

A STUDY THE IMPACT OF DEMONITIZATION ON INDIAN ECONOMY

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Abstract: Demonetization for us means that Reserve Bank of India has withdrawn the old Rs 500 and Rs 1000 notes as an official mode of payment. Demonetization is the act of stripping a currency unit of its status as legal tender. In an important move, the Government of India declared that the five hundred and one thousand rupee notes will no longer be legal tender from midnight, 8th November 2016. The RBI will issue Two thousand rupee notes and new notes of Five hundred rupees which will be placed in circulation from 10th November 2016.

Demonetization can be said as a „Surgical Strike“ on Black Money, Terrorism, Fake Currency, Unorganized trading, Real Estate, Share market etc. on the other hand if we talk about the Indian industry on a broader way it can be categories in three parts Manufacturing sector, Service sector and Agriculture sector. After demonetization only Agriculture sector shows some positive improvement while if we talk about the manufacturing and service sector both were crashed down and these will affect the whole Indian market in 2017 also. The present paper explores the impact of demonetization on various sectors of economy. It also analyzed the long-term benefits of demonetization.

Keywords: Demonetization, Black money, Sectoral impacts, Corruption, Cashless economy.

Introduction

Demonetization is the act of changing the existing currency in another form. The old units should be retired and replaced by new currency. In other words demonetization means either introducing new notes or coins of the same currency or fully replacing the old currency with new currency. There is a one important thing exist on economics, which is demonetization, in which forms of payment is restored as legal tender. There are so many reasons, why governments demonetized their nation's currency. Some reasons are like resisting inflation, resist corruption, and discourage a cash system in the country. In November 2016, The Indian government has taken a bold step to demonetize the 500 and 1000 Rs (fully ban). Currency notes, these two biggest denominated notes accounted 80% of the currency supply. The government's main objectives of note ban is, to eradicate counterfeit currency, resist tax evasion, destroy the black money, and terrorist financing activities, and to encourage the country towards the cashless economy. Similar measures have been taken in the past. In January 1946, currency notes of 1000 and 10,000 rupees were withdrawn and new notes of 1000, 5000 and 10,000 rupees were introduced in 1954. The Janata Party coalition government had again demonetized notes of 1000, 5000 and 10,000 rupees on 16 January 1978 as a means to curb forgery and black money.

Objectives of Paper

- To analyze the impact of demonetization on common people.
- To study the impact of demonetization on various sectors of economy.
- To analyze the long-term benefits of demonetization.

Research Methodology

The information in the study is collected from secondary sources that are from various online sources, websites, articles related to demonetization.

Review of Literature

Arpit Guru and Shruti Kahanijow (2010) researcher analyzed the black money income? Need for amendment in DTAA & ITEA and analyzed that black money is spread everywhere in India up to a large extent which continuously stashed towards abroad in a very large amount. The researcher also identified how black Money had caused menaces in our economy and in what ways it is used.

Sukanta Sarkar (2010) conducted a study on the parallel economy in India: Causes, impacts & government initiatives in which the researcher focused on the existence of causes and impacts of black money in India. According to the study, the main reason behind the generation of black money is the Indian Political System i.e. Indian govt. just focused on making committees rather than to implement it. The study concludes that laws should be implemented properly to control black money in our economy.

Tax Research Team (2016) in their working paper stated in favour of demonetization its main objective is to analyze the impact of demonetization on Indian economy. This paper shows the impact of such a move on the availability of credit, spending, level of activity and government finances.

Impact of demonetization on common people of India

Demonetization is a generation's memorable experience and is going to be one the economic events of our time. Its impact is felt by every Indian citizen. As the country says goodbye to the old Rs. 500 and Rs. 1,000 rupee notes and with restrictions on exchanging money and taxation on high amounts of deposits, Indian economy had faced through some serious churns. But how is this going to affect the common person of India in the short run as well as the long run. Initially, there was a huge hue and cry about the idea, people had to wait in really long queues just to withdraw the necessary money they needed. The public doubted prime minister's plan and revolted against the bad preparation they faced in this regard. The changes did invite a lot of trouble to the public in the beginning but it all seemed worth that, as far as the long-term effects were concerned. There was a limit to the per-capita withdrawal and that was a huge issue for many people, mainly because of their personal requirements which included marriage, health, property etc. In the process of curbing black money the innocent common people and poor had seemed most suffered like, those people who do not have access to post offices and banks had seemed panicking for exchanging notes. Those families who had weddings and other special occasions are depressed due to lack of money thousands of weddings have been cancelled which impacted the vendors who supply for those weddings. Also, farmers have faced lot of problems because they could no longer afford to sell their harvest from Kharif crop or sow Rabi crops. Also Many street vendors have loosed their business because do not want to part with cash or cannot make change. People have cut back spending because the banks are rationing cash. Many Daily wage workers are unable to find work. Also Demonetization has a direct impact on sectors dealing with cash—vendors, auto rickshaw owners, taxi drivers, daily wage earners and small traders. The Indian system mainly functions on cash, and so, less cash means disruption in the flow. Therefore, the government's step to curb black money and fake currency has hit hard to poor people the most. But as the time passed the things slowed down a bit. The queues in the banks shortened, ATMs were filled with money, new currency circulated and all these normalized the situation. Nevertheless, this change will have a huge impact on the economy. It will take some time for things to become normal again and for now, it is just a play of time till we get to know whether it was a really good decision or an overrated implication.

