

IMPACT OF DEMONETIZATION A STEP BY PRIME MINISTER

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ABSTRACT: Demonetization is a generation's memorable experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. Demonetization affects the economy through the liquidity side. Its effect will be a telling one because nearly 86% of currency value in circulation was withdrawn without replacing bulk of it. As a result of the withdrawal of Rs 500 and Rs 1000 notes, there occurred huge gap in the currency composition as after Rs 100; Rs 2000 is the only denomination. Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc. benefit is that due to people disclosing their income by depositing money in their bank accounts government gets a good amount of tax revenue which can be used by the government towards the betterment of society by providing good infrastructure, hospitals, educational institutions, roads and many facilities for poor and needy sections of society.

KEYWORDS: Demonetization, Liquidity, Inflation, Recession, Transaction, Investment

INTRODUCTION:

Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization is necessary when 1978 to scrap out Rs 1,000, Rs 5000, and Rs 10,000 notes immediately after emergency was lifted from India. Even that time, citizens were as shocked and surprised as they are today with the decision taken by our current Prime Minister Narendra Modi. Generally, the currencies of high value are vulnerable to be used for unfair purposes, and hence, it becomes necessary to take such big steps to eradicate the malfunctioning elements from society.

Tokens used as money in a country. In addition to the metal coins and paper bank notes, modern currency also includes checks drawn on bank accounts, money orders, travelers checks, and will soon include electronic money or digital cash. Indian government has demonetized the high value currencies i.e currency notes of 500 and 1000 with objective to unearth the black money, and to curb the corruption, counterfeit currency as well as terror financing. This decision was considered as biggest cleanliness drive against the black money in the history of Indian economy. But there is various view of experts

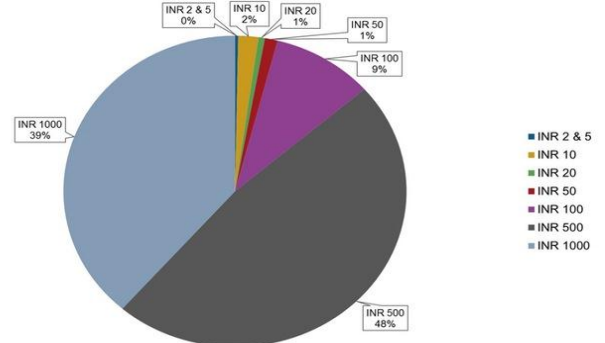
on demonetization, as some argues that it will hit the black money and other argued in negative.

MATERIAL AND METHOD:

Demonetization for us means that Reserve Bank of India has withdrawn the old Rs. 500 and 1000 Rs. Notes as an official mode of payment. According to Investopedia, demonetization is the act of stripping a currency unit of its status as legal tender.

Why India Demonetized 2 Currency Notes

Percentage Share of Denominations in Circulation by Value in FY 2015-16



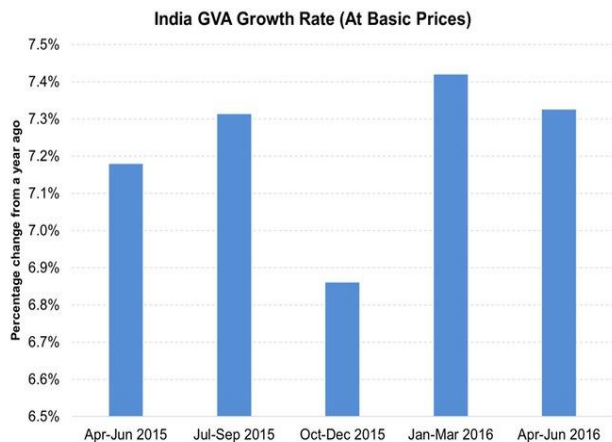
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Source: The Reserve Bank of India

According to the RBI's (Reserve Bank of India) Annual Report for April 2015 to March 2016, the value of the currency notes at the end of March 2016 was 16.42 trillion Indian rupees. The 500 rupee and 1,000 rupee currency notes formed 86.4% of the value. In one stroke, the government removed 86.4% of the currency in circulation by value. In terms of volume, the currency notes of these two denominations formed 24.4% of a total 90.27 billion pieces. Also, RBI data showed that as of March 2016, 632,926 currency notes were counterfeit—known as an FICN (Fake Indian Currency Note). As a proportion of NIC (Notes in Circulation), the 1,000 rupee and 500 rupee notes were the highest. Nullifying these FICNs was also part of the demonetization move.

India's economic growth: Growth in the Indian 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 2016–2017. 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: $GDP = GVA + \text{taxes on products} - \text{subsidies on products}$. The base year for calculating the GVA is 2011–2012.



