

Impact of Demonetisation on Indian Economy: A Critical Study

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ABSTRACT

Withdrawing units of money from circulation is demonetisation; units of money are denied the status of legal tender. Demonetisation is defined as a process by which currency units will not remain legal tender. The currency notes will not be taken as valid currency. Demonetisation is a step taken by the government where currency units are ceased of its status as legal tender. Demonetisation is a basic condition to change national currency. In other words, demonetisation can be said a change of currency where new units of currency replace the old one. It may involve the introduction of new notes or coins of the same denomination or completely new denomination. The currency has been demonetised thrice in India. The first demonetisation was on 12th January 1946 (Saturday), second on 16th January 1978 (Monday) and the third was on 8th November 2016 (Tuesday). The study attempts to understand meaning and reasons of demonetisation, the sector-wise impact of demonetisation. This study also gives an insight into the positive and negative impact of demonetisation on Indian economy. This study is of descriptive nature so all the required and relevant data have been taken up from various journals, magazines for published papers and websites. Books have also been referred for theoretical information on the topic as required.

Keywords: Currency, Demonetization, Cashless transaction, Digital economy, Indian Economy.

INTRODUCTION:

Demonetisation means withdrawing the legal tender rights of any denomination of currency. Units of money have deprived the status of legal tender. Demonetisation is an act of taking away the legal tender rights of any currency. The units of currency will not be considered as valid currency. Demonetisation is the process of ceasing a unit of money of its status as legal tender. Demonetisation is a necessary condition for changing the old currency with the new units of money... It may involve the introduction of new notes or coins of the same denomination or completely new denomination. The currency has been demonetised thrice in India. The first demonetisation was on 12th January 1946 (Saturday), second on 16th January 1978 (Monday) and the third was on 8th November 2016 (Tuesday). The government believe that this currency ban is required for the four main reasons. To control inflation, to fight against corruption, to remove counterfeit currency and to discourage the cash transaction. Developing country like India has to find the solution to come out of the problems like this for the betterment of the country. The government needed to keep the decision secret so that the tax evaders would not be aware of this clean-up mission before the announcement of demonetization took place

LITERATURE REVIEW:

Shanbhogue Girish, Kumar, A. Prashanth, Bhat, Swathi and Shettigar, Chethan (2016) defined currency ban as a move to stop counterfeit bank notes 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.

Shah, Ayash Yousuf (2017) stated that Demonetization is one of the major steps in fighting against corruption, black money and terror funding. However, this decision was taken without proper preparation and it adversely impacted the public. Without printing enough new currency notes 86% of the currency notes were withdrawn thrashing all market transactions. Only common people had to face problems exchanging their notes, not the people who were targeted. With an intention to rid the country of black money and dig out tax defaulters and black money holders, the government has taken the step to demonetized Rs 500 and Rs 1000 notes. The sudden announcement of demonetisation and failing to plan properly has created chaos among the general public. Common people are facing problems buying with no money in their hands, wasting their time standing in endless queues could have easily been avoided with advance planning.

Veerakumar, K. (2017) posits that the announcement of demonetization of 500 and 1000 currency notes by the government is a big shock to the citizen of India. The highest currency notes are withdrawn from the economy to counter the problem of tax evasion, counterfeit currency and financing of terror activities. It is shown that huge money is being deposited into the bank accounts which are more than specified limits and are subject to penalties and taxes. Usage of e-wallets, debit and credit card has been increased tremendously and this will create better cashless infrastructure.

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 the demonetisation a successful one. Their support matters a lot. Though the demonetisation move has failed to grab 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.

Shukla, Bal Govind and Gupta, Hariom (2018) in their paper entitled "An Exploratory Study Of Business Students Perspectives On Demonetization In India: With Special Reference To Allahabad City". They used primary data for their study and concluded that the people actively support any initiative taken by the government which are basically targeted to eradicate corruption, black money, and any other threats like terrorism and naxalism in the country.

OBJECTIVE OF THE STUDY:

1. To understand meaning and reasons of demonetisation.
2. To study the sector-wise impact of demonetisation.
3. To study the positive and negative impacts of demonetisation.

