

IMPACT OF DEMONETISATION: NET EFFECT

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Abstract: *Demonetisation announced on November 8, 2016 was aimed at addressing corruption, black money, counterfeit currency and terror financing. Although, demonetisation holds huge potential benefits in the medium to long-term, it was expected to cause transient disruption in economic activity. The analysis in this paper suggests that demonetisation has impacted various sectors of the economy. The latest CSO estimates suggest that the impact of demonetisation on GVA growth was modest. But there has not been any significant impact on the external sector. An important consequence of demonetisation has been the sharp increase in the use of digital transactions.*

Key Words: *demonetisation, GVA growth, digital transactions.*

1. INTRODUCTION:

Government of India on November 8, 2016 announced demonetisation of the high value currencies of Rs 500 and 1000 with an objective to unearth the black money, to eliminate Fake Indian Currency Notes (FICN), to strike at the root of financing terrorism and left wing extremism, to convert the non-formal economy into a formal economy, to expand tax base and employment, to give boost to digitalisation of payments and to make India a cashless economy, to curb the corruption as well as counterfeit currency. This decision is considered as biggest cleanliness drive against the black money in the history of Indian economy whose benefits will be reaped in the long run. The decision was guided by the aim of reaping its enormous potential medium term benefits in the form of reduced corruption, greater digitisation of the economy, increased flow of financial savings and greater formalisation of the economy. All these would lead to higher GDP growth and tax revenues that could be used by the government for inclusive and stronger economic growth within the norms of fiscal prudence, besides contributing to overall improvement in business environment. However, the impact of this sudden move is causing major cash crunch in the economy affecting day to day requirements of the common man and businesses. Demonetisation as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who does not have the digital transaction culture. Overall, economic activities has been dampened in the short term. But the unmeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits. The immediate effect of demonetisation of economy would probably be short lived. However, the long term effect will drive the Indian economy to new areas of growth not just only on black money, terrorism and corruption but also in improving tax compliance, better fiscal balance and lowering inflation.

2. OBJECTIVES:

- To study the impact of demonetisation in different sectors of the economy.
- To workout the probable consequences and to layout the post truth scenario of demonetisation in the economy.

3. METHODOLOGY:

The study is purely based on secondary data collected from different journals, articles, newspapers and research papers.

4. DEMONETISATION AS A TOOL:

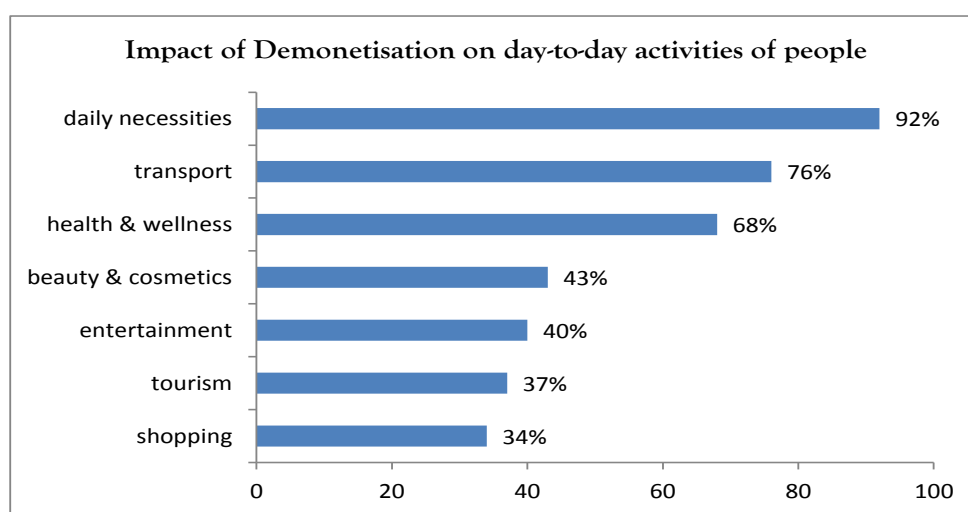
“There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency.” (Stated by J M Keynes in 1939). But demonetisation may not be a solution for tackling black money or economy which is largely held in the form of benami properties, bullion and jewellery. Because black money holders keep only 6 percent or less of their wealth as cash. If that is so, targeting this cash is clearly not the right strategy to eliminate black money. There is no question about addressing the stated objectives but the question is whether demonetisation is the right tool to achieve these objectives. As 98 percent of the transactions by volume and 68 percent in value are in cash. For the other, 86 percent of the cash in circulation is 500 and 1000 rupees notes. Again, 46 percent of GDP and 93 percent employment is contributed by the informal sector where most transactions such as wage payment, purchases and sales are carried out in cash.

