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EFFECTS OF DEMONETISATION ON THE INDIAN ECONOMY

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Abstract

Demonetisation process is a land mark in the History of Indian economy. It was an experience which has been created a fear in the minds of the people who indulge in illegal activities like tax erosion, and etc. During demonetisation, it was highly affected on higher class but middle class have been affected to some extent and nothing has affected to the poor. In the beginning it was adversely affected on some business activities like real estate, small scale industries, retail marketing, etc. But now after two years of its implementation business activities have returned to its normal track. As a result, GDP is increasing and other Economic activities are also improving in all dimension.

Key words: Demonetisation, Citizen, Inflation, Black Money, tax erosion, GDP.

Introduction:

The decision of Demonetisation is a landmark in the history of the Indian economy. It was an experience which has been created fear in the minds of the people who indulge in illegal activities like tax erosion or money laundering of any kind. On November 8, 2016, at 8pm The Prime Minister of India has declared that the 500 and 1000 rupee notes will be stripped of their status as legal tender effective from midnight. These notes accounted for 86 percent of the country's cash supply by value. Citizens were given time till December 31, 2016 to deposit their old currency notes and exchange them for the new currency notes of rupee 500 and 2000.

The Government's aim was to root out counterfeit currency, fight tax evasion, curb inflation, eliminate black money and terror-funding, and to promote a cashless economy. When a currency note of a particular denomination ceases to be a legal tender, it is termed as demonetisation. Legal tender refers to money which can be legally used to make payments of debts or other obligations. A creditor is obliged by law to receive such money in payment of due debt to him.

The term demonetisation is not new to the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the 10,000 rupee note in 1938 and again in 1954. It was demonetised first in 1946 and then in 1978. Since not many people had access to such notes at the time, this did not have a big impact on the country. The latest round of demonetisation has undoubtedly affected the common public and bankers. It has had many short term effects which are visible. The long term effects are yet to be experienced and felt.

Impact of Demonetisation on the Indian Economy

On Gross Domestic Product (GDP): The Indian economy is a cash-driven economy and demonetisation has largely affected its growth. The GDP growth rate of 8.01% in 2015-2016 fell to 7.11% in 2016-2017 after demonetisation. This was largely due to less availability of cash in cash-intensive industries like manufacturing and construction. It has also adversely impacted the primary function of banks to issue loans and has put pressure on them as current account holder's demand on large sums of cash.

On Daily Wage Workers: A major portion of the Indian workforce is a part of the informal economy. They use cash to meet all their expenses and demonetisation has resulted in a lot of them losing their jobs due to unavailability of cash. According to CMIE's Consumer Pyramids Household Surveys (CPHS), approximately 1.5 million jobs were lost during the final quarter of the financial year 2016-17. The estimated employment during this period was 405 million as compared to 406.5 million during the previous four months.

On Small Scale Industries: Businesses like the textile industry, salons, restaurants, and seasonal businesses are low capital enterprises and work on the basis of liquidity preference. Demonetisation gravely impacted their revenue collection and threatened their existence to an extent.

On Black Money: Though only a small portion of black money is stored in the form of cash and majority is in the form of physical assets like gold, land, and building, demonetisation of the rupee 500 and 1000 notes might take out a lot of black money from the economy.

On the General Economic Situation: 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. Households lacked liquidity and could not do transactions for daily items. Small shopkeepers who only accepted cash went into losses and some even shut down.

On Inflation: The Reserve Bank of India (RBI) considers the Wholesale price index (WPI) and the Consumer Price Index (CPI) to measure inflation. Demonetisation is expected to reduce inflation as consumers have cut down on spending and aggregate demand has considerably fallen. According to government press releases, the official WPI for 'All Commodities' (Base: 2004-05=100) for the month of December, 2016 declined by 0.2 percent to 182.8 (provisional) from 183.1 (provisional) for the previous month. The index started rising during the month of January and rose by 1.0 percent to 184.6 (provisional) from 182.8 (provisional) for the previous month. This may be correlated with the availability of cash with people who led to increased spending.

On Terror Funding: Demonetisation was aimed as a clean-up of the economy where Fake Indian Currency Notes (FICN) would be checked. It is aimed at rendering all fake notes of rupees 500 and 1000 useless and thus drastically affecting illegal funding of terror groups in Jammu and Kashmir, states in the North-East, and Naxalism-influenced states.

