

DEMONETISATION IN INDIA: CAUSES, IMPACTS AND GOVT. INITIATIVES

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ABSTRACT

The demonetisation was done in an effort to stop counterfeiting of the current bank notes alleged to be used for funding terrorism, controlling black money and reducing income inequalities among the people of the country. This article has made an attempt to assess the overall profile of parallel economy in India, particularly in terms of causes, impacts and Govt. Initiatives. The results indicate that Parallel economy has been expanding very rapidly in India as well as in developing countries. It is evident from the study that Govt. Of India already introduced various issues for estimating black economy but estimation reports are not same. Indian Govt. Is more concerned about the prevalence of the parallel economy and various commissioning are formed for controlling it but results are not so impressive. Thus the paper suggests that recommendations of the commissioning or laws should be implemented correcting for reducing bad effects of black economy and it helps to reduce income inequalities and inflation in the country.

KEYWORDS: Black Money, Inflation, Income Inequalities, Parallel Economy, Gross Domestic Product.

Demonetisation is the act of stripping a currency unit of its status as legal tender. Demonetisation is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit.

Demonetization is a generations' significant experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. Demonetization affects the economy through the liquidity side. An asset is said to be liquid if it is easy to sell or convert in to cash without any loss in its value . Its effect will be a telling one because nearly 86% (Rs 14.2 trillion) of high currency value in circulation was withdrawn without altering bulk of it. As a result of the withdrawal of Rs 500 and Rs 1000 notes, there occurred huge gap in the currency composition as after Rs 100; Rs 2000 is the only denomination.

Absence of intermediate denominations like Rs 500 and Rs 1000 will reduce the utility of Rs 2000. Effectively, this will make Rs 2000 less useful as a transaction currency though it can be a store value denomination.

Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. It creates a situation where lack of currencies squeezes consumption, investment, production, employment etc. In this context, the exercise may produce following short term/long term/, consumption/investment, welfare/growth impacts on Indian economy. The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks. The move by the Govt. Is to tackle the menace of black money, corruption, terror funding and fake currency.

OBJECTIVES OF STUDY

1. To analyse the causes and impact of Demonetisation in India.
2. To highlight the appropriate initiative which will be taken by Govt. To success the objective of demonetisation.

RESEARCH METHODOLOGY

The study is based on secondary data. The required data has been collected from various sources i.e., World Investment Report, Asian Development Banks' Reports, various bulletins of Reserve Bank of India, that are available in internet and publications.

REVIEW OF LITERATURE

“Demonetization: Impact on the economy”, by Tax Research Team, working paper number 182, NIPFP (2016)- this paper has elucidated the impact of demonetization in the availability of credit spending, level of activity and Government Finances. “The economic consequences of Demonetization of 500 and 1000 rupee notes” by M. Sabnavis, A. Sawarkar and M. Mishra in Economic Policy View November 09, 2016- this paper suggested that in spite of the initial hiccups and disruptions in the system of Demonetization today, eventually this change will be well assimilated and will prove positive for the economy in the long run. “Black Money and Demonetization” by Rahul Prakash Deodhar, SSRN, November 2016: This paper has emphasized and highlighted towards control of black money, corruption and terrorism through Demonetization.

CAUSES OF DEMONETIZATION

In a single master stroke, the government has attempted to tackle all three malaises currently

plaguing the economy—a parallel economy, counterfeit currency in circulation and terror financing.

In addition, the Indian economy has been provided a new lease of life—a "reset" if you will—with huge positive implications for liquidity, inflation, fiscal and external deficit in the short term. Over the next two-three years, improvement in India's position on transparency and corruption in the global stage will further add to its investor appeal. With GST to be implemented soon, India is now on the path of higher growth in the medium term and long term also.

IMPACT OF DEMONETIZATION

To understand the impact of Demonetization, it is important to first understand, what is it that cash does in the economy? There are broadly four kinds of transactions in the economy: Accounted Transactions, Unaccounted transactions, those that belong to the informal sector and illegal transactions. The first two categories relate to whether transactions and corresponding incomes are reported to tax purposes or not. The third category consists largely of agents, who earn incomes below the exemption threshold and therefore do not have any tax liabilities. The use of that cash is put to for these various segments of the economy can be summarized in the form of table 1.