An extreme step, such as demonetisation is taken only in a situation of hyperinflation leading to fast erosion of currency value or some form of financial crisis. But India recorded an average growth of 7.4 percent in 2014-15 and 2015-16 and is expected to grow at about 7.5 percent in 2016-17; inflation is well within the reasonable level of 3.15 percent WPI and 3.63 percent CPI; fiscal deficit is to be contained at 3.5 percent of GDP and foreign exchange reserves are at a healthy level of about USD 360 billion. In such a state of robustness of the Indian Economy, demonetisation is an ill- conceived measure. Demonetisation technically is a liquidity shock and a sudden step in terms of currency availability creates a situation where lack of currencies jams consumption, investment, production, employment etc. In this context, the present paper is likely to produce the short term, long term, consumption, investment, and welfare and growth impacts on Indian economy.

5. SOCIAL IMPACT:

Demonetisation is directly affecting the short term consumption needs of the people which includes daily wage labourers, women, students, small vendors, shop keepers etc basically the common men for whom cash is the primary mode of payment for their day to day activities. Alongwith this, the direct impact of demonetisation drive is seen on those who live in remote areas of country, having no bank accounts and no identification proofs.

TABLE: 1



Source: PHD Research Bureau, PHD Chamber Demonetisation survey 2016

From the above table 1, it can be assessed that the major impact of currency crunch is seen on daily needs of the people (92%) such as purchase of eatables, dairy products and other necessities, transport (76%), health care and wellness (68%), beauty and cosmetics (43%), entertainment (40%), tourism (37%) and shopping (34%). The sources inferred that the impact of demonetisation is seen not only on consumption, people are also facing lot of problems in exchanging currencies, withdrawing the money from ATMs or banks or depositing the money due to large queues. However, people belonging to the poorest sections of the society who don't have smart phones, internet facility and lack digital literacy are majorly impacted by demonetisation drive.

6. ECONOMIC IMPACT ON DIFFERENT SECTORS OF THE ECONOMY:

A. GROWTH AND INFLATION:

The growth of gross value added (GVA)² is expected to have been impacted primarily by the liquidity shock for effecting transactions in the economy. This impact is expected to have worked through two channels : (a) decline in demand due to shortage of cash to make payments, mostly on discretionary spending and (b) disruption in production activity due to man hours lost as some workers, especially those in the unorganised sector who get their wages paid in cash, experienced temporary loss of work. The construction sector and some of the labour intensive manufacturing sectors such as textiles, leather, gems and jewellery and the transportation sector engage casual or migrant labourers extensively. The loss of wage income for workers is expected to have caused a drag on consumption demand.

