

Demonetisation: It's Socio-Economic Impact

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Abstract: : India has become a bright spot in world economy. IMF and World Bank has labelled India as the fastest growing major economy .At the same time poverty,corruption,black money,terrorism are major hurdles in its growth path. India is ranked close to 100th in global corruption perception index two years ago. In spite of several steps taken by the government of India, it has only been able to reach at 76th position . Corruption leads to the generation of black money. This black money flows into the parallel economy. The flow of money in parallel economy become a source of terror financing, slow down economic growth, raises the level of inflation, directly or indirectly affects the purchasing power of currency. Government of India recently took a historic decision of demonitising 500 and 1000 rupee currency notes which were 86% of total currency, to fight against these socio economic evils.This paper attempts to identify the short term and long term impact of recent demonitization on corruption,terrorism and the society in general. This paper studies the various aspects related to demonitisation. It uses secondary data from journals, articles,internet resources, All India Radio and newspapers. The paper concludes that in short run withdrawel of these currency notes will affect to some extent the working of general public.But in long run it will definitely add some positives to the economy.

Key Words: Demonitisation, terror financing, parallel economy, black money

1. INTRODUCTION:

On 8th november, 2016 Indian economy faced a major change when the Prime Minister announced that Rs.500 and Rs. 1000 currency notes would no longer be recognised legally as currency except for some specified purposes.These notes were to be deposited in banks by December 30, 2016. 86 percent of the cash in circulation became invalid in one fell stroke. The objectives were stated as- Inflicting the losses on black money which was generated by income that has not been declared to the tax authorities, disrupting the use of high denomination notes for terror financing. Later on new objectives came out into view such as : enabling growth in bank credit, turning India into a cashless economy. . This proposition, however, is not backed by any evidence or proof and therefore portends distinct long-term, medium-term and short-term complications.

2. MEANING OF DEMONETIZATION:

Demonetisation is the process of eliminating the currency from the circulation. In Indian context, it means withdrawal of the currency by Reserve Bank of India as official mode of payment. It implies that the said currency ceases to be a legal tender. According to Investopedia, Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization 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.

3. PRIOR INSTANCES OF DEMONITIZATION IN INDIA:

Demonetization is not a new concept for India. It was done twice before in 1946 and 1978.

1.On January 1946 the pre-independent government of India passed the High Denomination Bank Notes (Demonetization) ordinance. According to which the currency notes of Rs. 500, Rs. 1000 and Rs. 10,000 were demonetized. The aim was to curb black marketing.

2.On January 1978, the high currency notes of Rs 1000, Rs 5000 and Rs. were demonetized, again with a view to curb black money transactions.But it did not had any significant effect on cash¹.

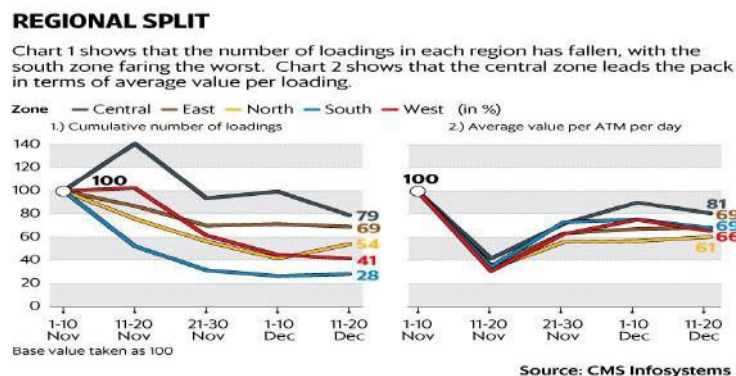
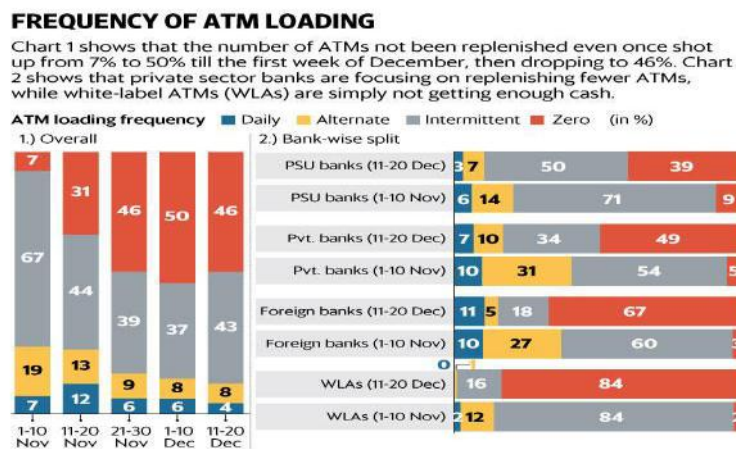
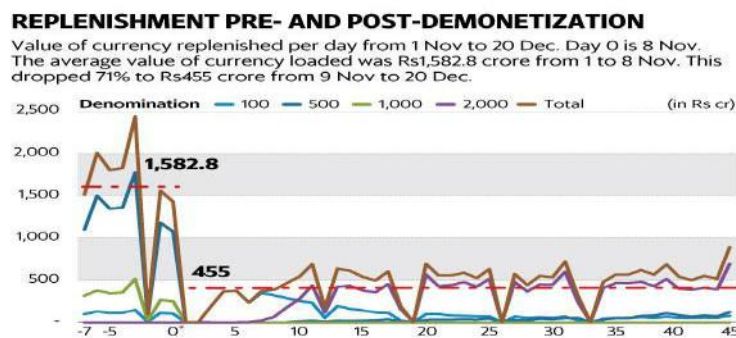
Thus this was not the first time that the country has seen but it might definitely be the first time when demonetisation has highly affected the society. The first and second demonetisations affected really high value notes which formed a small part of notes in circulation. But this time the demonetised notes were forming 86% of cash and were highly in circulation.

