Relevance and Consequences of 'Demonetization' on Indian Economy

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Demonetization is a cohort's unforgettable familiarity and is going to be one of the economic events of our future time. Its blow is felt by all Indian citizens now. Demonetization influences the economy through the liquidity side. Its effect will be a powerful one because almost 86% of currency value in circulation was withdrawn with no replacing bulk of it. As an end result of the removal of Rs 500 and Rs 1000 notes, there occurred enormous gap in the currency composition as after Rs 100; Rs 2000 is the only denomination.

Nonexistence of halfway denominations like Rs 500 and Rs 1000 will decrease the utility of Rs 2000. Effectively, this will create Rs 2000 less practical as a transaction currency though it can be a store value denomination.

Demonetization theoretically is a liquidity fright; an unexpected stop in terms of currency accessibility. It creates a state where lack of currencies jams utilization, investment, production, employment etc. In this circumstance, the exercise may produce subsequent short term/long term/, consumption/investment, welfare/growth impacts on Indian economy. The power of demonetization effects clearly depends upon the extent of the liquidity shocks. Following are the main collisions.

Demonetization is not a big tragedy like global banking sector crisis of 2007; but at the same time, it will proceed as a liquidity shock that perturbs the economic actions.

Liquidity chomp**:** liquidity shock means people are not talented to get adequate volume of popular denomination especially Rs 500. This currency unit is the favorable denomination in daily life. It constituted to nearly 49% of the previous currency deliver in terms of value. Higher the time required to resupply Rs 500 notes, elevated will be the length of the liquidity chomp. Current reports indicate that all safety printing press can print only 2000 million units of RS 500 notes by the end of this year. Just about 16000 mn Rs 500 notes were in circulation as on end March 2016. Some portion of this was filled by the new Rs 2000 notes. Towards end of March approximately 10000 mn units will be printed and reinstated. All these indicate that currency chomp will be in our economy for the next four months.

Wellbeing defeat for the currency using people**:** Most active segments of the population who constitute the 'base of the pyramid' uses currency to meet their transactions. The daily wage earners, other labourers, small traders etc. who reside out of the formal economy uses cash frequently. These sections will lose income in the absence of liquid cash. Cash stringency will compel firms to reduce labour cost and thus reduces income to the poor working class.

Hammering of enlargement momentum– India risks its place of being the fastest growing largest economy: reduced consumption, income, investment etc. may reduce India's GDP enlargement as the liquidity impact itself may last three -four months.

Bang on bank deposits and interest rate**:** Deposit in the short term may rise, but in the long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the savers when full-fledged new currency supply take place.

Impact on black money**:** Only a small portion of black money is actually stored in the form of cash. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. Hence the amount of black money countered by demonetization depend upon the amount of black money held in the form of cash and it will be smaller than expected. But more than anything else, demonetization has a big propaganda result. People are now much persuaded about the need to scrap black income. Such a nationwide alertness and advice will encourage government to come out with even strong measures.

On GDP expansion

India's GDP which grew at 7.6% in FY 2015-16 is likely to slow down by 0.5% to 1.5% as per reports of various agencies. This is is due to less availability of cash in cash-intensive sectors like manufacturing and real estate. Even the automobile industry which was growing rapidly earlier has seen a contraction in the October-December quarter of 2016. Purchasing power of consumers has been negatively affected due to cash not being readily available.

We need to remember that Indian economy is largely cash driven with more than 90% transactions taking place in cash and digital transactions accounting for just the remaining 10 percent.

Banks have also been focusing on the single task of deposit and withdrawals with the result that their core function of issuing loans has been adversely affected. Also current account customers, who are largely business owners, need large amounts of cash at short notice have not been able to access cash and credit owing to restrictions on withdrawals and inability of banks to focus on the task of issuing loans.