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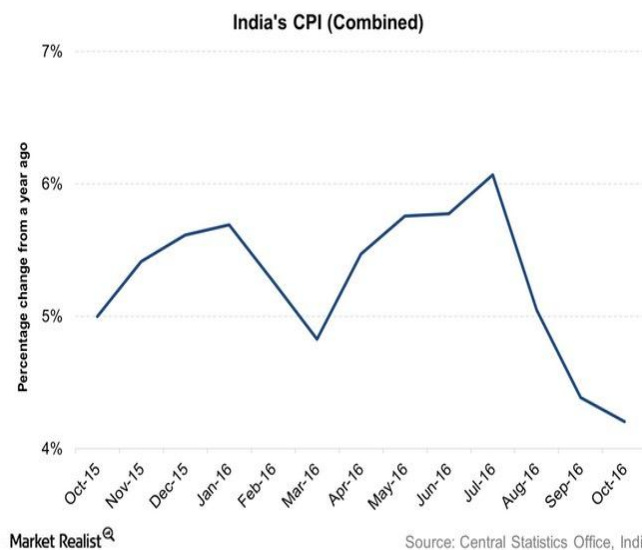
Source: Central Statistics Office, India

The fall in economic activity due to demonetization could last from two to three quarters. As a result, GDP and GVA growth in the quarters from September to December 2016 and January to March 2017 could be significantly lower than previous years. Some bounce back should be seen in the first quarter of fiscal 2017–2018. In the medium term, the Indian economy can grow considerably after curbing the debilitation caused by counterfeit money and an increase in economic activity. Though some relaxation was given to those women working with children they still wanted crèches to be provided at the worksite. The above responses were further analysed using a rating scale of 1-4, like for highly unsatisfied a rating of 1 was given and likewise for highly satisfied a rating of 4 was given. The scores thus obtained were classified into three levels—low, medium and high satisfactions. The following table shows satisfaction level of the beneficiaries in both the selected blocks.

Measures of inflation in India

The RBI (Reserve Bank of India) considers the CPI (consumer price index) as its primary gauge of measuring inflation. Prior to the RBI adopting the CPI in India (PIN) (FINGX), another measure of inflation—the WPI (wholesale price index)—was the key gauge of inflation and it's still considered for reference. To learn more about these measures of inflation, read India's different inflation measures—WPI versus CPI.

The RBI has CPI growth targets to adhere to while deciding its monetary policy stance. By January 2016, it was supposed to keep inflation below a target of 6%, which it was able to do. Its next target is to keep inflation at or below the 5% mark by March 2017.



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Source: Central Statistics Office, India

RESULTS AND DISCUSSION:-

Following are the main impacts:-

- 1. Tax:** Having closed the voluntary disclosure window for undisclosed money, it has been reported that government will keep a close watch on deposits over Rs 2 lakh in cash. This would mean increased tax net, higher tax collection and a better tax to GDP ratio.
- 2. Interest rates:** One of the biggest impacts of demonetization would be high value transactions, especially land and gold. This would result in lower inflation, tempting the central bank to reduce interest rates.
- 3. GST:** Demonetization comes at an important as the country heads to a new tax regime with the implementation of GST. Demonetizations would increase the tax net and along with GST result in reduction of black money generation.
- 4. Crackdown on terrorism and Naxalism:** It is an open secret that both terrorism and Naxalism run on counterfeit notes coupled with black money.
- 5. Impact on Online Transactions & alternate modes of payment:** With cash transactions facing a reduction, alternative forms of payment will see a surge in demand. Digital transaction systems, E-wallets, mobile apps, UPI, net-banking, usage of Plastic money etc. will definitely see substantial increase in demand.
- 6.** According to a Bloomberg survey of economists, expansion has probably accelerated to 7.5 per cent, while analysts are cutting down the growth forecast to 7.4 per cent from 7.7 per cent this year.

Advantages of Demonetization:

1. The biggest advantage of demonetization is that it helps the government to track people who are having large sums of unaccounted cash or cash on which no income tax has been paid because many people who earn black money keep that money as cash in their houses or in some secret place which is very difficult to find and when demonetization happens all that cash is of no value and such people have two options one is to deposit the money in bank accounts and pay taxes on such amount and second option is to let the value of that cash reduced to zero.
2. Since black money is used for illegal activities like terrorism funding, gambling, money laundering and also inflating the price of major assets classes like real estate, gold and due to demonetization all such activities will get reduced for some time and also it will take years for people to generate that amount of black money again and hence in a way it helps in putting an end this circle of people doing illegal activities to earn black money and using that black money to do more illegal activities.
3. Another benefit is that due to people disclosing their income by depositing money in their bank accounts government gets a good amount of tax revenue which can be used by the government towards the betterment of society by providing good infrastructure, hospitals, educational institutions, roads and many facilities for poor and needy sections of society.

Disadvantages of Demonetization:

1. The biggest disadvantage of demonetization is that once people in the country gets to know about it than initially for few days there is chaos and frenzy among public as everybody wants to get rid of demonetized notes which in turn sometimes can lead to law and order problem and chaotic situation especially in banks and ATMs which are the only medium to change the old currency units to new currency units.
2. Another disadvantage is that destruction of old currency units and printing of new currency new units involve costs which has to be borne by the government and if the costs are higher than benefits then there is no use of demonetization.
3. Another problem is that majority of times this move is targeted towards black money but if people have

not kept cash as their black money and rotated or used that money in other asset classes like real estate, gold and so on then there is no guarantee that demonetization will help in catching corrupt people.

CONCLUSION-

The demonetization will help to get long term benefits:

1. Once the black money is reduced, taxes would leapfrog.
2. Developmental activities would pick up significantly as the tax revenue increases.
3. Government can reduce rates of taxes since they can raise significantly more revenue with lower rates.
4. Corruption would reduce since there would be little black money to pay bribe to government officials.
5. Dowry and other social practices like extravagant marriages would reduce due to white economy.
6. Illegal activities like murder, kidnapping, drug-paddling, prostitution, terrorism etc. would reduce since all these activities need black money.
7. The honest people would live life of much more respect as dishonest would no longer be displaying their wealth for long time to come.

So, the Central government's recent decision to demonetize the high value currency is one of the major steps towards the eradication of black money in India. 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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