4. DEMONETIZATION AND ITS SHOR -TERM IMPACT:

Following the announcement, there was a rush at banks and ATMs, to exchange old notes and withdraw new currency (Debayan Roy, 2016; Press Trust of India [PTI], 2016). The two withdrawn denominations represented 86% of the currency in circulation (Reserve Bank of India [RBI], 2016). As the lines at banks grew, reports appeared in the press about the suffering experienced by people, especially among the poor, who had no access to credit cards or mobile wallets. (Soutik Biswas, 2016; Times News Network [TNN], 2016). As more days went by, the press reported that in both urban and rural India, the country’s large informal economy (Muna Kalyani, 2016) had been disrupted, and that notebandi would have negative impact on GDP. (Renu Kohli, 2016; Asit Ranjan Mishra, 2016; Press Trust of India [PTI], 2016)

4.1 Impact on the supply of cash

To find out the impact of demonitisation on the cash, the data is taken from 1 Nov 2016 to 20 December 2016. Knowing the status of cash supply is necessary to understand its impact on the GDP in short run. It is to be noted that CFM Infosystem (A company which manages 55000 ATMs out of 220,000 ATMs of the country) visits close to 30,000 ATMs for replenishment across 92% of the districts in India on a regular day. Since demonetisation, the number of ATMs CMS visits daily has not crossed 13,000, and is sometimes as low as 11,000.²

