

DEMONETISATION IMPACT ON INDIAN ECONOMY - A STUDY

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Abstract

Demonetization refers to the withdrawal of a certain form of currency from circulation. It is required whenever there is a national currency exchange; the old currency must be removed and replaced by the new monetary unit. The currency was demonetized for the first time in 1946 and the second time in 1978. On 8 November 2016, the current Modi government demonetized the currency for the third time. The public had the option of handing in the invalid notes within the next 50 days (till 31 December 2016) or visiting any bank branch in the country and exchanging the illegal tenders for valid notes of similar value. In a country with the world's second largest population, the move has led to extremely long lines, chaos, panic and more deaths. Chaos was created in all strata of society, be it upper, middle or lower. While the move was welcomed by some as it was seen as a reduction in black money, many are pained by the move. This paper discusses the current and immediate impact of demonetisation on the Indian economy and details the possible consequences of demonetisation.

Keywords: Demonetisation, Black Money, Cash Flow, Liquidity, Repo Rate, ATM, Debit Card, and Credit Card.

INTRODUCTION:

The withdrawal of currency or other valuables by a central bank for use in domestic legal payments. Such coins can either be turned into scrap or deposited in a bank and replaced with new ones.

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Governments of many countries around the world have taken this drastic measure to control black money and stop currency counterfeiting. Some nations failed miserably while others succeeded in the objective behind the destruction. Let's look at countries facing persecution and the impact they face.

See decision RBI/Government cancels status of banknotes for legal tender Generally, all currency issued by RBI can be legal tender as RBI promises stored value and Banknotes cannot be used when such value is suspended/withdrawn/cancelled. Central banks around the world are following the practice of recalling old banknotes and issuing new ones with advanced security features to combat the threat of counterfeit currency.

Reasons For Demonetization Done By Government

1. To tackle the menace of black money/parallel economy/shadow economy
2. The cash circulation in India is directly connected to corruption hence we want to reduce the cash transactions and also control corruption and thereby move towards cashless transactions.
3. To counter the menace of counterfeit currency
4. To prevent the cash from being used for terrorist activities/terror funding
5. This is the only second-time post-independence (even before Independence Demonetization was done in 1946) that a measure such as Demonetization has been announced. The last time this was done was in 1978 under the Morarji Desai government when Rs 500, Rs 1000, and Rs 10000 notes were demonetized. A CBDT report which evaluated this measure concluded that
 - a. It was an ineffective move as only 15% of the high denominations were exchanged
 - b. The rest never surfaced for the fear of stringent penalties by the government. The High Denomination Bank Notes (Demonetization) Act, of 1978, barred the transfer and receipt of high denomination banknotes and made any contravention including a false declaration by depositors and others punishable — with a fine or a three-year prison term
 - c. The report concluded that demonetization may not be a solution as black money was largely held in the form of benami properties, bullion, and jewelry. Such a measure would only increase the cost as more currency notes which have to be printed. It could also harm the banking logistics

(In the present age the European Central Bank has announced that it would demonetize €500 note)

1. OBJECTIVES OF THE STUDY:

- To work out the probable consequences of Demonetization.
- To know the positive and negative impact of Demonetization on India.

2. METHODOLOGY OF THE STUDY:

The document is based on secondary data. Secondary data was collected from various published sources such as reports, magazines, newspapers, journals, etc. The dictionary meaning of DEMONETIZE is to deprive (a metal of) of its ability as a monetary standard or evade use as currency. Accordingly, demonetization is the act of removing a monetary unit from its status as legal tender. It is the act or process of removing the legal status of a currency unit. A currency for which the governor guarantees the RBI on behalf of the central government by issuing a declaration promising to pay the holder the amount of money establishing its legal status. From the demonetization date, all legacy demonetized currencies will no longer be legal tender. From now on, this currency can no longer be used as money to carry out any transactions, but to replace it with a new currency. The Government of India announced on 8 November 2016 the demonetization of the high denomination Rs 500 and Rs 1000 banknotes. This means that 500 and 1000 rupee notes are accepted by everyone except the government appointed organization. A redesigned series of Rs 500 and Rs 2000 banknotes has been in circulation since 10 November 2016.

3. CAUSES OF DEMONETIZATION

There are many causes of demonetization in any economy some are unclosed black money, corruption, fake currency, currency storage, etc.

4. BASIC BACKGROUND OF DEMONETIZATION IN INDIA

India has had two previous experiences of demonetizing its currency. The first was when the Rs. 1000, Rs. 5000 and Rs 10000 notes were withdrawn from circulation on January 12, 1946. 10000 note introduced in 1938. The three Rs. 1000, Rs. 5000 and Rs. were reintroduced at 10,000 tickets. The second phase of demonetization took place on January 16, 1978 when an order was issued to ban banknotes of denominations of Rs. 1000, Rs 5000 and Rs. 10000. Demonetization was used on January 12, 1946, but the commission of inquiry into direct taxation noted in its interim report report that demonetization was not successful at the time because only a very small part of the total banknotes in circulation in 1946 were demonstrated and their value was Rs 1,235.93 crore. On January 16, 1978, the demonetization of high value banknotes was introduced. The high demonetization banknotes that day stood at Rs. 146 crores and the total banknotes handed over to the RBI stood at Rs. 125 crores according to data available up to August 1981.