On Political Parties: Many Political Parties use large amounts of undeclared cash to campaign for elections and meet other requirements. Due to Demonetisation such acts might get restricted to an extent and parties will have to formulate new strategies.

Towards a Digital Economy: Absence of liquid cash has led to people making transactions using cheques or account transfers. They have also switched to virtual wallets like Pay tm which allows electronic transfer of money. All this might result in a digital economy where transactions are being recorded and the economy has more white money. This might increase the government's tax revenue.

Quantitative Analysis of the Impact of Demonetisation on the Indian Economy

**Table 1: Macro-Economic Aggregates at Constant Prices
(Base Year: 2011-12; Amount in Rs Billion)**

Year	GVA at Basic Prices	Consumption of Fixed Capital	NVA at Basic Prices	Indirect Taxes Less Subsidies	GDP at Market Price	NDP at Market Price	GDP Growth Rate
2011-12	81069.46	9171.75	71897.71	6293.83	87363.29	78191.54	6.5
2012-13	85462.76	10106.61	75356.14	6667.41	92130.17	82023.56	5.46
2013-14	90636.49	11006.1	79630.39	7377.21	98013.7	87007.6	6.39
2014-15	97190.23	11807.24	85382.99	8179.61	105369.8	93562.6	7.51
2015-16	104905.1	12641.93	92263.21	8904.88	113810	101168.1	8.01
2016-17	111854.4	13479.37	98375.03	10044.14	121898.5	108419.2	7.11

Source: Handbook of Statistics on Indian Economy 2016-17

As per the data published in hand book of statistics on Indian Economy by RBI, GDP at Market price fell approximately by 1 percent as compared to previous financial year. It registered a growth of 7.11 % from previous year as compared to the 8.01% growth witnessed during 2015-16. Table 1 indicates that GDP lost its growth streak of 4 years in the financial year 2016-17. GDP growth rate increased from 5.46% in 2012-13 to 8.01% in the year 2015-16.

As per the estimates of the Central Statistics Office, all the sectors of the economy faced different situations in Q1 of the financial year 2017-18. According to these estimates, the GVA at constant prices in Q1 of 2017-18 was rupees 2904128 crores as compared to rupees 2751407 crores in the Q1 of the previous financial year. These shows a decline in growth from 7.6% in 2016-17 to 5.6% in 2017-18 (see table 2)

Quarterly Estimate Of GVA At Basic Prices In Q1 Of 2017-18 (at 2011-12 prices)

Industry	April - June (Q1)				
	(Crore) Gross Value Added for Q1			% Change Over Previous Year Q1	
	2015-16	2016-17	2017-18	2016-17	2017-18
Agriculture, forestry, & fishing	371468	380833	389732	2.5	2.3
Mining and quarrying	87294	86485	85911	-0.9	-0.7
Manufacturing	458128	507223	513139	10.7	1.2
Electricity, gas, water supply & other utility services	55324	61018	65289	10.3	7
Construction	222464	229321	233919	3.1	2
Trade, hotel, transport, communication & services related to broadcasting	474733	516958	574261	8.9	11.1
Financial, insurance, real estate & professional services	594754	650607	692522	9.4	6.4
Public administration, defense & other services	293784	318963	349356	8.6	9.5
Total	2557949	2751407	2904128	7.6	5.6

Sectors in the economy such as Construction, Agriculture, Forestry & Fishing which employ a large number of daily wage workers and have liquidity preference witnessed a decline in growth. Agriculture grew by 2.3% in Q1 of 2017-18 as compared to 2.5% in Q1 of 2016-17, Construction grew at a rate of 2.3% in Q1 of 2017-18 and witnessed a drop of 0.2% since the Q1 of 2016-17.

Manufacturing, which is the most important indicator of economic growth and employment, has grown at a very slow rate post demonetisation. It grew by only 1.2% in Q1 of 2017-18 as compared to a massive growth of 10.7% in Q1 of 2016-17.

Conclusion

Demonetisation has been praised as well as criticised on various grounds. There has been a lot of opposition regarding the implementation of this policy. In the short run, there have been problems related to liquidity crunch, unemployment, loss of growth momentum, and a temporary halt to major economic activities. All this is evident from the data provided by the RBI.

The long term effects of Demonetisation are yet to be ascertained. It is expected that it can improve the Indian economy in the long run by increasing tax compliance, financial inclusion, consequently improving the state of the economy. It can boost the GDP by increasing the availability of funds for lending and also by reducing transaction costs if the economy moves to digital modes of payments.

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