

Impact of Demonetisation on Indian Economy

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ABSTRACT

This research paper highlights the effects of demonetization in India. The term 'Demonetisation' became a household name in the nation after Government decided to demonetise the notes of Rs. 500 and Rs. 1000 currency notes. This study attempts to showcase the aspects for which demonetisation was implemented, for example, to check the use of black money, fake currency, terrorism, corruption etc. This was a cleanliness drive which was conducted by the Government in the interest of people against black money and corruption. While this decision helped the country dispose-off the black money from its system, its impact in the international can be determined only after a certain point of time. But there are various views of experts on demonetisation; some are of the opinion that it will hit the parallel economy. It is a monetary policy which was established to handle black money. A major part of the GDP is the black money stock. There is a need to study the medium and short term effects of the decision of demonetisation on the economy of the country. This study will be helpful in providing useful inputs for remonetisation. This paper intends to give an exact picture of the effects of demonetisation and the various steps taken by the Government to help minimise the after effects on the lives of the common people.

Key Words: Demonetisation, Remonetisation, Black money, Parallel Economy

INTRODUCTION

Demonetisation came into existence on 8th November 2016. Honourable Prime Minister of India, Narendra Modi, took the decision and only after that people started to talk about it. The decision was to demonetise two big notes of Indian currency i.e. 500 and 1000 rupee notes, the two biggest denomination notes. These notes were mainly responsible for the black marketing and corruption increase in the country. The rough estimate was that a total of 86%

of the cash supply of the country was incorporated in these two notes as was stated by a renowned economist has compared the pain of common people by stating what if 86% of their blood was removed from their bodies. The main agenda of the government behind this decision was to stop the terrorist funding, to stop the circulation of black money, to promote cashless economy and make people digitally advanced. This was a landmark decision which will help India in becoming a cashless nation.

MEANING OF DEMONETISATION

According to Merriam Webster Dictionary, “The term demonetisation has its root word from verb demonetise.” Demonetisation has multiple meanings. It is required to replace an old currency unit with a new one. Legal system also recognises this medium of payment. Many countries have coins as well as paper notes as used forms of legal tenders. This initiative of the Government was to scrap the circulation of certain notes for different reasons.

HISTORY OF DEMONETISATION IN INDIA

The first currency ban in India was on 12 Jan, Saturday 1946 , at that time the notes which were demonetised were of Rs 1000 and Rs 10000. but this ban was not much effective because these notes were not accessible to the common people in that time. New currency of Rs 5000 and both Rs 1000 and Rs 10000 notes were reintroduced in the year 1954.

The second currency ban was announced by Honourable Prime Minister of India Morarji Desai on 16 Jan, Monday 1978 the decision was to put these notes out of market. The basic reason was to stop parallel economy from running in the country. On 28th Feb 1978 the finance minister H.M. Patel spoke in his budget speech, “The demonetisation of high denomination bank notes was a step primarily aimed at controlling illegal transactions. It is a part of series of measures which government has taken and is determined to take against anti-social elements.”

IMPACT OF DEMONETISATION

It is not easy to analyse the actual impact of demonetisation. Because demonetisation it is recent economic event, it is yet to unfold its full impact particularly over a longer period of time. Impact of demonetisation as discussed in the present literature is mostly immediate impact or short period impact. One can only make a guess about long period impact of demonetisation. Short period impact of demonetisation is split as good and bad impact. This is discussed as under.

GOOD IMPACT OF DEMONETISATION

Following observation highlight the good impact of demonetisation:

- 1. Check on food inflation:** Owing to a substantial withdrawal of currency in circulation, demonetisation led to a check on food inflation in the economy. Liquidity crunch led to a substantial fall in stock-piling of food grains. Accordingly, there was a sharp fall in food inflation by about 240 basis points between November 2016 to January 2017.
- 2. Real Estate Cleansing:** Demonetisation led to a deep cleansing of real estate sector. This sector served as the centre-stage of shadow economy (economy that is driven through black money transactions). With the eradication of black money (following demonetisation) real estate sector lost its sheen for speculative investment through black money. Prices in the real estate sector have crashed and housing is becoming more and more affordable for the middle and lower sections of the society.
- 3. Push towards Digitalisation:** One intermediate objective of demonetisation is to improve tax collection and compliance and create a cashless country. It is evident that the cash transaction are mostly anonymous there are more chances of people using this money for hidden transaction which are not shown in their income tax returns. As against this, digital transactions are fully tracked and helped control the flow of black money. Economic survey 2016-17, mentions two cardinal virtues of such transactions. Firstly, this initiates the modern wired era and secondly they introduce the reduced tax evasion and increased financial market savings.
- 4. Reduction of Black Money:** Demonetisation chocked the Parallel economy. The estimated Rs. 17 lakh crore which was in circulation, Rs.3 lakh crore was estimated to be black money. Black money operators run a parallel economy which results in making country's economy very weak. The decision taken by the government to demonetise led to huge deposits in banks of unaccounted money with either penalty or was simply destroyed.
- 5. Reduction in illegal activities:** black money is utilized for funding of terrorism, gambling and money laundering and is also used to inflate the price of assets like real estate, gold etc. Demonetisation is helpful in curbing such malpractices and it takes a lot of time to generate the black money again. Huge sums of money especially in

Demonetisations of Rs. 500 and Rs. 1000 were used to fund terrorists and naxalites. Now these organisations will face a shortage of funds. These funds were used for buying arms and weapons, which will become an extremely difficult task after the Demonetisation.

6. **Impact on Economy:** By cleaning-up the black money demonetisation has proved to be a turning point for the economic growth. After demonetisation GDP increased and improved inflation outlook. There is a boost in infrastructure and manufacturing sector because investment opportunities have been revived. After demonetisation a huge amount of money was deposited in the banks by people which helped reduce interest rates by the banks.
7. **Increase in Tax Revenue:** Tax collections have multiplied after demonetisation. The collection of property, water and other taxes has risen considerably. The decision of the IT department to monitor the accounts with transactions of Rs 2,50,000 either in deposit or withdrawal has also increased the tax revenues. This revenue can be utilized to provide good infrastructure facilities building new roads and providing facilities for poor and needy sections.

ADVERSE EFFECTS OF DEMONETISATION

Demonetisation was not all boon, it was a bane as well. It generated a bad impact in the economy, as evident from the following observations.

1. **Inconvenience to the people:** The demonetisation was incurred in such a manner that it was a huge inconvenience to the common people. People faced inconvenience in depositing or withdrawing money. Many people who did not have their bank accounts faced a lot of problems in opening bank accounts and depositing their money. Most adversely affected was the labour class. Billions of man-hours were wasted in queues waiting for cash, millions of persons lost jobs and incomes particularly in the informal sector and tragically many deaths were also reported. General public faced a problem due to the delay in printing of new notes.
2. **Adverse effect on Economic Activities:** In our country which is still a developing country most of the monetary transactions take place in cash. The use of internet banking and other online transactions are very limited and restricted to a few classes of society. This dearth in cash money availability was the main cause of downfall

trade, business and consumptions. Some people suffered more as they were restricted to use cash only and they found it hard to pay for even basic commodities. This decision will certainly effect the growth and output. As far as consumption expenditure concerned, it dropped sharply while investment activity was also badly impacted because of liquidity crunch.

3. **Cost of Remonetisation and pressure on RBI:** Demonetisation has incurred on banks the extra expenditure of printing new currency. Reserve Bank had to spend Rs. 7,965 crore this amount was approximately twice the amount that was spent in the preceding year that is in 2015. The surplus amount of Rs. 30,659 crore which was transferred to the Govt. of India was also half of less what it was in the year 2015. This was the result of the increased expenditure of the reserve bank as many banks had large deposits with Reserve banks. This was because RBI had to pay huge amounts to these banks in the form of interest.
4. **Limited scope for digitalisation:** Deepak Nayyar has pointed to the fact that in India “just 53 percent of adults have bank accounts, but two-fifth of these accounts is dormant. And only 15 percent of existing bank accounts are used to make or receive payments. Bank penetration would have been far less but for the 250 million accounts that were opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY) during 2014-16, of which 60 million of accounts have zero balances even now. It is thus, clear that almost half of our population has no access to the banking system and even a larger proportion does not use it”. Digitalisation in such condition is a difficult proposition especially taking into the account the fact that the bulk of India’s population is not technology-savvy. There are also high cyber-security risks involved in a massive transition to digitalisation, exposing a vast number of bank accounts to fraud and thefts.
5. **Not much effect on black money:** According to Arun Kumar, “the black money the government was targeting is only about 1 percent of the black money held in the country and only 3.5 percent of the black income generated in 2016.” The main problem is that the black economies have the tendency to still exist and thrive. There are still many fields in which the black money is generated. There is another big drawback that those people who have hold a strong position are literally unaffected as

they have amassed their wealth in the form of real estate gold and other assets. Some even have assets abroad. None belonging to this class was affected by demonetisation.