The demonetization of Indian currency has created numerous hardships to common person but in long way it has lot of advantages.

1. To the extent of penalties imposed by the Income Tax department on the illegal conversion of black money into white money, the revenue to the government will increase in the immediate future.
2. Unaccounted monies held as cash which was not productive will become productive as it enters the legal system.
3. Counterfeit money in circulation which was a ongoing menace all over India will cease to exist with immediate effect.
4. Funding of terrorist and other illegal activities will be curtailed as they generally are funded by black/counterfeit money.
5. To the extent the black money held by the political parties is flushed out, the elections in the near future will be clear and more transparent.
6. With huge cash at the disposal of the banks, the borrowing of money will get cheaper providing impetus to economic growth.
7. Government can avail finances at lower rates and speed up the infrastructural spending creating huge job opportunities.

So far, it can be said that this is a historical step and must be supported by everyone. We should look at the bigger picture which will definitely fetch results in the future.

Impact of Demonetization on various sectors

The different affected sectors of demonetization are as follows:

Agriculture: The sector typically sees high cash transactions and therefore near-term impact could be seen till liquidity is infused in the rural areas. As farmers face a temporary shortage of cash in hand, it could lead to a delay in payment which in turn would hurt the related companies in the short term. As liquidity eases and cashless transactions gain acceptance, the fundamentals would be driven by the longer term drivers of normal monsoons and positive traction in acreage.

Banking: The banking industry benefitted with a surge in deposits allowing banks to lower the cost of funds and better margins. There is no need to borrow funds at high costs as the non-interest income for banks increased due to deposits. Increased focus on cashless transactions, benefitted payment banks and digital wallets in terms of value and volumes. However, NBFC including gold financing companies and micro-financing companies that make disbursements and collections in cash witnessed a negative impact on their business. The fall in property prices may lead to longer period to liquidate properties thus adding to the woes of NBFC lending against property. So, in totality although the banking system became plush with money the financial services sector was at a loss of consumers.

Automobile: After Demonetization, there was dip in BSE auto index of 2.5 percent on December 10, 2016. It is because, the potential buyer make their down payment in cash component in small cars segment, whereas if we see the two wheeler industry majority of buyers make payment in cash as there is a limited scope of loan/financial need the demand of 2 wheeler has decreases by 40% to 50% because of non availability of cash into the market.

If we look into the tier 2 cities buyers generally prefer cash to buy the vehicles, so there is hit into the sale of 2 wheeler and 4 wheeler industry.

If we see the used car industry it is badly hit by this decision in short term as this industry is dependent on cash component and limited cash supply has given negative impact on this industry.

Real Estate: It is still too early to accurately gauge the depth of the shakeup caused by demonetization, but its impact on the real estate sector is apparent. Since the announcement of demonetization, the ripples have been spreading through the already disturbed sector, which has been experiencing excruciatingly slow growth in recent times. The real estate sector will definitely be affected by the demonetization exercise, as it has traditionally seen a very high involvement of black money and cash transactions. But, over the long term, the Indian real estate sector will emerge stronger, healthier and capable of sustained growth.

E-Commerce: After Demonetization, Online Payment is one thing that has been growing at good pace. There has been a significant growth mobile wallet sector. Now a day's transferring money and making payments for online orders is very easy with mobile wallet instead of COD(Cash on Delivery)And Online transaction do come with a lot of benefits.

Service Sector: Hit hard by demonetization, the services sector slipped into contraction in November 2016, worst slump in nearly three years, as new orders dried up and customers cut spending due to cash shortages. The Nikkei India Services Purchasing Managers' Index (PMI), which tracks services sector companies on a monthly basis, stood at 46.7 in November, down from 54.5 in October. Due to cash crunch in the economy, businesses declined in hotels, restaurants and renting activities. The gloomy PMI figures for the Indian service sector shows that companies were heavily impacted by the ban on Rs.500 and Rs. 1,000 notes. The drop in services activity suggests larger dependence on cash transactions.

