

IMPACT OF DEMONETIZATION: ORGANIZED AND UNORGANIZED SECTOR

***Joshini V, II B.Com(CA), AJK College of Arts and Science**

****Sandhya.M, II B.Com(CA), AJK College of Arts and Science**

*****Sruthy.M, II B.Com(CA), AJK College of Arts and Science**

******Athira S Nair, II B.Com(CA), AJK College of Arts and Science**

Abstract:

The argument posited in favour of demonetization is that the cash that would be extinguished would be “black money” and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. Therefore, it is imperative to evaluate the short run and medium-term impacts that such a shock is expected to have on the economy. Further, the impact of such a move would vary depending on the extent to which the government decides to demonetize. This paper elucidates the impact of such a move on the availability of credit, spending, and level of activity and government finances.

Keywords: demonetization, cashless transactions, credit, tax evasion

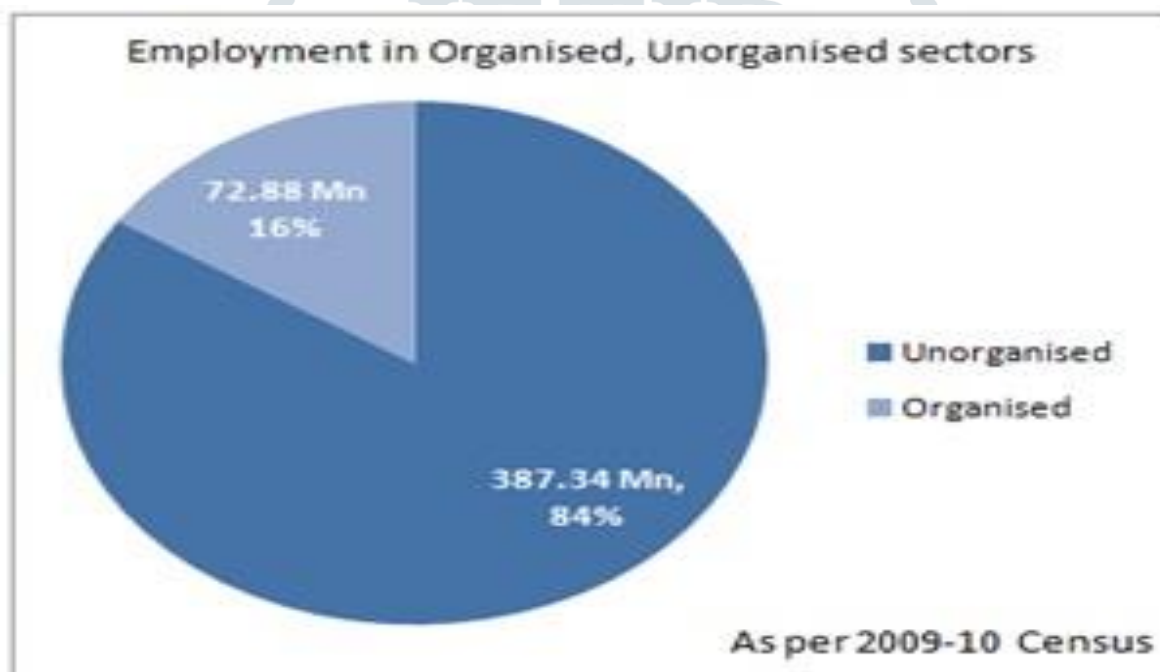
INTRODUCTION

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.¹ The proposal by the government involves the elimination of these existing notes from circulation and a gradual replacement with a new set of notes. In the short term, it is intended that the cash in circulation would be substantially squeezed since there are limits placed on the amount that individuals can withdraw.

In the months to come, this squeeze may be relaxed somewhat. The reasons offered for demonetization are twofold: one, to control counterfeit notes that could be contributing to terrorism, in other words a national security concern and second, to undermine or eliminate the “black economy”. There are potentially two ways in which the pre-demonetization money supply will stand altered in the new regime: one, there would be agents in the economy who are holding cash which they cannot explain and hence they cannot deposit in the banking system. This part of the currency will be extinguished since it would not be replaced in any manner. Second, the government might choose to replace only a part of the currency which was in circulation as cash. In the other words, the rest would be available only as electronic money.

DEFINITION OF 'DEMONETIZATION'

Demonetization is the act of stripping a currency unit of its status as legal tender. It 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. The opposite of demonetization is remonetisation, in which a form of payment is restored as legal tender. This could be a mechanism used to force a transition to cashless medium of exchange. The empirical extent of these two components will be unravelled only over the next six months. These two would have different effects on the economy in the short term and in the medium term, as will be explored below. To understand the effects of these dimensions, it is important to first understand what is it that cash does in the economy? There are broadly four kinds of transactions in the economy: accounted transactions, unaccounted transactions, those that belong to the informal sector and illegal transactions. The first two categories relate to whether transactions and the corresponding incomes are reported for tax purposes or not. The third category would consist largely of agents who earn incomes below the exemption threshold and therefore do not have any tax liabilities.