6. **Fraud and corruption:** Many activities which were illegal and many fraudulent cases were registered in which the post offices and banks were involved. Many officials were engaged in exchanging of currency by taking bribes and commissions. There was also misuse of Jan Dhan accounts which are meant for the poor by the rich people to exchange their black money.
7. **Difficulty in implementation:** Government is finding it hard to implement this policy. The printing of the new notes has incurred a lot of expenditure. Government is also facing difficulties in circulating new currency. The introduction of Rs 2000 note which is again a high value currency is likely to help run a parallel economy.

MACRO ECONOMIC IMPACT OF DEMONETISATION

Growth and Inflation: According to data released by CSO, the decrease in GDP was 0.4 percent from 6.1% (last quarter of the year 2016) to 5.7% (1st quarter of the year 2017) after demonetisation. The 1st quarter of 2016 had registered a growth of 7.9 percent. According to economic survey 2016-2017 (volume II released in Aug 2017) this decline in GDP growth rates “predated demonetisation but intensified in the post demonetisation period.” The main cause of decline was that although the organized sector on the whole remained resilient as a result of demonetisation, some manufacturing and services segment were adversely affected. The sector that was particularly badly affected was the sectors of fast moving consumer’s goods particularly the automobile sector, construction sector and real estate. As far as impact on inflation is concerned, the main impact was on food. The inflation rates fell from 3.7 percent in Oct.2016 to 2 percent in December and further 1.3 percent in Jan 2017. As the vegetables and fruits market is primarily based on cash transactions, the less cash available in the market led to immediate rise in the rates. There were many problems which the farmers faced as they were dealing in those articles which have a small life span.

1. **Financial Sector:** Demonetisation had impact on the balance sheet of Jan Dhan accounts NBFIs (Non Banking financial intermediaries) banks etc. Banks have to lower the domestic term interests and their loan rates post demonetisation as the total currency in circulation declined by approximately Rs 8,800 billion. The reduction in the rates of interest has attracted the investors to the debt oriented mutual funds.

2. As for as impact of PMJDY accounts is concerned deposits under them increased significantly post demonetisation as many people used these accounts to convert black money into white (deposits under PMJDY as on Nov.9,2016were Rs.456 billion which rose to as high as 746 billion as on Dec.2016.)
3. External Sector -40 percent of India's exports is comprised of about 36 million micro small and medium enterprises (MSMES) which provide employment to approximately 80 million persons. These sectors are labour centric and operate mostly on cash and include leather, jewellery, handicrafts, carpets, textiles and handlooms industries. Reflecting these factors, exports shipments of gems and jewellery, readymade garments, handicrafts and carpets either declined or recorded a lower growth in Nov.2016 as compared with Oct.2016.
4. Digital Mode of Payments: After demonetisation the digital mode of payments picked up sharply. Reserve Bank of India and the Government has started some reformations to promote cashless modes of payments.
5. Some of these are:
 - a. Service tax relief on MDR (Merchant discount rates) for small transaction.
 - b. Monetary incentive in the form of discounts and prizes.
 - c. Charges for small value transactions were waved off for immediate payment service (IMPS) and unified payment interface (UPI).

After demonetisation the level of digital activity was low due to the involvement of people in depositing and exchanging specified bank notes (SBNs). However an increase in the digital activity was registered with remonetisation. The usage of year over year electronic payment mode was good in Oct 2016 during festive season. The continuance of the growth was further registered from November to January 2017. But there was a decrease in the pace of growth in the month of February 2017.

CONCLUSION

Removal of old Rs.500and Rs.1000 notes are replacement of same with new Rs.500 and Rs.2000 notes is expected to remove black money and temporarily decrease the volume of counterfeit currency (a currency produced without the legal sanction of the Government) in circulation. It also helped to decrease the assets being used for anti-social activities like espionage, terrorism and smuggling, etc. The advantages associated with demonetisation are

more than its disadvantages and it will be useful for the country in the long term. Government should take all necessary steps to hardships being faced by the public. It is expected that demonetisation will bring positive change in our country.

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