Fulfillment on Tax

India's tax-to-GDP ratio is quite low at 16.6% compared to other emerging economies. It is estimated that since more money, including black money, gets accounted for this will lead to better tax compliance owing to better targeting of income. The positive impact could be lower tax rates as the tax base widens and more people start paying taxes. The digital push of the government will also result in higher indirect tax revenue for the govt. in the form of service tax. Moreover businesses that under-reported their revenue earlier, will have to make proper disclosure, especially, of revenue received through digital or cashless means.

Future of Small and Medium-sized Enterprises

The small and medium-sized enterprise (SME) sector, as we understand, is a big chunk of the economy, contributing to eight percent of the GDP whilst employing more than 80 million people year on year.

The labor wages in this sector are largely paid in cash and wages have been adversely affected by the demonetization move. Unemployment has also been reported owing to decline in demand of SME goods as the purchasing power of the consumers has contracted in the short term. Other sectors within the SME space like restaurants and transport operators have also been negatively impacted since economic activity has declined and also due to the fact that there is high tendency in this segment to accept payments through cash only.

Consequences of Agriculture

This is one sector where all transactions are in cash and, given the values involved, involve the higher denomination notes. The withdrawal of the old currency notes has put pressure on the mantis; farmers are having problems in selling their produce as both the parties have to agree on the mode of payment. Also since there is acute shortage of Rs 500 denomination notes presently, change for the high denomination Rs 2000 notes is not readily available with the vegetable and fruit vendors. This is also taking the buyers away from these vendors to big retail markets thus impacting the livelihood of the unorganized sector.

Creation of Employments in the nation

Since consumer demand has slowed and consequently industrial production has declined, employment generation has been adversely impacted by the currency demonetisation drive. Since the manufacturing sector which accounts for the highest employment of skilled and semi-skilled labourers, is witnessing slowdown in production; not only less jobs are being created but lay-offs are also taking place at a higher rate.

Brunt of Demonetization on Cashless dealings

As already explained above that cashless transactions account for only 10% of all transactions on daily basis. The government in order to divert some of the blame for the poor implementation of this demonetization exercise announced mid-way that making India a cashless or less cash economy was one of the important objectives of this demonetization drive. Towards this end, the Finance ministry, RBI and NITI Aayog announced a host of incentives to boost cashless transactions**.** This was also done to ease some of the problems that have resulted due to acute shortage of cash in the economy.

As a result, use of mobile wallets and cashless transactions, as a whole, have increased by about 300% since the launch of demonetization exercise. However we need to remember that this 300% increase is against a very low base of digital transactions and most of this increase has been noticed in the urban areas where people have ready access to, internet banking, and mobile wallets.

Conclusion

Demonetization of old currency notes surely has had **some positive impact** like reducing the cash flow to terror organizations, dismantling of counterfeit currency infrastructure, better income tax and indirect taxation, boost to digital economy. However, it has come at a huge social and economic cost. Sandeep Dongre writes that demonetization costs are estimated at Rs 1.28 lakh crores to the economy for the 50-day time period till the end of depositing period of old currency. This includes a cost of Rs 17,000 crore towards the government and the RBI for implementing the demonetization process in India.

Demonetization is a **one-time event and will not have much long term effect**. It alone is not sufficient to counter black money and corruption in the country; rather other measures are more crucial like bringing the offshore tax evaders to book whose names figure in the Panama papers, raid on benami properties, making donations to political parties open to public scrutiny and making it mandatory for all donations above Rs 2000 to political parties and religious places to be through digital means only.

This entire exercise seemed more like a **carpet bombing than a surgical strike** where the vast majority of honest and law abiding citizens had to undergo terrible hardships in order to catch the few black sheep who have hoarded black money and who also managed to convert their black income into white.

Demonetization: Merits and Demerits

On November 8, 2016, the Prime Minister of India, Narendra Modi announced the demonetization of all Rs.500 and Rs. 1,000 denomination banknotes of the Mahatma Gandhi Series. The demonetization announcement made the use of Rs.500 and Rs.1000 banknotes invalid past midnight of November 8. It was announced that the new Rs.500 and Rs.2000 banknotes of the Mahatma Gandhi new series would be introduced in exchange for the old banknotes.