The Reserve Bank in its Fifth Bi monthly policy statement on December 7, 2016 placed the GVA growth for 2016-17 at 7.1 percent, which was lower than 7.6 percent GVA growth projected in its Fourth Bi- monthly monetary policy statement of October 4, 2016. The 50 basis points (bps) downward revision in GVA growth was on account of 35 bps loss in momentum, which was reflected in GVA growth in Q2 estimated by the Central Statistics Office (CSO) in November 2016 and 15 bps on account of the adverse impact of demonetisation. The CSO in its first advance

estimates released on January 6, 2017 placed the GVA growth for 2016-17 at 7.0 percent. The overall GVA growth in the Sixth Bi-monthly monetary policy statement on February 8, 2017 was pegged lower at 6.9 percent. The impact of demonetisation on GVA growth was estimated at about 33 bps for the full year 2016-17. After the peak impact in Q3, GVA growth was estimated to strengthen with the progressive remonetisation in Q4. As per the estimates of CSO released on February 28, 2017, GVA growth for 2016-17 is pegged at 6.7 percent, which is about 30 bps lower than what was estimated on January 6, 2017. Importantly, Q3 growth (6.6 %) was only marginally lower than that recorded in Q2 (6.7%) thereby suggesting that demonetisation had only a modest impact on growth in Q3 of 2016-17.

B. ORGANISED SECTOR:

Although the organised sector remained resilient, some manufacturing and service segments were adversely affected. Organised manufacturing was impacted adversely due to the decline in the sales of fast moving consumer goods (FMCG) and automobiles in all the months from November to January, contraction in the manufacturing Purchasing Manger's Index (PMI) and deceleration in export growth. The organised corporate sector appeared to have remained largely resilient to the impact of demonetisation which is the key indicator for estimating growth in GVA.

The sectors which are majorly impacted by demonetisation includes retail sector followed by agriculture sector, real estate, construction, media and entertainment , gems and jewellery , tourism and hospitality, labour intensive sectors and automobile sectors:

1). RETAIL:

The impact of demonetisation is majorly seen on the retail sector as the cash crunch is leading to low consumer demand of their products causing fall in their sales since Indian retail segment generates a lot of cash transactions. The impact is comparatively higher on the small traders and the unorganised retailing segment.

2). AGRICULTURE:

Agriculture sector is majorly impacted since sale, transport, marketing and distribution of ready produce to wholesale centres or mandis, is dominantly cash-dependent. Agriculture is impacted through the input-output channels as well as price and output feedback effects. Farmers were not able to purchase inputs like seeds from market. The problem of the demonetisation is largely associated with the rural areas of the country having lesser number of banks and ATMs compared to the urban and semi-urban areas. Besides, those negative effects of demonetisation there is also hope of every Indian farmer upon demonetisation that this historical step will concrete our economy and also fruitful for our country in future.

3) REAL ESTATE:

Organised real estate sector is also majorly impacted due to demonetisation as cash is always a major component of their transaction. It essentially reflected the performance real estate companies. According to Knight Frank India, demonetisation move created a real dent in the residential real estate sector, pulling back the last quarter trend of residential sales across the cities.

C. UNORGANISED/INFORMAL SECTOR:

MSMEs have played a pivotal role in providing large employment opportunities to over 80 million people in India. The sector contributes about 8% to GDP besides 45% to the total manufacturing output and 40% to the exports from the

D. FINANCIAL MARKETS:

Demonetisation impacted various segments of the financial markets in varying degrees. However, in most segments, the impact was transient. Surplus liquidity conditions post-demonetisation have imparted an easing bias to G-sec yields. Overnight call money market rates remained within the corridor but traded with a distinct softening bias. In sympathy with the overnight call rate, other short term rates also eased. In the equity market, share prices relating to cash intensive sectors such as realty, consumer durables, auto and FMCG declined significantly in November and December, but most of these sectors recovered the lost ground subsequently. The impact on the foreign exchange market was transitory.

