

An Insight on the Impact of Demonetization on the Indian Economy

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Abstract—“*Demonetization is the withdrawal of a particular form of currency from circulation.*” In other words it means discontinuity of the particular currency from circulation. Through demonetization the old currency is replaced by the new currency or a currency circulation is blocked. On the evening of 8th November 2016, an unprecedented move on the demonetization policy was declared and all the currency notes of denominations Rs. 500 and Rs. 1000 were to lose legal sanction from midnight .

The government stated objective behind the demonetization as an attempt to make India corruption free. It is done to curb black money, to control escalating price rise, to stop funds flow to illegal activity, to make people accountable for every rupee they possess and pay income tax return.

This paper tries to analyze how far does the demonetization policy succeeds in its endeavor. It also aims to study the pros and cons of Demonetization and its impact on various factors of Indian economy.

Keywords: Corruption, Demonetization, Indian Economy.

1. INTRODUCTION

Demonetization

Recently the Indian government decided to demonetize the biggest denomination notes i.e. 500-1000 Rupees notes, this step has been declared as a master stroke for the Indian economy by various experts. This is not just the first time that India has demonetized its currency. The main objective of this step is to unearth the black money, to curb corruption, counterfeit currency as well as terror financing. This step is considered as the biggest cleanliness drive against the black money in the history of Indian economy.

As per RBI, 87% transactions in India are cash transactions and this loophole is used by corrupted people to build a parallel economy with unaccounted money. This parallel economy helps in terror financing which in turn hampers the growth and development of country.

Currently high- values notes account for total value of 86% of the notes in circulation in India. It is expected that this step will help in reducing the fiscal deficit of India and promote the cashless economy in India which can be easily monitored.

Demonetization History and Background In India

This is not the first time when Indian Currency is Demonetized In India .

- The first instance was in 1946 and the second in 1978 when an ordinance was promulgated to phase out notes with denomination of Rs 1,000, Rs 5,000 and Rs 10,000.
- The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data.
- The Rs 1,000 note made a comeback in November 2000. Rs 500 note came into circulation in October 1987. The move was then justified as attempt to contain the volume of banknotes in circulation due to inflation.

Reasons for Demonetization

The possible reasons and causes of Demonetization in any economy can be -

- Introduction of New Currency
- Black Marketing
- Currency Storage
- Corruption, etc.
- Excess fake currency in the economy.

2. PROS AND CONS OF DEMONETIZATION

Advantages

Attack On Black Money Holders

- People who possess huge amounts of black money in hard cash are at a complete loss now .
- Their black money in hard cash is now a pile of trash.
- Now If a Black money holder Want to Deposit Money in Bank Account they need to submit an ID proof .

- There Will Be **200 % Penalty on Income tax amount** for tax evaders.

Death Knell To Fake Currency Rackets

- Most of the fake currencies used to be in the denominations of Rs. 500 and Rs. 1000 .
- By banning Rs. 500 and Rs. 1000 notes, Modi has busted all these unethical rackets completely .
- Now There Will be no use These Money

End Of Terrorist Funding

- Huge sums of money especially in hard cash in the denominations of Rs. 500 and Rs. 1000 was used to fund Islamic terrorists , Naxalites and other non-state actors
- Now , these Organizations will suffer from shortage of funds .
- Most of These terrorist ,Maoist Organization Used These Funds For Buying Arms and Weapons
- Buying arms is an extremely difficult task now after this ban .

Transparency

- Online transaction = More transparency = Financial Intelligence Unit Will tack All Online transactions
- Now there Will be More Transparency In Real Estate Sector.

End of Huge Donations

- Huge amounts of donation that is taken in the private education and healthcare sectors would be stopped .
- Schools, engineering and medical colleges and hospitals (private ones) used to take huge amounts of money as donations especially in the form of hard cash in the denominations of Rs. 500 and Rs. 1000 .StudyDhaba.Com
- These money-minded people running these institutions won't be able to make any easy money now .
- Same applies to the real estate sector.

Towards A Cashless Economy

- While it is practically impossible to have a 100% cashless economy , the proportion of hard cash in the economy will decrease and our economy will get more digitized .
- This will result in greater transparency .
- Now government has put Some limitation for Cash Withdraw from bank Accounts. People Will go for online payments ,They Will Use PayTM Or other Online

payment Companies For Buying goods or Making payments.

