

THE IMPACT OF DEMONETISATION ON INDIAN ECONOMY

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ABSTRACT: On 8th November 2016 night at 8.15 P M Prime Minister of India Mr. Narendra Modi in his unscheduled television address to the nation announced that the currency notes of 500 and 1000 denomination will not be a legal tender money from midnight. Such a process of removing currency from general usage or circulation is known as Demonetisation. The study here attempts to understand the meaning and reasons of demonetisation, and provides an insight into the positive and negative impacts of demonetisation on the Indian economy. Government took this step of demonetizing the currency as a tool to fight against black money and corruption in Indian Economy. If government successfully clears all the problems, drawbacks associated with the demonetization, this demonetization will become the successful economic revolution in India and we can expect a better tomorrow with corruption free India.

This study is descriptive in nature and relevant data has been acquired from secondary sources such as journals, published papers, magazines and websites. Books were also referred to in the process in order to gain theoretical information on the topic as required.

Keywords: Black Money, Corruption, Demonetisation, Digitalisation, Government, Impact, Indian economy.

1. INTRODUCTION

The currency has been demonetised thrice in India – first on 12th January, 1946 (Saturday), second on 16th January, 1978 (Monday) and the third and recent was on 8th November, 2016 (Tuesday). In the November 2016 Demonetisation, the Indian government banned the high denomination notes of Rs 500 and Rs 1000 as a move to uproot the problems of corruption, black money and counterfeiting. This master plan orchestrated by the Prime Minister Narendra Modi, with a little warning, sent a shockwave across the Indian economy.

1.1 MEANING

The term 'demonetisation' or 'note-bandi' has become a household name since the government pulled the old Rs 500 and Rs 1000 notes out of circulation. Demonetisation is an act of cancelling the legal tender status of a currency unit in circulation. In the words of a layman, we may understand demonetisation as "withdrawal of currency units from use".

Demonetisation occurs whenever there is a change of national currency - the current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency.

One dramatic example of demonetisation across the globe was when the European Monetary Union nations decided to adopt Euro for a period of time in order to ensure a smooth transition. Zimbabwe, Fiji, Singapore and Philippines are other countries who have opted for currency demonetisation in the recent past. India, too, has adopted this measure thrice to curb the menace of black money and fake notes, which have taken deep roots, by reducing the amount of cash available in the system.

1.2 REASONS FOR DEMONETISATION

The move of demonetisation has always been supported with explanations that demonetisation is done to control fake notes which could add to fear based oppression and, to undermine or take out the “black economy”. Based on the same premise that “the magnitude of cash in circulation is directly linked to the level of corruption”, the Indian government demonetised two of the country’s largest denomination notes. Thus, the government’s goal and rationale for the abrupt announcement was to combat India’s thriving underground economy on several fronts – eradicate counterfeit currency, fight tax evasion (only one per cent of the population paid taxes), eliminate black money gotten from money laundering and terrorist-financing activities, and to promote a cashless economy.

Nations often adopt the demonetisation policy as a measure to counterbalance the current economic condition, anticipating positive changes on the liquidity structure as a whole. Countries across the globe have also used demonetisation at some point or the other to control situations such as inflation and to boost the economy.

Hence, the reasons behind undertaking of demonetisation may be summed up as under:

- To combat corruption and crime(counterfeiting, tax evasion and terrorism)
- To combat inflation
- To discourage a cash-dependent economy

Demonetisation is a generations’ memorable experience and is going to be one of the economic events of our time. Its impact has been felt by every citizen in India. It technically is a liquidity shock; a sudden stop in terms of currency availability. This cleaning exercise may produce both short term as well as long term impacts.

1.3 SIGNIFICANCE OF THE STUDY

India is facing problem of black money in the currency form and fake currency notes. To eliminate this problem from roots, Government introduced demonetization. The significance of the study of impact of demonetization is justified on the grounds of its impact over the agents of the macro economy and the economy as a whole. Further, an insight into the opinions and preferences of individuals is the need of the hour to subside the hue and cry about the problems created due to Demonetisation.

1.4 LITERATURE REVIEW

HDFC Bank Investment Advisory Group (2016), elaborated that in the long run, demonetization would be a positive move in case of infrastructure and banking, through an equity market perspective. In short term, it can have negative impact on sectors like Luxury goods, Consumer items, Luxury, Jewellery and Gems, Real Estate and few related sectors. In long run, it can lead to improved tax compliance, better fiscal balance, lower corruption, lower inflation and complete elimination of fake currency. It will also help in improving the economic growth in long run.

