

Demonetisation, GST and Other Challenges before Indian Economy

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Abstract: Indian economy has been emerging as the fastest growing economy in the world as per the CSO and IMF. At the same time it faces many challenges which negatively effect the growth rate. UK has always been a gateway for Indian firms to enter into EU. After Brexit this will cause short term tensions. With the hike in US interest rates, the interest rates gap between India and US reduces, that will increase the value of dollar and decrease the value of Indian rupee. The world bank said that India saw an 8.9 percent of remittances by its citizens from other countries in 2016. US citizenship and immigration services tightened the H-1B work visa rules, which will affect India's inflow significantly. The biggest challenge for Indian economy is to implement GST into action efficiently so that economy which took step backward due to the demonetisation can make GDP take a jump. After demonetisation, 4 lacs workers mostly daily wagers may have lost their jobs due to lack of payment so far. Despite RBI announcing numerous restricted schemes, the bad loans has rises up from 26,184 crore by 135 percent in last 2 years. To face this challenge government has launched mission **Indradhanush** to make working of public sector banks more transparent in order to control the problem of NPAs.

Key Words: GST, Demonetisation, Unemployment, NPA, Banking Sector, Brexit, US Fed rates.

1. INTRODUCTION:

Despite doubts raised about India's GDP numbers the fact remains that India is one of the fastest growing large economies. Since 1991 the Indian economy has witnessed development in trade and Commerce, infrastructure, technology and more. However, the Indian economy still faces various challenges like Demonetisation, exit of Britain from Europe, implementation of GST and many more. Here are seven such Challenges :-

2. IMPACT OF DEMONETISATION:

With the announcement of the Government of India on 8th of November, 2016 about the demonetisation of existing rupees 500 and 1000 currency notes and introduction of new notes, Indian economy has moved towards the cashless economy .

The IMF cuts the India's growth rate for the current fiscal year to 6.6% from its previous estimate of 7.6% due to the "temporary negative consumption shock" of demonetisation. The reduction in growth rate is expected to persist into 2017-18 with growth set to reduce to 7.2% against the estimate of 7.6% this 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 in 2016.

Purchasing power of consumers has been negatively affected due to cash crunch. In India more than 90% of transactions are taking place in cash and digital transactions just for remaining 10%.

Banks have also been focusing on the single task of deposits and withdrawals. This results in that their main important function of issuing loans has been adversely affected . Current account customers who need large amount of cash at short notice have not been able to access cash and credit due to restrictions on withdrawal.

The small and medium sized enterprise sector(SME) as we understand is a big part of the economy contributing to 8% of the GDP while employment more than 18 people every year. The labour wages in this sector are largely paid in cash and thus the wages have been adversely affected by the demonetisation. Low wages leads to low purchasing power and thus the low demand for goods and which leads to unemployment. Other sectors like restaurants and transport operators have also been negatively impacted due to the slowdown of economic activities and also due to fact that in the sectors mainly the payments are through cash only .

The wholesale vegetable markets have been witnessing declining demand and prices of food items have fallen badly making it impossible for the farmers to produce these crops. Agriculture is the one sector where all the transactions are in cash . The withdrawals of old currency notes has put pressure on the *Mandis* and thus farmers are having problems in selling their produce in the market.

Also since there is acute shortage of rupees 500 denomination notes presently, change for the high denomination rupees 2000 notes is not easily available with the vegetable and fruit vendors. This also impacting the livelihood of the unorganised sector. The Employment generation has been adversely impacted by the currency

demonetisation, the consumer's demand has slowed and thus industrial production has declined. Even the manufacturing sector is witnessing slow down in production which accounts for the highest employment of skilled and Semi skilled labours, it not only created less jobs but layoffs are also taking place at a higher rate.

As many as 4 lakh people mostly daily wagers may have either lost their jobs or shunned work temporarily due to lack of payment so far and the number is only going to grow in the cash crunch persists.

3. IMPLEMENTATION OF GST:

GST is a comprehensive indirect tax that would replace existing levies such as excise duty, service tax and VAT. The tax is levied on the value added and on consumption only. Total burden of the tax is exclusively borne by the domestic consumers. Government announced to implement GST from 1st of July, 2017 but there are some challenges before GST Council which are as following:

- It is hoped that GST would be simple and with low tax rates. Everyone wants a simple GST but there is a fear amongst the states that they might lose revenue. There is a problem in assigning commodities rate slab and currently different states have their own priorities. For example; biscuits are essential commodity in Kerala but are luxury item in Bihar. Assigning anything a rate slab would be difficult.
- The biggest challenge of GST implementation is bringing all the indirect taxes under same roof. There has been opposition asking to include purchase tax by a few States other states are reluctant about alcohol tobacco products coming under GST. This is due to the fact that a major part of state revenue is derived from these products.
- With the transportation services available everywhere the place of sale and consumption may not be the same. This makes it difficult to go forward with revenue allocation.
- Determining GST rates is a major step in ensuring the success of GST which should conducive to government and public.
- Input tax credit system which forms the backbone of GST like VAT system would be fully digital. To prepare the government system to cater the E-Filing of the tax a backend infrastructure named project SAKSHAM is being prepared by Wipro and frontend system named GSTN(GST Network) is being developed with the help of Infosys. Training our officials to operate the system would be a one time challenge specific to this year .Over which we are yet to know what impact would it make on state revenue and how would States respond to that.
- GST is absolutely different from existing system ,it therefore requires the tax administration staff at both state and Centre to be trained properly in terms of Concept, legislation and procedure.
- GST has to develop GST portal which ensure Technology support for GST registration ,GST return filing, tax payments, IGST settlements etc.