7. SHORT TERM EFFECTS:

Demonetisation is not a big disaster like global banking sector crisis of 2007; but it is a great liquidity shock for the developing countries that disturbed the whole economic activities. Apart from questioning about the soundness of the policy of demonetisation, its execution was totally unplanned, haphazard and casual that caused immense misery to the people. A month after demonetisation, that is, on December 7, 2016 only 3.81 lakh crore new notes or less than a quarter (24.7 percent of 15.4 lakh crore cancelled 500 and 1000 notes) were put in circulation that led to the acute shortage of cash and long queues. This bold step caused difficulties in carrying out smaller transactions for the non-availability of smaller notes. More than 100 people reportedly lost their lives while standing in queue to withdraw their own money from ATM or banks. A huge number of those who were engaged in the informal sector which are basically the cash based economy lost their daily wages and millions of man-hours were wasted while standing in

queue to obtain cash in limited doses. India has a higher cash GDP ratio at 11 percent than most major economies such as US – 7.5 percent UK – 3.4 percent and South Korea – 3.9 percent which shows the role of cash in economic transactions. The informal sector which are mostly cash based provides job to 93 percent of the workforce. Manufacturing, trade, construction and transportation contribute 73 percent of the informal employment. Demonetisation thus has hit this sector most and slowed down its growth.

Again, cash crunch seems to have a heavy toll on investment because only 177 investment proposals worth Rs. 43,700 crore were made during 53 days between Nov 9 and Dec 11, 2016 of October-December quarter as against 227 new investment proposal worth 81,800 crore during 38 days prior to the pre-demonetisation. In short, demonetisation leads to lower growth, lower inflation, lower interest rates and lower tax revenue collection. According to a forecasting agency, demonetisation has hit rural consumption demand harder than urban demand, services more than manufacturing and exports more than imports.

8. LONG TERM EFFECTS:

People are still missing the wood for the trees and are concentrating on short term effects like long queues and ATMs. But the latest move of demonetisation merely happens to be a part of a larger grand plan.

8.1. Surgical Strike on the parallel black economy: India has a huge parallel black economy which the Government cannot tax and which forms an island away from the main economy. It has been estimated to be in the range tens of thousands of crores of Rupees in the past to lakhs of crores today. But through demonetisation a good chunk of this is expected to come into the main economy.

8.2. Make the corrupt lose their money: This is one of the positive effect where the corrupts are losing their money in large numbers. Huge sacks of money are being burnt, thrown or caught. Some of it is also percolating down as commission for the poor who are converting the old money into new, so it's an unexpected benefit for them too.

8.3. Get everyone to have a bank account: The bank scheme for the poor under the UPA was a quiet affair but it picked up under Modi's Pradhan Mantri Jan Dhan Yojana which is a big push towards the direction. Money deposited after demonetisation has been phenomenal. Having own bank account could withdraw Rs. 24,000 in one stroke and those without a bank account had to struggle to convert their old cash which pushes more and more Indian citizens into the banking system and this is exactly what the Government wants.

8.4. Get every citizen in India to be monitored online: A cashless economy is not just convenient for citizens, but also for the government to monitor. The government wants each and every transaction in India to be online so that it can be easily tracked and taxed. Credit card and net banking usage is up, debit card transactions have soared while PayTM has struck a virtual goldmine. This is a huge step forward in India becoming a cashless economy.

8.5. Counterfeit currency:

Demonetisation has dealt a death blow to the counterfeit Indian currency syndicate operating both inside and outside the country. This is an open secret that Pakistan has been printing fake Indian Currency at its government printing press in Quetta and its security press in Karachi. Babasaheb Ambedkar, the Father of the India's economy after Independence, said that notes should be changed every 10 years. Thus, With Prime Minister Modi's decision to pull out the old Rs 500 and Rs 1000 notes and replacing them with new Rs 500 and Rs 2000 notes has completely stalled the circulation of counterfeit Indian currency.

8.6. Crackdown on terrorism and Naxalism: Both terrorism and Naxalism run on counterfeit notes coupled with black money. With the drive of demonetisation, they have been severely hit as their funds have dried up.

8.7. Boost the economy: For one a good amount of black money will make its way into the white economy and that will only boost the latter. People burning their notes and counterfeit ones being taken out of the system, the value of the Rupee will become stronger. The more the notes there are in the market, the higher the inflation. If bad notes are taken out of the market, prices will fall and the Rupee's buying power will marginally increase.