The objective of demonetization as claimed by Government of India was to curtail the black money running as shadow economy and to stop the use of counterfeit cash to fund illegal activity and terrorism. The sudden nature of the announcement—and the prolonged cash shortages in the weeks that followed—created significant disruption throughout the economy, threatening economic output. The demonetization move was heavily criticized as poorly planned and unfair, and was met with protests, litigation, and strikes.

The announcement was sudden and unscheduled. It was a live television address at 8PM on November 8, 2016. In the days following the demonetisation, the country faced severe cash shortages with severe detrimental effects across the economy. People seeking to exchange their bank notes had to stand in lengthy queues, and several deaths were linked to the inconveniences caused due to the rush to exchange cash. As the cash shortages grew in the weeks following the move, the demonetization was heavily criticized by prominent economists and by world media.

Advantages of Demonetization on Indian Economy

One of the biggest achievements of demonetization has been seen in the drastic curb of terrorist activities as it has stopped the funding the terrorism which used to get a boost due to inflow of unaccounted cash and fake currency in large volume.

Demonetization policy of the Government has been termed as the greatest financial reform that aims to curb the black money, corruption and counterfeit currency notes.

All the people who are not involved in malpractices welcomed the demonetization as the right move.

Demonetization was done to help India to become corruption-free as it will be difficult now to keep the unaccounted cash.

Demonetization will help the government to track the black money and the unaccounted cash will now flow no more and the amount collected by means of tax can be better utilized for the public welfare and development schemes.

Money laundering will eventually come to halt as the activity can easily be tracked and the money can be seized by the authorities.

Demonetization aims to stop the running of parallel economy due to circulation of fake currency as the banning of Rs.500 and Rs. 1000 notes will eliminate their circulation.

The unaccounted cash could be deposited in the Pradhan Mantri Garib Kalyan Yojana after paying 50% tax. The money will remain deposited for 4 years with the bank without incurring any interest. However, after 4 years the amount will be returned. This amount can be utilized for social welfare schemes and making the life of low income groups better.

The Public Sector Banks which were reeling under deposit crunch and were running short of funds have suddenly swelled with lot of money which can be used for future finances and loans after keeping a certain amount of reserve as per RBI guidelines.

Disadvantages of Demonetization on Indian Economy

The poor planning on the part of the government has also added to the woes of the common people with low incomes. The Rs.2000 currency note does not find many takers as it is difficult to get the balance back when you are buying daily needs like vegetables, milk, bread or paying for petty expenses like bus fare. While rs.100 currency notes were not available in sufficient number, Rs.500 note arrived in the market very late.

The sudden announcement has made adverse impact on business and economy. Instead of a growing economy India has become a standstill and no growth economy. It is fearedthat a fall of 2-3% in the GDP growth will be recorded coming year.

India is an agriculture based economy. Due to the cash crunch, the farmers especially small and marginal who largely depend on cash to buy seeds, fertilizers and to pay for sowing, borrowing water for irrigation and for other related agriculture equipments remained worst affected and could not complete the crop related activity.

Since small branches of the banks were also not supplied with adequate cash within time of sowing season of the crop, farmers could not get their crop loans disbursed. This added to the woes of the farmers leading to a weak agriculture production the coming year.

Real Estate sector came to a stand still and is still gasping for buyers of the constructed and half constructed inventory without buyers. This has resulted in poor cash flow leading to a poor demand.

Demonetization has made the situation become chaotic. Tempers are running high among the masses as there is a delay in the circulation of new currency.

Due to the inability to pay cash to poor daily wage workers, the small employers have stopped their business activity.

Demonetization is the 2 way sword in regard to incurring the public expenditure. On the one hand huge cost is to be incurred on printing the new currency and on the other hand managing the lakhs of crores of old currency volume has also become a big expenditure incurring item.

Many Economists are of the view that Rs.2000 currency note will be much easier to hide and can be used to store black money in shorter space.

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