Dr. Manmohan Singh (2016), former Prime Minister of India, contended that this measure has thrown the lives of millions of poor people in disarray as cash is the bedrock of lives of these people. This brazen policy measure has neither tackled the stock of black money nor has it stemmed the flow of it. The policy can act as a negative shock to the economy also.

Tim Worstall (2016) favoured demonetisation as it would lead to lower budget deficit, interest rates and inflation. The effects of change on GDP will emerge from system itself because we cannot calculate an economy beforehand.

Mamun Rashid (2016) viewed it as a painful exercise for not only the corrupt, but for the poorest and most marginalised people too. Demonetisation can be a futile exercise in the absence of steps to curb the generation of black money. Fake money once again may recirculate. Terror cannot be stopped by banning notes. The economy will be catatonic in short term, followed by a period of easing out. Only time will tell if it was all worth it.

Shanbhogue Girish, Kumar, A. Prashanth, Bhat, Swathi and Shettigar, Chethan (2016) defined currency ban as a move to stop counterfeit bank notes which were allegedly used for terror financing, as well as a surgical strike to black money and corruption in the country. Demonetisation leads to cash shortages in the country which proves detrimental to a number of small business, agriculture and transportation. The shortage of cash led to chaos and most people faced problems to exchange their banknotes due to long queues outside banks and ATMs across the country. This demonetisation step was proved to be the biggest attack on black money and corruption in the history of Indian Economy and a movement toward digitalisation. It also encourages digital payments. They concluded that demonetization is advantageous in short, medium and long-term.

Muthulakshmi, E. Kamatchi (2017) in her paper entitled “Impacts of Demonetisation on Indian Economy-Issues & Challenges” states that when the money is withdrawn from the economy, the country will not be benefited in short term. On the other hand, if the money paves its way into the economy, it would have a positive and meaningful impact. She also states that the demonetisation move, on one hand, was a serious attack on black money, corruption, hawala transaction, counterfeit currency and terror financing. On the other hand, it had a negative impact on various sectors like commodities and real estate.

Abhani Dhara K. (2017) posits that this demonetisation is proving to be more successful than the previous two. The era is changing. People are using online banking as a mode of payment. Bank employees are giving their best to make this demonetisation a successful one. Their support matters a lot. Though the demonetisation move has failed to grab the total black money in the economy, this has at least created fear in the minds of people holding black money. He concluded that demonetisation was a compulsory step to tackle the problem of black money, terrorism and corruption etc.

1.5 OBJECTIVES OF THE STUDY

- i) To understand the meaning and reasons of demonetisation.
- ii) To investigate the real impact of the ‘November 2016 Demonetisation’ on the Indian economy.
- iii) To gain insights on the positive and negative impacts of demonetisation on the Indian economy.
- iv) To check the proficiency of the enforced demonetisation.

2. RESEARCH METHODOLOGY

This study is descriptive in nature and tells about the meaning and reasons of demonetisation. It also attempts to investigate the impact of demonetisation on the Indian economy, furthermore classifying these impacts into positive and negative in the process. Hence it makes use of secondary data. The required and relevant data are collected from different research papers, journals and publications, and applicable sites available on web. Books were also referred to in the process in order to gain theoretical information on the topic as required. The entire study is based only on observation and documentary analysis.

3. RESULTS AND DISCUSSION

3.1 POSITIVE IMPACT

Demonetisation came as a big bonanza for digital payment platforms. The digital transactions in all modes have taken a 440 per cent increase in the past two years. This increase has been profound in National Electronic Fund Transfer (NEFT) and mobile banking.

The drive against black money helped in the deregistration of over two lakh shell companies with doctored accounts.

Demonetisation has been very good for widening and deepening the tax base of the country. Our gross direct tax growth rate and net direct tax growth rate have come up to 16.5 per cent and 14.5 per cent respectively.

With the increased tax collections, government revenues increased, hence reducing the size of budget deficit.

The measure really helped to bring in cash into the banking system, hence lowering the cost of loans.

Slashing of interest rates by banks eased the availability of credit to the poor.

Along with bank deposits, mutual funds too benefitted from the massive net flows because of the dropping interest rates. Hence, the demand for financial assets enhanced and that for physical assets reduced.

