demonetization, what are different ways of demonetization, and demonetization in India by PM Modi explained. The Indian Express Web Desk | New Delhi | Updated: November 14, 2016 12:20 pm

11. Ze Zhu and Barbara Krug (2006), "China"s emerging tax regime: Local tax farming and central tax bureaucracy
„EUR, Rotterdam and UTS, Sydney Chapter 8 in: Barbara Krug and Hans Hendrischke (eds.) China"s Economy in the 21st century: Enterprise and business behaviour. London: Edward Elgar (2006).