RESEARCH METHODOLOGY:

This study is of descriptive nature and tells about the meaning and reasons of demonetisation along with the sector-wise impact of demonetisation and positive and negative impacts of demonetisation on Indian economy. Hence makes use of secondary data. The entire study is based only on observation and documentary analysis. Furthermore, the required & relevant secondary data are collected from various Research Papers, Journals, & Publications, websites and many others. Books have also been referred for theoretical information on the topic as required

FINDINGS:

This part is divided into following sub parts as under:

- Reasons of demonetisation.
- Sector-wise impact of demonetisation.
- Positive and negative impact of demonetisation on Indian Economy.

Reasons of Demonetisation:

Black money:

Demonetisation was a bold and revolutionary action taken by the government of India to curb black money and one that will have the deep impact on the parallel economy in the country. Pockets and persons with black money can be identified with this move. A few businesses like property dealers, jewellers, foreign currency dealers, private money lenders generally hold huge amounts of unaccounted money in form of currency notes. Such unaccounted money had created a parallel economy in the country. Such illegal money has reached the bank accounts through direct or indirect channels.

To hit the fake currency rackets:

Fake Currency Notes have been wasted by the demonetisation. Withdrawing highest currency notes out of the economy will have a serious impact on the fake currency syndicates, thus putting an end to the terror funding in Jammu and Kashmir, Naxalite hit states and North-eastern states. The fake currency with racketeers have been left in vain, and new currency notes with high security; making a counterfeit impossible. Demonetisation was a surgical attack on a fake currency circulating in the economy. Demonetization has converted those fake currency notes into a mere piece of papers.

Online transactions:

Demonetization's motto was to encourage the cashless/digital economy. More and more cash-less or less-cash transactions will lead to more disclosure of income which will increase the direct tax collections. With a reduction in cash transactions, alternative forms of payment will more in demand. Electronic mode of payment like online transaction, payment through applications, E-wallets E-banking, usage of debit and credit cards etc. will surely see the substantial increase in demand

To hit Maoists:

This step actually made money with Maoists worthless. As reported Maoists had hoarded over Rs.7000 cores with them at Baster in Chhattisgarh. All such currency is now nothing but pieces of papers

Rise in GDP:

Though demonetisation has negatively impacted sectors such as real estate and property, construction, and household consumption in general, it is believed that long-term benefits for GDP growth will outweigh the short-term transitional impact. We are now heading towards a 9% GDP growth by FY2018-19.

Sector-wise impact of demonetisation:

Real estate and Property:

This sector would be one of the most affected sectors by note ban. Demonetization has finished the businesses of the majority of the builders as a major portion of their transaction depends on cash rather than based on banks transfer or cheque transactions. As other sectors, marginal builders are adversely impacted reason being the high involvement of cash component in payment in this sector. Unorganised builders have been most affected. Builders will face a cash crunch due to the unexpected drop in sales, in order to attract buyers; builders are required to introduce lucrative offers & other benefits. Demonetisation will have a direct impact on resale and land segment as cash plays a major role in these transactions. Most of the accounted cash have been pulled out by demonetisation from the system.

Gems & Jewellery:

The substantial portion of the payment by customers involves cash for purchasing jewellery so the impact of demonetisation in this sector is quite high. Demonetisation made people with less cash available in their hands for fulfilling their daily needs let alone purchasing jewellery. Smaller retailers in the unorganised sector were the most to be impacted which reduce the demand for jewellery. Many jewellers started selling gold at more

than their market price to take advantage of banned notes which resulted in income tax raids on such jewellers. Notices have also been issued to many jewellers. This sector is seriously hit by demonetisation as buyers prefer to pay in cash.

Banks:

Banks have proved to be the backbone of this entire process of demonetisation and also the biggest beneficiaries. As on the direction of government, old notes have to be exchanged with the new one, this resulted in increased liquidity position of banks which could be utilised for lending. Both deposit and lending rates have been cut by many banks.

Media and Entertainment industry:

Currency ban adversely impacted the media and entertainment industry as it resulted in lesser number of viewers. The major portion of the drop has been seen in lower middle class. The sudden decision of demonetisation affected the film industry as well. This brought the production of films to a halt. Also, the new and small players in the industry are most affected by demonetisation.

Hospitality and tourism:

Due to demonetisation Indian tourism industry have been severely impacted as the majority of spending is in cash. Most of the luxury foreign trips are sponsored by black money has come to a halt. Due to the cash crunch, local tourism will also get affected. The unorganised sector is most impacted with the inability to make payment in cash. Further, the slowdown is also faced by the restaurant's businesses with the inability of cash.

