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DEMONETIZATION IN INDIA: IMPACT ON THE ECONOMY

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Abstract

Government of India announced that Rs. 500 and Rs. 1000 denominated will cease to be legal tender. The move was targeted towards tackling black money, corruption and terrorism.

Demonetization is an established practice in monetary policy to tackle black money. The Prime Minister has explained why this is a financial surgical strike. It was meant to be suddenly implemented. In the past demonetization has taken place twice but it fails because the idea is to tackle black money existing in circulation.

The Demonetization in India is the very big move in the country. In the single move, the government has attempted to tackle all the three issues affecting the economy i.e. parallel economy, counterfeit currency in circulation and terror financing. It is the Prime Minister's master stroke by which he has reportedly destroyed the base of corruption in India.

Keywords: Demonetization, Tackle, Monetary, Implemented, Counterfeit.

Introduction

The government has implemented a major change in the economic environment by demonetizing the high value currency notes of Rs. 500 and Rs. 1000 denomination. These ceased to be legal tender from the midnight of 8th of November 2016. People have been given up to December 30, 2016 to exchange the notes held by them. The proposal by the Government involves the elimination of these existing notes from circulation and a gradual replacement with a new set of notes. In the months to come, this squeeze may be relaxed somewhat. In other words a national security concern and second, to underlines or eliminate the "Black economy".

There are potentially two ways in which the pre-demonetization money supply will stand altered in the new regime: one, there would be agents in the economy who are holding cash which they cannot explain and hence they cannot deposit in the banking system. This part of the currency will be extinguished since it would not be replaced in any manner. Second, the government might choose to replace only a part of the currency which was in circulation in cash.

In a press conference on November 12, 2016 the Union Finance Minister too said that,

"Those in business should start using digital payment gateways, cards and banking system. Life will become simpler in the new financial system that is the only viable option."

Review of Literature

Deepa Divakaran (2013), Rupee depreciation has been the hot subject in current economic scenario. We are experiencing a tough time with rupee depreciation every day. Current economic context created anxious moments to various industrial sectors in India. On 1st Dec, 2013 the value of Indian rupee stood at 62.44. The experts in the field perceived the situation in different manners. Some considered it as highly depressed and threatening environment; some others considered it as an opportunity in disguise. There are various positive and negative impacts which are being predicted by experts in the fields. Rupee depreciation, no doubt it will affect upper and lower sectors of the economy. This spectacular decline of rupee value will loss India's confidence in its growth prospect too. RBI and government is taking various measures with the objective of making a stabilized floor for Indian rupee. Mr. Raguram Rajan, RBI Governor, has shown reflections of hope in the

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present crisis. The author tried to explore the causes and impact of rupee depreciation on the Indian economy and also to review various measures taken by RBI and Government to get over the present crisis.

Plamen Pachev (2014), In a case study of a “classical” issue on the interpretation of money as a special kind of commodity, “balancing” and measuring the value of all the other commodities by its own value. The analysis is based on two main lines. The first line deals with the reasons of the doubts of the representatives of the Austrian School on the necessity to introduce a private market alternative to the “state” money “imposed” by the administration. The second line covers the issue whether and how much the „demonetization” of the precious metals in the 1970-ies as a “classical” symbol of money under the conditions of currency – financial crises, has been replaced now convincing enough by the contemporary circulation of paper money. Very interesting, although not indisputable views on a reform in the global currency are focused, that have been suggested by leading bankers and distinguished scientists.

Agnieszka Łukasiewicz-Kamińska (2015), The purpose of this paper is to verify the following thesis: Digital money affects the global monetary system, has an impact on the demand for real money, may cause it to increase or decrease, leading to problems in forecasting the supply volume of real money. Cryptocurrencies are relatively new, developing rapidly thanks to ICT innovations. The extent of digital money is still too small to pose a threat to national monetary systems, but may have a bearing on the demand for real money. Growing popularity of digital currencies due to their characteristics has to be taken under consideration while assessing a future shape of the global monetary system.

Dr. Roshan Kumar M. Bhigania (2012), It is a well-recognized fact that there exists in India a parallel economy based entirely on black money transactions. Black money, also described as tainted money, has seeped into every walk of life and is posing a great threat to the stability of our real economy. The most unfortunate aspect is that it has come to be accepted as normal fact of life. People hardly feel say qualms of conscience while dealing with it. In their jaundiced eyes, the black appears to be bright and beautiful.

History of Demonetization in India

India faced the big move by three times in 1946, 1948 and 2016.

1. January 1946: Notes of Rs. 500, Rs. 1,000 and Rs. 10,000 demonetised-

On January 11, 1946, the government announced that notes of Rs. 500, Rs. 1,000 and Rs. 10,000 will not be legal tender from January 12, 1946 from that day, the move was made with an aim to curb black marketing. The repercussions were similar with people dying of shock, exceptionally long lines at the bank and the middle classes being hit. The old notes were being sold at 60 and 70% of their price. The move was called a “death blow” to black marketers.