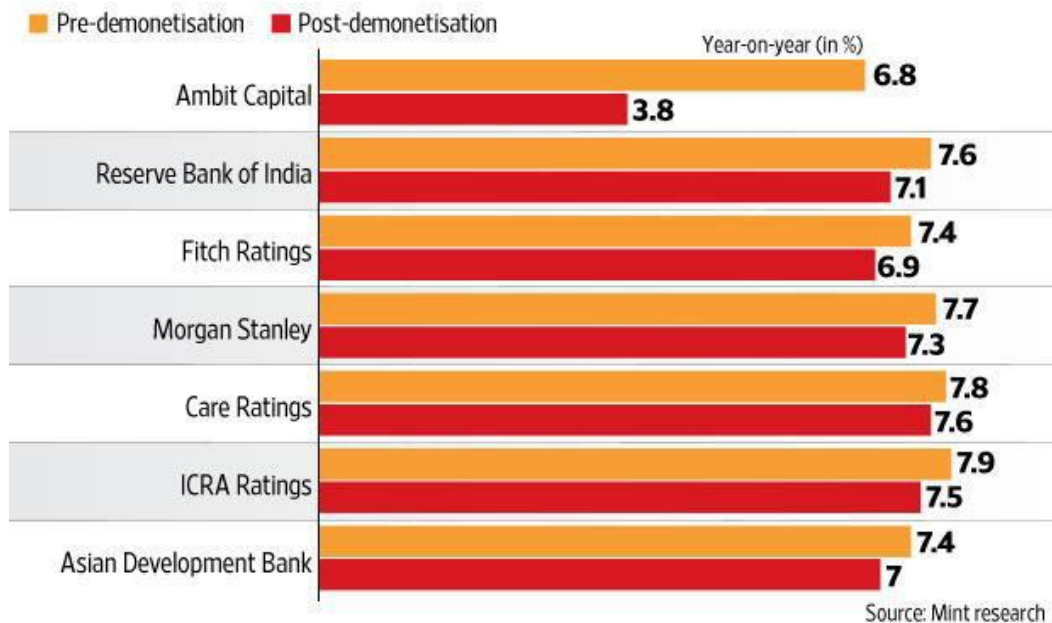


4.2 The impact on GDP

In India cash is the preferred mode of transaction. The transactions carried out through cash amounts to 95 per cent of the total transaction. The reason why people prefer cash to other modes is easy accessibility, its certainty of acceptance and efficiency as the settlement is not dependent on any additional infrastructure, and no additional

charges are involve. The cash-intensive sectors (agriculture,real estate,jewellery) were affected more due to demonetisation.

GDP GROWTH PROJECTIONS FOR INDIA IN FY17



The graph shows GDP growth projections for India in FY17 by different agencies including ADB and RBI .

Since the injection of liquidity is slow, there was a cash crunch this leads to a fall in the consumption (except the necessary consumption) which in turn slows down the investment plans of firms and ultimately fall in GDP. The Asian Development Bank forecasted that India's GDP growth would reduce to 7% from 7.4% for the current fiscal 2016-17. Demonetization was one reason given by the agency for this fall in GDP. However, it further added that this slowdown is expected for short run only and in 2017 India is likely to grow at the rate of 7.8%.

4.3 Impact on Income tax collection

After demonetization the income taxes rose because of increased disclosure. The payments to local bodies also increased because demonetized notes remained to be the legal tender for tax payments and clearances of arrears.(Economic survey 2016-17). On the other hand the collection of Indirect tax would decline as there is a reduction in the consumption.⁸

4.4 The long term impacts

The long term benefits can only be predicted on the basis of present evidences.

5. THE ISSUES OF BLACK MONEY:

Black Money has been a major problem for India since independence. Black money refers to the illegal money earned from illegal sources which has not been disclosed to the government.Fighting black money was described as the biggest mission of demonetization. Admittedly, much of the underground economy is cash-based. Illegal activities in particular, such as accepting bribes, including to political parties as 'donations', drug trafficking, prostitution, bootlegging and gambling, involved transactions in cash. And within currency notes, high currency notes are preferred medium of transaction.

Black money when accumulated for several year become black wealth. Black wealth is several times more than black money. Demonetisation is only against black money and not against black economy. However, to see the actual impacts we need to wait for a long time.

6. CASH-LESS ECONOMY:

Cashless economy is a situation in which the flow of cash within an economy is non-existent and all transactions are done through electronic media channels such as direct debit, credit and debit cards, electronic clearing, payment systems such as Payment Service (IMPS), National Electronic Funds Transfer (NEFT) and Real Time Gross Settlement (RTGS). Making India cashless economy is an intermediate objective of demonetization. Watal committee has recently estimated that cash accounts for about 78 percent of all consumer payments.⁵As mentioned earlier in this paper cash is preferred because it is accepted everywhere, it's use does not involve any cost, it is convenient to use, and also that it does not need any special equipment like other modes of payment require.

Government has taken a number of steps to replace cash transactions with e-transactions. Such steps include (The following data is taken from the economic survey)

1. launch of BHIM(Bharat Interface For Money) app allowing simple and quick payments,
2. Launch of Aadhar Merchant Pay for those not having mobile phones. The user require just an Aadhar card and a bank account to make merchant payment using his biometric identification.

3. Tax Benefits for digital transaction

Digitalization should reduce the economic leakages and ultimately unaccounted income. This will also reduce to some extent the supply of money for illegitimate activities.

7. FINDINGS:

1. In short run (in first 60 days of demonetization), demonetization has caused shortage of cash in ATMs, Banks and Post offices
2. Due to the shortage of cash, general public faced difficulties in their day to day activities
3. Demonetization increased the deposit of demonetized currency notes
4. GDP in short run got adversely affected by demonetization
5. There was an increase in income tax collection
6. Payment for utility bills through online mode increased
7. Cash less transactions also increased
8. People started using e-wallets
9. Several steps to ease online transactions were taken by government
10. There was not seen a very effective impact on black money in short run.

8. CONCLUSION:

It can be said that demonetization is an historic step in Indian economy. This step has caused great distress to the general public and their day to day activities. The act slowed down the growth in short run. However the deflationary effect of demonetization will also be witnessed in Indian Economy in long run. With demonetization, illicit activities and money laundering too will be checked.

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