Luxury items:

Demonetisation will have a drastic impact on this sector. Majority of the people spend their unaccounted money on luxuries. After the note ban, luxury segments and allied business like clothing, electronics, luxury car will have a huge setback.

Automobiles:

Demonetisation has also affected automobile industry. The major decline in demand has been seen in two-wheelers business as compared to four wheelers/luxury cars because buyers prefer to pay in cash for buying a two-wheeler. The used car industry is another segment affected by a demonetisation wherein sudden decrease in sales has been reported by several dealers. In this industry, payments are not regulated.

Retail:

The cash crunch is leading to low consumer demand for the products. This ultimately leads to decline in their sales volume. Since cash is the favourable mode of payment in buying daily needs which in turn result in the number of cash transactions. The impact of demonetisation on small and the unorganized traders is higher than the organised sector.

Agriculture:

There are various factors impacting agriculture such as sale, distribution, marketing and transport, such factors are dominantly cash-dependent. Further, demonetisation disrupted the supply chains, this sector has severely been impacted by huge wastage of perishables. The small farmers selling their products on daily basis to the wholesale centres, mandis and to the consumers have also been impacted by demonetisation.

Labour-intensive sectors:

In order to pay daily wage labourers huge amount of cash is required, they have faced problems buying their routine stuff. Limitations on the withdrawal amount from the bank is affecting the weekly payment to contract personnel in mining, textile and leather industries. Additionally, daily requirements of the factory owners are being affected by the restrictions on cash withdrawal. This is adversely impacting the procurement and production in this sector. However, the situation will improve once the cash flow becomes normal.

Impact of demonetisation on Indian Economy: Positives and Negatives**Positives:****Black money:**

Prime Minister Narendra Modi on a single stroke has choked the black money. Out of total currency which is

Rs 17 lakh crore, Rs 3 lakh crore is estimated as black money. Operators of black money run a parallel economy which weakens the base of the country's economy. Modi's demonetisation decision resulted in the collection of huge deposits with the bank, all unaccounted money has either been deposited into the banks with the heavy penalty or been simply destroyed.

Economy:

This demonetisation has proved to be a turning point for the economy by cleaning-up the black money which in turn has brought more borrowings to the treasury, improved inflation outlook and increased GDP of India. Investment opportunities have also been revived and gave a boost to infrastructure and the manufacturing sector. A huge amount of money deposited in banks which in turn helped reduces interest rates and lower income tax rate.

Real estate:

It is said that real estate is an industry prospers on black money. The amount of illegal money involved in this sector is huge. An estimate tells us that in Delhi-NCR at least 40 percent of real estate deals are in black. Modi's demonetisation move reduced the flow of unaccounted money into the real estate sector. This will help in curtailing the use of black money in real estate sector which in turn result in the reduction in the prices of land and property.

Hawala transactions:

Demonetisation was a big thrash to the hawala racketeers. In Hawala money is transferred without its actual movement. Hawala had become the route to facilitate money laundering and terror funding. Hawala rackets run on black money. The sudden withdrawal of black money out of the economy was a surgical strike to hawala operations. Destruction of currency notes by hawala operators have also been reported.

Counterfeit currency:

Demonetisation was a mighty blow to the counterfeit Indian currency. Currency with syndicate operator operating both inside and outside the country has been wasted. Counterfeit currency is one of the main reasons behind the devaluation of the real worth of Indian currency. Indian Statistical Institute reported that at any given point of time fake currency notes amounting to Rs 400 crore were in circulation in the economy and around Rs 70 crore fake currency notes are pushed into the country every year. But the real number could be much larger. With Prime Minister Modi's demonetisation decision to ban old currency notes of Rs 500 and Rs 1,000 notes and replacing them with new one completely sucked the circulation of fake currency. As new currency notes have come with highly advanced security features which are barely possible to replicate.

Terror financing:

The main source of Terror financing is through counterfeit currency and hawala. This is how it works. Fake currency is circulated by the network of hawala operators. These hawala operators have a link with gamblers and smugglers of arms and drugs. Indirectly, they all end up financing terrorism. In addition, the terrorists obtain huge money by donations routing such money through hawala transactions. All channels of terror financing are now closed with the control in the circulation of counterfeit currency and hawala operators.