2. January 1978: Notes of Rs. 1,000, Rs. 5,000 and Rs. 10,000 demonetised-

The Janta Dal demonetized high currency notes of Rs. 1,000, Rs. 5,000 and Rs. 10,000 in a second such historic move, again with a view to curb black money transactions. People who possessed these notes were given till January 24, the same year – a week’s time – to exchange any high denomination bank notes.

3. November 2016: Notes of Rs. 500 and Rs. 1,000 demonetised-

On 8th November 2016, the Government of India announced the demonetization of all Rs. 500 and Rs. 1,000 bank notes of the Mahatma Gandhi series. Prime Minister of India Narendra Modi announced the demonetization in an unscheduled live televised address at 20.00 Indian Standard Time (IST) on 8th November. It was heavily criticized by members of the opposition parties, leading to debates in both houses of Parliament and triggering organized protests against the government in several places across India. The move is considered to have reduced the country’s GDP and Industrial Production Demonetization Scenario- On November 8th, 2016, GOI declared that Rs. 500 notes and Rs. 1,000 notes are invalid. New currencies in denomination of Rs. 2,000 and Rs. 500 are to replace the old currency. People can exchange the old currency in the banks to new currency upto Rs. 4,500 initially till 24th November. People can deposit the old currency in their bank accounts. GOI has extended old currency exchange in EB officer, tax officer, Petrol banks etc. till 15th December 2016. In the ATM’s initially Rs. 4,000 was allowed to be withdrawn but now only Rs. 2,000 is the daily withdrawn limit. GOI aims to make a cashless economy through financial inclusion measures like payment banks, card based transactions and online transactions etc.

Reasons for Demonetization

There are many reasons of demonetization. Some of them are following:-

1. To tackle black money in the economy.
2. To lower the cash circulation in the country which "is directly related to corruption in our country." According to PM Modi.
3. To eliminate fake currency and dodgy funds which have been used by terror groups to fund terrorism in India.
4. To pushing India towards a cashless economy.
5. To combated the tax evasion.

Impact of Demonetization

The demonetization of the Rs. 500 notes and the Rs. 1,000 notes. The two highest currency denominations available in India – will likely hit the economy hard in the short term. The service sector, which dominates economic activity and involves a sizable chunk of cash transactions, will likely be hit the hardest.

India's Economic Growth

In the above graph, Growth in the India economy remained solid in the quarter from April to June 2016 (the latest available). In India, a financial year begins in April and ends in March of the following year. The previously mentioned quarter is the first quarter of fiscal 2016-17. During that period, the GDP (Gross Domestic Product) rose 7.1%, while the GVA (Gross Value Added) rose 7.3%. The relationship between the GDP and GVA is:
GDP = GVA + boxes on products – subsidies on products.

The base year for calculating the GVA is 2011-12.
Following are the main impacts of demonetization:-

1. **<u>Demonetization is not a big disaster</u>**: like global banking sector crisis of 2007; but at the same time, it will act as a liquidity shock that disturbs economic activities.
2. **<u>Consumption will be hit</u>:** when liquid shortage strikes, it will consumption that is going to be adversely affected first.
   Consumption-----Production-----
   Employment------Growth------Tax revenue.
3. **<u>Impact on black money</u>:** Usually black money is kept in the form of gold, land, buildings etc. Hence the amount of black money countered by demonetization depends upon the amount of black money hold in the form of cash.
4. **<u>Impact on bank deposits and interest rate</u>:** People are actually saving liquid cash in the banks accounts. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest.
5. **<u>Impact on counterfeit currency</u>:** The real impact will be on counterfeit/fake currency as its circulation will be checked after this exercise.

Merits of the Demonetization

1. Unearthed of cash which is not in circulation and locked within few hands.
2. Curb of black money and fake notes.
3. Increase the transaction in digital system.
4. Increase the job opportunities in future.
5. Protection from the illegal activities.
6. Reduction of interest rates may be the favourable move in startups and making India.
7. India is a developing as best investment destination with the view of ease of doing business, reliability and strong government administration system.
8. Ease of recovery of long term dues in public sector and banking sector from public.

Demerits of Demonetizations

1. Business are encountering with the loss due to limited cash circulation.
2. Black money holders are searching the alternative ways for come out of the situation.
3. Overwhelming move in notes. However implementation is not with the expectation.
4. Unfavourable impact on GDP growth.
5. High scarcity of money change.
6. It will destruct the old currency. Black money holders are burning and destroying the cash. It is the big loss to economy.
7. It will create the inconvenience to common people. Common people are in big trouble because of the non availability of cash for some days.

Conclusion

The Demonetization was undertaken by the government is a large stock to the economy. Modi has staked his position as a leader capable of making bold decisions. The demonetization drive will affect some extent to the general public but for larger interest of the country such decisions are inevitable. Also it may not curb black money fully, but definitely it has major impact in curbing black money to large extent.

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