SMEs /informal sector which have been hit hard by demonetisation are also the one to be hit hard by GST that should be another worry for policy makers as over 90% of Indian workforce is employed by this sector.

4. IMPACTS ON INDIA FROM BREXIT:

“As far as India is concerned , if there is an entry point for us to EU that is UK”[Narinder Modi, PM]. Britain has voted to leave the EU. This means that in the coming months British and European leaders will begin negotiating the terms of Britain's departure. India is in a position to face the possibility of Britain's exit from the EU. India is one of the most profitable markets for foreign investors and hence we attract attention globally. Any major change across the globe be its political or Economic is bound to have an impact on India too. *Following are the impacts on India from Brexit:*

- UK has always been a gateway for Indian firms to enter EU. After Brexit this will cause short term tension to Indian firms.
- Britain pound is expected to fall 20 percent in case of Brexit against major economies. India cannot remain immune to this. SENSEX and NIFTY will drop in the short term.
- Many Indian businesses have their offices in Britain so they can avail benefits and continue to remain a part of EU, but with Brexit this benefit will be taken away and may result in companies relocating their business setup to other places.
- Indian IT companies may need to establish separate offices and their different teams for UK and the EU after the fall out. It will put heavy expenditure burden on IT companies in the near term. Automobile, Pharma and IT might be a most affected.
- India has been negotiating a free trade agreement (FTA) with EU for almost 10 years and now will need to revise its strategy.

There are 800 + Indian companies in UK generating 26 + million pounds every year. Indian main companies like pharmaceuticals, Automobiles, IT are the major employers in UK which operates throughout the EU, without trade barriers.

EU is our biggest export destination and amongst 28 nations, UK is our major trading partner. Any decline in trade to either UK or EU is not at all good for Indian economy.

5. US FED INTEREST RATES HIKE INDUCE CAPITAL OUTFLOWS:

US Fed is the central bank for the US, like RBI in India. US fed rates hike refers to the raising of interest rates that the US fed is willing to provide to the banks of US for lending and borrowing activities. This in turn increases the interest rates of everything else in the US – of government bonds, bank savings deposits by customers, of consumer loans etc.

How does interest rates hike affect India economy:

It mainly affects India by decreasing the value of Indian currency against the US dollar. Emerging economies like India have higher inflation and higher interest rates than developed nations like US and Europe. Recently the interest rates in India are around 7-8 % and inflation is 5-6% and in US, interest rates and inflation rates are close to 1-1.5%. So, due to low interest rates in US, investors or financial institutions borrow money from US in dollar terms and then invest that money in government bonds of emerging countries like India to earn higher interest. This is called as currency carry trade. With the hike in US interest rates, the interest rate gap between India and US will reduce. This gap reduction will cause capital outflows. Due to carry trade, some of the money exists India and flows back to the US. The investors are selling their Indian investments, converting them into rupees, which they get from the sale of US dollars and sending it back to US dollars. That will raise the demand for dollars and reduce the demand for rupees in the FOREX market. This will increase the value of dollar and reduce the value of rupees. Rupee may come under pressure and may depreciate further due to increase in interest rates.

Indian companies have increasingly resorted to foreign borrowings to meet their financing needs, thanks to near-zero interest rates. With hikes in Fed interest rates, companies may have to bear the burden of a higher outgo while repaying their loans, in case dollar appreciates further. A higher cost of borrowing on future dollar loan will also impact a company's balance sheet.

6. DECLINE IN REMITTANCES TO INDIA:

Low oil prices and US adopting more job protection measures to their citizens leads to decline in remittances for the first time in 30 years will continue in 2007 as well. A Muscat based Indian finance expert Jose Chacko said, "Not only the oil price in gulf countries but also Donald Trump moves to tighten the job issuance for foreigners is going to affect remittances inflow in India. The World bank said that India saw an 8.9% drop in remittances by its citizens from other countries in 2016. India saw dollar 69.9 billion in remittances from 2014, which drop to dollar 68.9 billion in 2015 and dollar 62.7 billion last year in 2016. World Bank statistics revealed at around 50% of remittances to India come from Gulf migrant workers and remittance amount is 3.2 percent to the GDP. Due to oil price crisis, thousands of Indian workers in Saudi Arabia were laid off by companies and they are returning home in phases through amnesty. The Indian government official data reveals that in comparison to 2015 the number of Indian migrating to six Gulf countries was short by 2.5 lakh in 2016.