Positive & Negative Impact of Demonetization:-

Impact on Black Money and Corruption: 'Black Money' or 'Dirty Money' is the money on which no tax is paid to the Government and it goes unaccounted for in the duration of the country's tax assessment period which causes revenue loss to the government. It is argued that steps taken by the government of demonetization can help curb black money in the country. Corruption will also be automatically reduced by removing black money from the economy.

1. **Source:** SBI Research, RBI Table details public holdings of high denomination banknotes valued at Rs. 9,926 crore as of March 2016. There are 3 scenarios in the table. In scenarios 1 and 2, it is assumed that 50% of the higher denomination banknotes will not fit into the system. It is also reasonable to expect Rs 60%. 500 bills and 40% of Rs. By 31 Mar 2017 1000 notes would be exchanged at banks/post offices and RBI. 4.5 billion money could disappear from the system.
2. **Impact on Counterfeit Currency:** The Biggest positive impact of demonetization will be on counterfeit/fake currency as it is currently thrown out of the system fully.
3. **Impact on GDP:** GDP falls because money in circulation is lower due to the liquidity crisis in the country. The formation of GDP could be affected by this measure, with a reduction in consumer demand. In addition, this projected impact on GDP may not be significant as some of this demand will only be deferred and flow again once liquidity conditions normalize.
4. **Lower Inflation:** Inflation arises due to higher liquidity in the market. Because of demonetization, there is less liquidity and less cash flow in the market that's why inflation becomes down. As the black money goes out of the system the money supply will shrink to some degree. This will reduce the inflation rate in the Lower absence of any open market interventions by the Reserve Bank of India. Inflation is of four types.
5. **Impact on Purchasing Power:** The demonstration movement affected purchasing power. Long-term assets such as real estate, vehicles and the key sectors of cement and steel are particularly affected. The share prices of companies in these sectors will have a negative impact. The purchasing power of consumers is also being impacted by cash shortages as 90% of transactions in the Indian economy are settled in cash.
6. **Impact on Real Estate Sector:**

Demonetization has shattered the housing market and will result in a decline of more than 50% and will remain so for another 5-6 months. While the short-term impact is negative, experts are hopeful that the rate cuts will boost home sales in the coming months.

7. Impact on Banks and Financial Institutions:

The impact of demonetization on banks will be both positive and negative. In the long term, however, things will become more positive. Government regulations require people to deposit their money in banks, which increases bank liquidity in the short term. This liquidity can be used by banks for long-term lending purposes.

As banks become more liquid, they are expected to improve the lending cycle by lending money at a lower interest rate. But also the negative impact as the profits of the banks will also be affected in the next 2-3 quarters. We may not see the loan book growing as the banks will be busy facilitating the demonetization process.

8. Impact on Lending Rate:

The lending rate become down because Banks getting money at the Repo Rate and banks are lending money at the Base Rate. In this situation, Repo Rate becomes and automatically Base Rate will become down and banks have sufficient money to lend so the lending rate become down.

9. Impact on E-commerce:

The effects of demonetization on e-commerce are mostly negative, some positive. For the online retail market, players' Gross Merchandise Value (GMV) dropped 40-50% in the first few weeks after demonetization, in the middle of their peak revenue quarter. It could remain gloomy well into March. High-quality items such as expensive smart phones are also sold at lower prices. Returned products will be increased by 50%. And experts believe consumer sentiment won't improve anytime soon. But the push towards digital payments (100% increase in transactions) has prompted the industry to hope for a positive mid-term. Additionally, grocery and food delivery companies perform better because they sell essential items. Some have seen new customer orders increase from the usual 15-16% to 25%.

10. Impact on Tourism:

Cash crunch is hitting the tourism sector hard. It is very difficult for people to get money from banks and ATMs. The travel and hospitality industry is facing a challenging time.

The November-December tourism peak season has been hit hard. For tourist destinations outside of metropolitan areas, a company can see a drop of up to 40%. Tourist activity on the subways could decrease by 10%. Liquidity bottlenecks in airports and hotels are a big problem. And many entrances to national monuments do not have card payment options. Western countries have issued liquidity warnings in India.

11. Online Transactions and other modes of payment:

The government wants to go cashless, demonetization will have a positive impact on digital transactions and other payment methods. With the reduction in cash transactions, alternative forms of payment are increasingly in demand. Digital transaction systems, e-wallets, online transactions via e-banking, use of plastic money (debit and credit cards), UPI, EFTPOS, Net Banking Aadhar cards, etc. will see a significant increase in demand. Ultimately, this should lead to the strengthening of these systems and the necessary infrastructure

Conclusion

In the long run, there are some positive and some negative effects of demonization, but the negative effects do not outweigh the positive effects. After demonetization, some sectors were unaffected, such as B. Pharma, FMCG, Education, Agriculture, Hospitals, Energy and Telecom. From a stock market perspective, this move would be positive for the banking and infrastructure sectors in the medium to long term. This would be negative for real estate, durable goods and luxury goods in the short to medium term

Demonization can lead to the elimination of counterfeit money and corruption, it can be said that this is a historic move by the Modi government and should be supported by everyone. This government decision will deliver long-term results, this is the stepping stone to sustainable long-term economic growth.

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