9. DEMONETISATION- THE POST TRUTH:

While the benefits of demonetisation in the finance ministries are either meagre or illusory, but the statement remains silent on the costs of demonetisation. Economic Survey 2016-17 recognised the fiscal costs of demonetisation: costs of printing new notes over and above normal replacement, the costs of sterilising the surge in liquidity into the banking system through the issuance of market stabilisation scheme bonds, loss in corporate and indirect tax revenues of the centre in the case of decline in economic growth.

The RBI has informed that the surplus paid to the central government came down from Rs. 65,876 crore in 2015-16 to Rs. 30,659 in 2016-17. The reduction in RBI's surplus was because of reduced earnings and higher expenses in 2016-17, much of which were a direct outcome of demonetisation. The cost incurred on printing notes increased from Rs. 3,421 crore in 2015-16 to Rs. 7,965 crore in 2016-17, that is, an increase of Rs. 4,544 crore. This significant additional expense was incurred because supply of new currency notes rose by 37% over the previous year, with the supply of higher denomination notes rising by 160%, alongside higher freight and forwarding expenses. RBI suffered a whopping loss of Rs. 18,004 crore in 2016-17 compared to last year on account of interest payment

expenditure due to absorption of surplus liquidity in the banking system post-demonetisation. Therefore, RBI lost Rs. 22,548 crore in 2016-17 compared to the previous year due to demonetisation related costs. There has been a net loss of Rs. 27,500 crore so far, to the government alone. There are, of course other significant costs that were inflicted on the private sector, which led to losses in earnings and jobs in both the formal and informal segment of the economy. Thus, a close examination of the finance ministry's statement regarding the post demonetisation reveals that they are mostly false and deceptive and even the fiscal costs of demonetisation have far surpassed its benefits.

10. SUGGESTIVE MEASURES:

In order to ease the burden of demonetisation, the government has introduced numerous measures to ease the burden of demonetisation on common man but there are various challenges which need to be solved at the earliest possible:

10.1. Set up digital literacy booths outside banks majorly in rural regions: The need of the hour is to create digital literacy across all the sections of the nation as very small portions of the country is using internet and phone banking for their daily requirements. Since, majority of the people belonging to lower and middle class have their bank accounts in government banks. It is highly essential to create digital literacy booths outside the banks wherein there is a facility of opening of new bank accounts and demonstration of how to make digital payments, use internet and phone banking.

10.2. Subsidy scheme for smart phones: Government should come up with subsidised schemes for low cost smart phones which would make smart phones accessible to all and would help in spreading digital literacy among people. Further, this will boost Make in India Programme since the positive impact will be seen on Indian Mobile phone manufactures.

10.3. Increasing penetration of banks in rural areas: The penetration of banks in rural areas is very less and the major impact of demonetisation is seen on people residing in rural region since they don't even have their own bank accounts. Hence, the government need to ensure easy flow of money in the banks located in the rural regions and special camps for their support.

Faster implementation of the suggested measures would contribute in the process of remonetisation and would play an essential role in increasing the demand thereby refunding the economy to higher growth trajectory.

11. CONCLUSION:

Demonetisation is a one step of many steps in fighting corruption, black marketing, and fighting insurgency. However, preparation for demonetisation was lop-sided, and its impacts were terrible on Indian public. Demonetisation impacted various sectors of the economy; however the adverse impact was short lived. Overall, demonetisation has had some negative macro-economic impact, which, however, has been transient as remonetisation has moved at an accelerated pace in last twelve weeks. More importantly, demonetisation is expected to have a positive impact over the medium to long term with increased use of digital payments. The advantages are much dominating and it will be in the long term interest of our country comfortably outweighing the disadvantages. Government need to take all the necessary steps so as to ensure that there will be a smooth flow of currency exchanges. It will make a massive change in our economy. We, thus congratulate the entire government and those hidden brains of our democracy who brought this decision.

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