Recently, the US citizenship and immigration services has tighten the H-1B work visa rules, which will affect India's remittances inflow significantly. Entry level techies will find it hard to get a US job and those who are already employed are on the path of losing them. Australia has also abolished the 457 visa program- a migrant workers scheme, very popular among Indians looking to move to Australia. So this all result in less jobs and less remittances.

7. UNEMPLOYMENT:

Among the implications of demonetisation its impact on employment is important, particularly in a situation when majority of wage payments are made in cash form. "More than 95% of total transactions in India are in cash from"[Live Mint Jan 1 2017]. For employment growth economic growth is one of the important factors. In a situation of recent move of demonetisation, will push growth downward has predicted by most economic Agencies including RBI and IMF. The prediction of decline in GDP growth rate ranges from 0.5% to 2%. A unit decline in growth rate results decline in employment growth rate, concept is called as employment elasticity of output.

According to the 5th annual employment and unemployment survey:

(a) Among all, very few households 20% with monthly income less than or equal to rupees 10,000 have bank account.(b) majority of workers belong to this income group only 82% among self employed ,60% among regular

workers ,87% among contract workers, 96% among casual workers. (c) Majority of workers in all categories of employment ,have no written contract.(d) Majority of workers receive no social benefits.(e)60% of workforce just belong to six States Tamil Nadu, Maharashtra, Andhra Pradesh, Gujarat, Karnataka and Uttar Pradesh.

Informal unemployment which constitutes high as 95% of all employment is backed with more social security such as house education and provident fund benefits. “Workers are subject to lay off at any point of time during production process”[Financial Express]. An estimated 4 lakh workers largely been on this segment will be affected by the decision since majority of the wage payment is made in cash form ,they are thus the ones to face misery caused by the recent announcement of demonetisation.

Casual workers were among the worst hit by demonetisation. According to Labour Bureau data around 1.52 lakh casual workers engaged across eight sectors including manufacturing and IT/ BPO lost their jobs during the period of October -December 2016.

According to quarterly employment survey, casual workers in the manufacturing sector are the worst hit with 1.13 lakh people losing their jobs during the period last year followed by 20,000 in the IT/ BPO sector . At this point the slowdown of the economy is rendered lacs of people jobless and a million deprived of the livelihood.

The Shock Therapy of demonetisation which we are witnessing without structural transformation is capable of dropping the strength of job creation in long run.

8. NON PERFORMING ASSETS:

The Assets of the banks which do not perform are called as NPAs or bad loans. Banks assets are the loans and advances given to customer ,if customer do not pay either interest or part of principal amount of the loan, it turns into bad loan.

Despite the series of government measures to deal with bad loans and relentless efforts by RBI bad loans have risen up from rupees to 61,843 crores by 135 percent in last years . It is set to rise further in next two quarters with the small and medium sectors struggling to repay the loans after the NDA government demonetisation move in November.

It was reported by Indian Express that the gross NPAs surged to Rupees 614,872 crores. In all, the total NPAs including both the public and private sector banks were rupees 697,409 crores in December 2016. “Five banks have reported gross NPA ratio of over 15% . Indian Overseas Bank gross NPA ratio is 22.4% which means rupees 22.42 out of rupees 100 lend by the bank will be classified as bad loan”[Financial Express]. Similarly,UCO Bank posted NPA ratio of 17.18%, Bank of India -15.98%, IDBI -15.16 % and Bank of Maharashtra - 15.08% .

One of the main reasons of rising NPAs the relaxed lending norms especially for corporate sector. Five sectors textile,aviation, mining, infrastructure contributes to most of the NPA . Public sector banks provide around 80% of the credit to industries that forms a great portion of NPA. Last year ,when Kingfisher was ruined in financial crisis, SBI provided it huge amount of loan which is not able to recover from it.

The effects of India’s recent demonetisation decision are uncertain, which adversely affected the banks business results of operations and financial condition. Post-demonetisation, there has been a rise in the current and savings account(CASA) deposits of banks. According to RBI report, the sharp increase in the share of CASA deposits in aggregate deposits by 4.10% to 39.30% (as on February 17 2017) resulted in a reduction in the cost of aggregate deposits and banks have correspondingly lowered their term deposit rates. SBI said increased competition may have adverse effects on the net interest margin and other income and if the banks are unable to compete successfully its profitability may decline.

More than Rupees 7 lakh crores worth loans are classified as NPAs in India . This means that about 10% of loans are never paid back resulting in substantial loss of money in the bank . This will cause the balance sheet syndrome in both public banks and corporate banks. This will stress the balance sheet and will cause halting of the investment- led developing process.

9. CONCLUSION:

Though it is a good move towards a cashless economy but if black money did not return to the system then there is resurgence in growth may prove to be a challenge. Now-a-days the biggest challenge for Indian economy is to implement GST . RBI also taking a tough approach in ensuring banks classify certain stressed assets as NPA and making adequate provisions.The lack of bankruptcy code in India and sluggish legal system make it difficult for banks to recover these loans from both corporate and non corporate sectors.

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