- More Use of Debit and Credit Cards.

Hawala Transactions End

- Most Hawala transactions used to be carried out in the denominations of Rs. 500 and Rs. 1000 .With this ban , Modi has delivered a fatal blow to the unethical Hawala traders as they can't trade anymore using denominations of Rs. 500 and Rs. 1000 .

3. SHORT TERM LIMITATIONS OF DEMONETIZATION

Rush At Banks

- Banks will be extremely over-crowded by people .
- People will forget everything else and throng to the places where the banned notes are being officially exchanged leading to a tremendous chaos .
- There Will be Shortage of Money For Common people .

Stock Market

- Due to currency being sucked out of the market coupled with Trump's victory, the mood at the stock market was completely bearish .
- Sensex lost 1600 points at open . This can adversely have a negative effect on trade in general .

Problem For House Wives

- Many housewives store money to secure themselves during times of financial crisis in their households.
- The accumulated money of our respected Indian housewives is of no use now until they exchange in the banks and post-offices .
- Difficult For Those Families those have marriage or wedding ceremony

Short Term Inflation

- Due to shortage of money in the market , a short-term cost push inflation will occur .
- The price of gold has already become sky high .
- Prices of vegetables and fruits have also soared burdening the common man .

Equities fall, but prospects are better

Indian equity markets have been on a near secular falling trend since the government demonetized the 500 rupee and 1,000 rupee currency notes after midnight on November 8, 2016. The two benchmark equity indices—the Nifty 50 and the S&P

BSE Sensex—fell on each trading day since the demonetization except for November 10 and November 22. While the Nifty 50 fell 6.3% from November 8 until November 22, the S&P BSE Sensex fell 5.9% during the same period. Due to the rise in the US dollar, the dollar equivalents of the Sensex and the Nifty fell more than 8% each.

Demonetization can help monetary transmission

Monetary policy transmission is the translation of monetary policy actions into the financial system through banking and trading channels. The RBI (Reserve Bank of India) has been on a rate reduction cycle since January 2015. Before the January 2015 meeting, the repo rate stood at 8%. Its journey from that level to 6.3% currently includes six rate cuts totaling 175 basis points. However, banks have been slow in transmitting the benefit to consumers.

After being flush with deposits, it's expected that banks will reduce their lending rates sizably, improve monetary transmission, and benefit consumers—both corporate and individual.

Any increase in economic activity due to more consumption on account of lower rates can be beneficial to India-focused funds as well.

Impact on economy

The Indian Economy which was billed as the “fastest growing major economy” in the world and the “only bright spot” among Emerging Markets seems to have slowed down even before the latest “shock therapy” of “demonetization”. Indeed, the recently released growth figures from the CSO or the Central Statistical Office considered to be the official department that releases projected, and actual growth figures (apart from the RBI or the Reserve Bank of India and the Finance Ministry) hints at a slowdown in the Indian economy even during the quarter before demonetization happened.

But some economists point out to some short-term risks, particularly a dip in the December quarter GDP growth and corporate performance.

While this is indeed cause for concern with projected growth figures revised downwards from 7.6 % to 7.1% for the financial year ending March 2017, what is cause for greater worry and even alarm is the view among some economists including the former Prime Minister Dr. Manmohan Singh (who is a reputed economist in his own right) that the current and ongoing attempt to flush out black money would shave a good 2% of the GDP or the Gross Domestic Product.

4. CONCLUSIONS

- India is a cash based economy and demonetization will temporarily decrease liquidity in this economy for a short period. Decreased liquidity will lead to decreased demand which will result in decreased productivity causing a slowdown in consumer market.

- People have panicked due to sudden demonetization. This will force them to save and store more money. Thus, a decrease in demand leading to slow down in consumer market may be seen as a temporary phase.
- Demonetization is seen as a big reform as it expands the GDP. It pushes revenues, pushes economy, pushes money into banking systems, curbs parallel economy, boosts tax compliance and it is an effective way to make this country cashless.
- The Government and its various agencies are sparing no efforts to block all escape routes for the tax evaders. Hence, tax collections would increase, deposits will increase in banks and their capacity to support the economy will increase.
- As such, success of demonetization is being seen as the key to a more progressive and vibrant Indian Economy.

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