Maoism:

Maoist sympathisers have declared Modi's demonetization move as "undeclared financial emergency". There are reasons for it. Currency ban proved to be a serious attack on the Maoists movement. Black money is the major source of fund for Maoists. Maoists used to raise crores of rupees annually through extortions. Such unaccounted money is used to purchase arms and ammunition. with Modi's demonetisation move, all those black monies are reduced to pieces of papers. Ever since note ban, no major incidence of violence took place from the states like Andhra Pradesh Odisha, Telangana. and Chhattisgarh.

Kashmir violence:

Stone pelting has reduced in Kashmir because of note ban. No stone pelting has been reported in Kashmir since the withdrawal of highest currency notes from the economy. As reported by. Intelligence agencies 1,000 crores are sent annually by Pakistan to the separatists for creating chaos in Kashmir. The money to the separatists is transferred through hawala. With hawala transactions completely curtailed left separatists curelessly. Modi completely dismantled the Kashmir unrest with his surgical strike called demonetisation.

Negatives:

Liquidity crisis:

Demonetisation gave rise to liquidity problem as people found it difficult to get sufficient amount of cash to fulfil their basic needs. Marginal section of the society mainly depends on cash to meet their daily transactions. Out of total currency in circulation 500 rupee notes constituted nearly 49% in terms of value. More the time is required to resupply Rs 500 notes, the more will be the duration of the liquidity crisis.

Loss of well-being:

Most of the population who constitute the lower middle and lower class uses currency to meet their daily transactions. Such class of the society such as daily wage labourers, small traders and other marginal section of the society use cash more often. These sections of the society have lost their income in the scarcity of cash. Cash crunch made firms to cut their labour cost and thus reduces the income of the lower middle class.

Consumption:

Cash shortage adversely affected the consumption behaviour of the people in India. The sales of consumer durables likely to be hampered in short-term, especially sales through unorganised channels are cash purchases. Most of the purchases by retailers are through cash which brought down their volume of trade.

Decrease in GDP:

Withdrawal of highest currency notes reduces the growth rate of the economy. Demonetisation reduces consumption pattern, income, investment etc. This may bring a slowdown in India's growth rate as the liquidity crisis itself may last three-four months.

Interest rate and Bank deposits:

Deposit of the bank may increase in short-term due to demonetisation, but will come down in long-term. Such liquid cash deposited in the bank by people may not be assumed that such amount of money once stored in the banks will be invested for long term. Such money may be saved into banks just to convert the old notes with the new one. These are not voluntary savings aimed to get interest rather it is because of demonetisation. It will be withdrawn by the savers as soon as the supply of new currency takes place. This indicates that new savings are only for short-term which may be encashed at the appropriate time in future. It may not be said that demonetization will generate big savings in the banking system in long term, this may reduce interest rates in short but not in the long term

Black money:

One of the main reasons behind demonetisation move was to curb black money but only a small portion of the black money is actually stored in the form of cash. Most of the black money is kept in the form of land, gold and buildings etc. Hence the amount of unaccounted money deposited with the banks is only up to the amount of cash deposited. Countrywide awareness is created among the people to fight against black money

CONCLUSION:

The move by the government to demonetise old currency and replacing it with the new one has taken the country by surprise. The move was an effort to handle the threat of illegal money, corruption, terror funding and counterfeit currency. The decision regarding demonetising the old currency was considered as a surgical strike against the undeclared money in the history of Indian Economy, it may be a move towards the cashless economy. The demonetisation is followed by a liquidity crunch in the country, banks and ATMs across the country faced severe cash shortages with detrimental effects on various small business, agriculture and transportation. Currency ban by the government of India created chaos in short-term as most people with old currency notes faced difficulties exchanging them in long queues outside banks and ATMs across India. The total value of old currency notes in the circulation was to the tune of Rs 14.2 trillion, which constitute about 86% of the total value in circulation. The black money has either been accounted by paying heavy taxes and penalties or has reached the bank accounts through direct or indirect channels. Demonetization would bring a positive impact on Indian economy as it encourages the digital mode of payment like E-wallets and apps, online transactions using E-banking, usage of plastic money etc Demonetization is beneficial for the economy in the medium to long-term.

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