Hawala trade, which is used as a means to ease money laundering and terror financing, was struck at its roots. Days after the move, the hawala network almost went into complete paralysis. One year after the wiping out of the Rs 500 and Rs 1000 notes, money laundering activities dropped by 50 per cent, as per reports.

Real estate and gold, two avenues where the incidence of black money is way higher than other sectors, was somewhere brought under the radar.

Demonetisation complemented several other steps to reduce the circumference available for the activities of a parallel economy, like making PAN documentation compulsory for high value transactions and against all investment in physical assets was a supportive step.

3.2 IMPLICATIONS ON PUBLIC

The withdrawal of currency notes of Rs 500 and Rs 1000 notes created a cash crunch for more than a year in different parts of the country.

The worst hit was the informal sector-agriculture and construction workers, transport sector, poor families and others whose daily subsistence depends on daily cash and cash-credit. The scarcity of cash led to chaos in their lives.

Cash stringency compelled firms to reduce labour cost, thus reducing income to the working class. Employment and the number of jobs also dipped.

More than 600 million citizens live in villages with no bank at all, and about 300 million have no basic ID such as Aadhar card -thus not allowed access to the banking system, hence demonetisation came as a disaster for them.

Till months after demonetisation, the general economic situation was disturbed. The public had to queue up outside banks to exchange their old currency for new ones. Small shopkeepers, who only accepted cash, went into losses and some even shut down.

Demonetisation could not succeed much in hitting the illicit wealth held as real estate, shares, gold, silver and foreign currency. Only small time concealers of income, like women, who hid cash to create a stash which they could use to buy gold or in a health emergency.

Overall impact on the Indian economy

Demonetisation was not a big disaster like the global banking sector crisis of 2007, but at the same time, it acted as a liquidity shock that disturbed all the activities of the economy. It created a situation where lack of currencies jammed consumption, investment, production, employment etc. Most active segments of the population who constitute the 'base of the pyramid' and use cash to meet their transactions lost income in the absence of liquidity. Consumption was also adversely affected and overall economic activities dampened with liquidity shortage. As per reports, the government's note ban decision also shaved off economic growth by at least two percentage points for the October-November quarter of 2016, in which the move was effected.

In contrast to these temporary slowdowns in the economy and a few other effects which will pass soon, the measure of demonetisation brought with it some unmeasurable long term benefits. Transparency increased as more and more transactions became cashless. Indirectly, 56 lakh additional people have been brought under the tax net. The formal economy saw a growth. Real estate sector was brought under the radar. The downward pressure on interest rates generated more appeal for financial instruments. To some extent, the volume of black money activities reduced, counterfeiting and hawala transactions checked, and artificial inflation curbed. With people depositing money into the banks, bank's cash deposit base increased, thus enabling banks to cut down the cost of funds and also offer subsidized loans.

The country is moving towards a digital economy now, where transactions are being recorded and economy has more white money. This might help to raise the government's revenue and improve the state of the Indian economy.

4. CONCLUSION

Demonetisation has had a big propaganda effect. People are now much convinced about the need to fight black income. It is considered as the mother of all reforms in India. The Indian economy, which is a cash-driven economy, was largely affected in its growth. The big jump in the number of tax filers was praiseworthy. It also brought a social shake up in the country. Such a national awareness and conscience against black money can help in reducing the area available for black money activation. Another

demonetisation gain was a rise in the digital payments with faster adoption of alternative payment technologies.

But Gandhiji's mission to wipe every tear from every eye still remains unfulfilled. Demonetisation yet does not seem to have achieved the goal of slaying black money; rather it has increased the debt burden of the poor and the middle class. The grievous injury came to those who earn wages in cash, transact in cash and save in cash legitimately. Also, the current measure does not address the continued generation of black money. Low level of literacy rate and the high percentage of people below poverty line are natural barriers in digitalising the Indian economy.

Another point that remains is the political impact. Journalists had many a time raised this question whether the real goal was ending black money or bringing about any other economic outcome, or to position the PM as a champion of the poor who takes on the filthy rich on their behalf. The chorus which stood in support of demonetisation actually came up expanding the BJP's support base. So, whether this move was a political gimmick or in true faith a step toward the good of the Indian economy, remains unanswered.

As a matter of fact, demonetisation has won the battle resoundingly on many fronts. Some economists are, however, of the view that the last word on demonetisation is yet to be written, and indeed may not be written for years to come.

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