Healthcare: In the healthcare sector, the worst hit is the medical tourism industry, since patients had come from outside India and were unable to get their treatment done due to financial cash crunch. Even the pharmaceutical industry had been affected due to the transactions which are done on the basis of cash.

Tourism: Favourite foreign Tourist Destinations of Indian people like Thailand, Singapore, Malaysia, Maldives, Hawaii, Vietnam, Sri Lanka, Nepal, China, Indonesia and Dubai will see negative impact in tourism revenues all black money sponsored trips will come to a halt. Indian Local Tourism will also get affected as they lose large chunks of the pay-in-cash-only clientele. Illegal foreign currency conversion is also reported to be badly hit, because they were big acceptors of Rs500 and Rs1000 denomination currency.

Gems & Jewellery: the impact of demonetization on Gems & Jewellery sector is quiet high since cash payment is the significant mode of payment for purchasing jewellery by the substantial portion of the customers. The sector is impacted because people are not

able to fulfill their daily needs. It is estimated that the domestic demand for gems and jewellery is expected to be muted in the near to medium term with the smaller jewellery retailers in the unorganized sector being the most impacted.

Media and Entertainment: Media and entertainment industry is impacted majorly as viewership has dropped to a very low number. The drop in demand is comparatively higher from the lower middle class. The respondents reported that the businesses in cinema halls and the production of few films have come to a halt with the sudden decision from the central government on demonetization. Also, the impact of demonetization is majorly seen on the smaller and emerging players in the industry.

Long-Term Benefits of Demonetization

The demonetization program has been evaluated in the context of its short-term costs and long term gains. Short term losses include loss of welfare for the low-income people and decline in GDP growth. On the long-term gain side, a large number of benefits are identified which will appear with time. Spread of cashless transaction culture, growth of the formal economy, registration of new income tax payers, linking or accounting physical asset investment to PAN, cleansing of the real estate sector, conscience about avoiding black income transactions, etc., are supposed to be the major long term gain. All of these necessitate additional or supportive policy measures by the government as well.

- i. Rise of the cashless economy: Spread of the digital payment culture will start the 'formalization' process in the economy. It will reduce the use of physical cash as well. Once bulks of the economic transactions are digitalized it will result in revealing the expenditure made by individuals to the tax authorities especially big transactions.
- ii. Growth of the formal economy will be another associated long term gain. If additional measures like cleansing the real estate sector and bringing all traders under the digital payment system, the unorganized sector transaction will be made accountable. Even if it is a slow process, bringing the informal sector into the formal economy will reduce black money.
- iii. Social shake up: Black money can be eliminated only if we eliminate the deep rooted social mentality that dealing with black money is economically rewarding and legally feasible. Demonetization may bring a social shake up in the country by destroying this mentality. It will spread an attitude against black money. People will be averse to deal with black money if they know that they are easily traceable and harder legal steps are initiated against them. Such an awareness and conscience can reduce the area available for the activation of black money.
- iv. Demonetization will reduce the circumference available for the activities of parallel economy: Demonetization is not an isolate arm or not the only one against black money. It may be complemented by several other steps. One such supportive step is making PAN compulsory for high value transactions up to Rs 10000. Similarly, PAN documentation should be made compulsory against all investment in physical assets like gold, land etc. If these happen, parallel economic activities can be reduced substantially.
- v. Large number of new tax payers may appear with demonetization. This is because demonetized money will reveal their income size and tax officials may check them in future, compelling to pay tax.
- vi. Cleaning of the real estate sector will be associated long term gain of demonetization. Modification of stamp duty structure is badly needed to provide energy to the sector at the same time, making it accountable.
- vii. Rise in financial savings: At present, more than 50% of household savings are in physical savings like gold and land. Significant portion of these are in black money. Now with the low reward in the real estate and gold holdings, people may tempt to save in financial forms like bank deposits, mutual funds etc.

As Krugman suggested, demonetization is a highly disruptive way to fight black money and it is only a one-time effort to flush out hoarded money. We can't do it always. Similarly, only a fraction of black money is stored in liquid cash. All these indicate that fight against black money will be successful in the long term only if the other measures suggested here are adopted.

Above all, the legal system should be prudent to prevent people to invent new ways of hoarding and dealing with black income.

Conclusions

Demonetization is very unique step taken by the government of India, earlier this step is taken by few of countries when there is a down fall in economy but this is the first time when this step is taken by the country when the economy is stable.

Demonetization is a deep psychological strike on Black Money. The move was also described as an effort to reduce corruption, the use of drugs and smuggling. This decision was considered as biggest cleanliness drive against the black money in the history of Indian Economy and we might move towards digital economy. Demonetization seeks to bring in a sharp, sudden but long lasting behavior change that encourages electronic payments. Demonetization is advantageous in short, medium and long term.

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