Table 1: Demand for Cash by various agents in the economy

Description of the activity	Unaccounted Transactions (legitimate transactions but tax not paid)	Illegal Transactions (Corruption, Crime, etc.)	Informal Sector Transactions	Accounted Transactions
Medium of Exchange	Incomes are earned through exchanges in cash, payments are made in cash.	Payments for crime.	Incomes are earned in cash and spent in cash.	Transaction demand for money.
Store of Value	Balances held in interim until alternative investment options become available. (there exists a number of instruments which yield better return than cash- real estate, lending in the unaccounted or informal sector and so on).	Balances held in interim until alternative investment options become available. (there exists a number of instruments which yield better return than cash- real estate, lending in the unaccounted or informal sector and so on).	Savings as well as precautionary purposes (as yet unbanked in the psychological sense)	For emergencies (precautionary demand for money)

(Source: http://nipfp.org.in/media/medialibrary/2016/11/WP_2016_182.pdf)

Liquidity Crunch (Short Term Effect)

Liquidity shock means people are not able to get sufficient volume of popular denomination especially Rs 500. This currency unit is the favourable denomination in daily life. It constituted to nearly 49% of the previous currency supply in terms of value. Higher the time required to resupply Rs 500 notes, higher will be the duration of the liquidity crunch. Current reports indicate that all security printing press can print only 2000 million units of RS

500 notes by the end of this year. Nearly 16000 mn Rs 500 notes were in circulation as on end March 2016. Some portion of this were filled by the new Rs 2000 notes. Towards end of March approximately 10000 mn units will be printed and replaced. All these indicate that currency crunch will be in our economy for the next four months.

Welfare Loss For The Currency Using Population

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.

There will be a trickle up effect of the liquidity chaos to the higher income people with time.

Consumption Will Be Hit

When liquidity shortage strikes, it is consumption that is going to be adversely affected first.

Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓

Loss Of Growth Momentum

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

Impact 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. This means that new savings with banks is only transitory or short-term deposit. It may be encashed by the savers at the appropriate time. It is not necessary that demonetization will produce big savings in the banking system in the medium term. Most of the savings are obtained by biggie public sector banks like the SBI. They may reduce interest rate in the short/medium term. But they can't follow it in the long term.

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 depends 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 effect.

People are now much convinced about the need to fight black income. such a nationwide awareness and urge will encourage government to come out with even strong measures.

Impact On Counterfeit Currency

The real impact will be on counterfeit/fake currency as its circulation will be checked after this exercise.

Demonetization as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn't have the digital transaction culture. Overall economic activities will be dampened in the short term. But the unmeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

Other Impacts

Impact on Parallel Economy

The removal of these 500 and 1000 notes and replacement of the same with new 500 and 2000 Rupee Notes is expected to - remove black money from the economy as they will be blocked since the owners will not be in a position to deposit the same in the banks, - Temporarily stall the circulation of large volume of counterfeit currency and - curb the funding for anti-social elements like smuggling, terrorism, espionage, etc.

Impact on Money Supply

With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to reduce in the short run. To the extent that black money (which is not counterfeit) does not re-enter the system, reserve money and hence money supply will decrease permanently. However gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pick up.

Impact on Demand

The overall demand is expected to be affected to an extent. The demand in following areas is to be impacted particularly: Consumer goods, Real Estate and Property, Gold and luxury goods, Automobiles (only to a certain limit),

All these mentioned sectors are expected to face certain moderation in demand from the consumer

side, owing to the significant amount of cash transactions involved in these sectors.

Impact on Prices

Price level is expected to be lowered due to moderation from demand side. This demand driven fall in prices could be understood as follows: Consumer goods: Prices are expected to fall only marginally due to moderation in demand as use of cards and cheques would compensate for some purchases.

GOVERNMENT INITIATIVES TO MAKE DEMONETIZATION A SUCCESS

The government has taken a number of steps to curb black money. Searches, seizures, surveys, and scrutiny of income tax returns are being done by the Income Tax Department. Amendments have also been made to the Finance Act 2004 to intensify efforts to curb black money. For the success of demonetization and smooth functioning of the economy, the Government has taken the following initiatives:

1. Controlling the election expenses.
2. Find out the root cause of generation of black money and make emphasis to stop it. Unless this problem is tacked the menace of black money will continue to increase.
3. PAN Card is essential for all tax payers but many transactions especially those related to property and conducted in cash and are unlikely to be reported. For this it is better to create a property and wealth account in the name of an individual.
4. Government has also taken initiative in the last two years to open Dhana jan Account, which is essential to judge individual source of income.
5. Government has also taken initiatives and also motivated the people towards cashless transactions, which help to make a proper record about transactions between parties.
6. Government has also taken initiative to aware the people through mass media about the cashless transactions and income tax, etc.

CONCLUSION

Parallel economy is a new threat for the Indian economy. In India parallel economy is expanding very rapidly. There are many factors like Controls and Licensing System, Higher Rates of Taxes, Ineffective Enforcement of Tax Laws,

Inflation, Funding of political parties etc. that influence its growth. In India amount of black money are increasing continuously which badly impacts the economic growth of the nation. Such money is a new challenge for Indian economy. Indian economy is badly affected by black money as it is underestimating GDP, increasing inequality of income, increasing illegal activities etc. Over the past 50 years, the government has at various times announced several schemes offering opportunities to bring black money overboard but the result are not so effective. Some of these schemes are: introducing the scheme of Special Bearer Bonds, demonetizing high denomination currency notes, stringent raids and scheme of voluntary disclosures. These instruments are expected to reduce the volume of the black economy.

Black money holders will definitely lose out eventually boosting the formal economy in the long run. Short term fall in real estate prices might benefit for middle class citizens in India.

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