IMPACTS ON DEMONETIZATION: ORGANIZED AND UNORGANIZED SECTOR

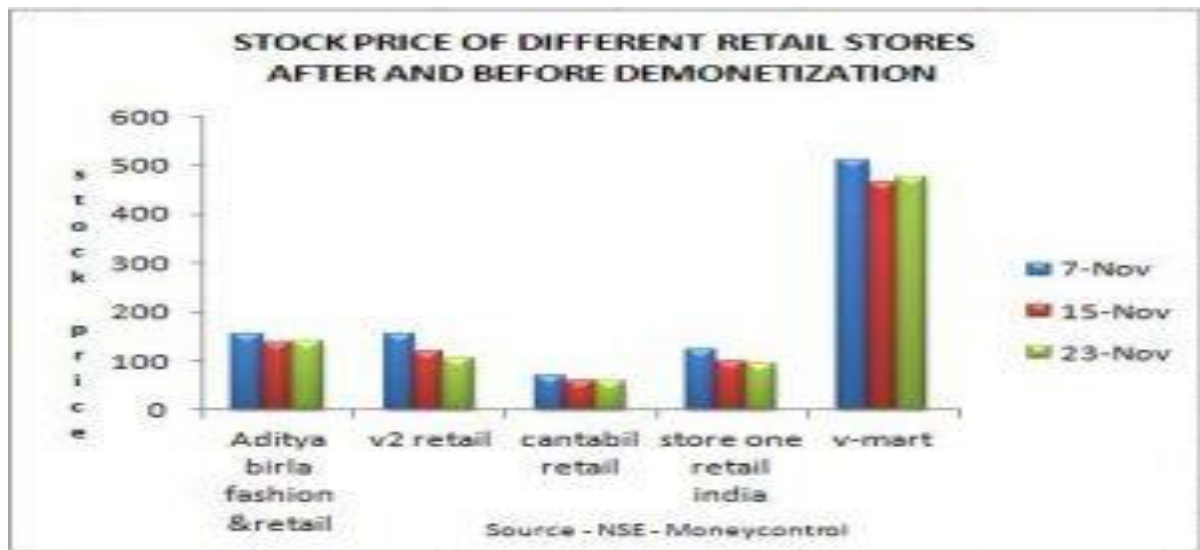
- The Effect of Demonetization on Organized Sectors Organized sectors is already familiar with banking and other formalities in one way or other.
- But mostly the unorganized sector, the farmers and labourers will suffer the most as they had been used to get and save in currency notes.
- Electronic or transactions by bank was limited to below 20% of daily transactions. Over the short and medium terms, the demonetization drive will have varied effects on the many sections of the hospitality industry in the country, but in the long term will positively impact the growth of the hospitality sector.
- Often, the strong season for the hospitality sector in the country extends from October to March, which to a large extent defines the success for the industry in any given year.

- The lack of available currency will force some hospitality customers to either postpone / cancel their travel and accommodation or to use hospitality products that easily allow the use of the other modes of payments.
- The demonetization drive will benefit the organized hospitality sector in India the most. Combined with the general uptake in the sector, the movement of customers to the organized sector due to ease of alternate modes of payment will positively impact the market.
- However, given the larger base of hotel rooms in the country is in the unorganized sector, we anticipate the general performance of the industry to witness some stress in the short term.
- The hospitality and the tourism markets are renowned for their ability to create a large number of direct and indirect jobs in the country.
- With the inability of customers / tourists to easily spend on frills due to lack of available currency, the unorganized industry will suffer the most in its ability to create new jobs.
- The impact of demonetization will also be felt by the suppliers of consumable goods, who often work on cash transactions with their wholesale counterparts.
- The unorganized inventory of hotels in the industry will be most impacted by this move. In addition, the leisure sector hotels and restaurants segment will see a higher impact on account of the discretionary nature of spending in this sector, and the substantially larger base of cash transactions that occur in its when compared to mainstream business hotels.
- Also, the restaurants business – both in hotels and standalone – will see a short-term slowdown in growth on account of the reduced availability of cash and the generally high usage of cash spending in restaurants.
- The organized banqueting business will witness growth, as customers move from the almost cash-only unorganized sector of standalone party venues and farm houses to hotels for want of non-cash means of payment.
- The weddings business will also return to Indian hotels from their overseas counterparts, as unofficial channels for offshore transfers of cash have dried up, forcing the cancellation of many Indian weddings from foreign locales back to hotel venues in India.
- The tourism and hospitality sectors are intrinsically tied to the economic conditions of any country.
- The boost provided by the demonetization move to the macro economy of the country will effectively trickle down to the industry.
- With banks being flush with liquidity, we anticipate a major reduction in interest costs, which augurs well for the growth of the industry.
- As more liquidity enters the organized sector along with some further softening of land rates and gradual movement towards cleaner real estate transactions, we anticipate investments into the sector to increase from the organized players who have, in the past, shied away due to complexities associated with underlying real estate.

DEMONETIZATION ON UNORGANIZED SECTOR IN INDIAN SCENARIO

- The unorganized sector in India will be the worst hit by the November demonetization of high value currency, while lots of industries in the organized sector would be impacted by the shortage of cash required to run business, a market analyst said on Monday.
- The unorganized sector is expected to bear higher brunt of demonetization.

- Within the organized space, a lot of industries would get impacted owing to the sucking out of daily liquidity needed to run the business," Centrum Wealth Research said in a report.



- India was heavily depended on currency in handling financial transactions. Electronic or transactions by bank was limited to below 20% of daily transactions.
- People used to save money in currency as it was essential to handle day to day transactions. 90% of the stores in markets were not accepting electronic money.
- They all insisted on cash in currency. Generally India had a stable economy and people started trusting currency and they trusted the economy enough to keep the savings in currency.
- India remained stable for long only because people maintained their money flexible for transactions.

CONCLUSION

Business houses are an integral constituent of the country's economy. While medium and large scale business is unaffected to such ban, many small-size commercial establishments are deeply affected by such sudden move by the government. The economy of the country may experience recession in the coming few weeks but is expected to get back to its shape shortly after the influence of Modi government. Central government's recent decision to demonetise the high value currency is one of the major step towards the eradication of black money in India. The demonetization drive will affect some extent to the general public, but for larger interest of the country such decisions are inevitable. Also it may not curb black money fully, but definitely it has major impact in curbing black money to large extent.