Impacts Of Demonetization On India – A Study

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ABSTRACT
At the historical date 8th November 2016 declaration of 86 percent of Rs.500 and 1000 notes currency notes as become illegal tender. This was momentous decision and unexpected one which was declared without any prior information in the evening at 8:15 p.m. addressed by our honorable Prime Minister Shri Narendra Modi. The main aim for this historic step is the disclose “Black Money” in the other sense not paid income tax on that money. Most people of India suffering by this instant movement, but the supreme sufferers of this move were the informal sector of Indian Economy includes 106 activities like agriculture, workers in construction, local transport, community services and small workshops like garment makers, rural population as well as urban population. In my research paper we will focus on current situations as well as forecast the future analysis.

KEYWORDS: Demonetization, black money, Indian Economy.

INTRODUCTION
Changes want any country at the level of top authority they takes some major steps on the security level. 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 become legal tender from the midnight of 8th of November 2016. People have been given up time to exchange their currency in any bank or post office till December 30, 2016 to exchange the notes held by them. The proposal by the central government involves the elimination of these existing notes from circulation currency replacement with a new set of notes in all banks. In the short term, it is intended that the cash in circulation would be substantially squeezed since there are limits placed on the amount that individuals can withdraw. In the months to come, this squeeze may be relaxed somewhat. The reasons taken decision for demonetization are two-fold: first fold is: to control fake currency that could be help contributing to terrorism, in other words a national security region and second fold is: to undermine or eliminate the “black economy” in same country.

There are two ways in which the pre-demonetization of money supply will break in the new regime: one, there would be big agents or middle man 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 fixed amount of cash of the currency which was in circulation as cash. In the other words, the rest would use of the money in the form of cards they will be available as electronic money with the help of fund transfer and payments. This could be a mechanism used to force a transition to cashless medium of exchange. The empirical extent of these two components will be unraveled only over the next six months. These two would have different effects on the economy in the short term and in the medium term.

To understand the effects of these dimensions, it is important to first understand what is it that cash does in the economy? There are broadly four kinds of transactions in the economy: accounted transactions, unaccounted transactions, those that belong to the informal sector and illegal transactions. The first two categories relate to whether transactions and the corresponding incomes are reported for tax purposes or not. The third category would consist largely of agents who earn incomes below the exemption threshold and therefore do not have any tax liabilities. In the finally, there would be defiantly do the demand for cash for illegal purposes and work like bribes in elections, spending over sanctioned limits, dealings in crime and corruption. If one can takes coverage of the location of cash at any given point of time, it is very difficult to predict what the breakup of the cash according to these categories would be, but it would be safe to say that each of these components would be represented in that snapshot.
REVIEW OF LITERATURE

Demonetization is defined as act of stripping a currency unit of its status as legal tender. It refers to cessation of current currency and replacing it with new currency. Demonetization is not a new concept; in the past also it has been utilized by various countries as well as India to curb currency some failed very badly with this move. Table shows the countries which previously banned the notes and their effects on economy.

COUNTRIES WHICH IMPLEMENTED DEMonetIZATION EARLIER

<table>
<thead>
<tr>
<th>Serial No.</th>
<th>Country</th>
<th>Year</th>
<th>Effects on Economy</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Ghana</td>
<td>1982</td>
<td>Made economy week unsuccessful</td>
<td>People support for black market and investment in physical assets</td>
</tr>
<tr>
<td>2.</td>
<td>Nigeria</td>
<td>1984</td>
<td>Economy collapsed unsuccessful</td>
<td>Debt-ridden and inflation did not take change well.</td>
</tr>
<tr>
<td>4.</td>
<td>Soviet Union</td>
<td>1991</td>
<td>Unsuccessful</td>
<td>People did not take change positively due to poor harvest.</td>
</tr>
<tr>
<td>5.</td>
<td>Australia</td>
<td>1996</td>
<td>No side effect</td>
<td>As the purpose was only to replace paper with plastic.</td>
</tr>
<tr>
<td>6.</td>
<td>North Korea</td>
<td>2010</td>
<td>Week unsuccessful</td>
<td>People left with no food and shelter</td>
</tr>
<tr>
<td>7.</td>
<td>Zimbabwe</td>
<td>2015</td>
<td>Week unsuccessful</td>
<td>Face value one hundred trillion dollars dropped to $0.5 dollar.</td>
</tr>
<tr>
<td>8.</td>
<td>Pakistan</td>
<td>2016</td>
<td>Cannot be predicted</td>
<td>As the people have ample time to get their note exchanged.</td>
</tr>
</tbody>
</table>

OBJECTIVE OF THE STUDY
1. To analysis the demonetization steps a biggest Economic Reform by the Modi Government.
2. To check the improvement in Government’s fiscal position in future.
3. To check the early position for potential long-term benefits.

A CONCEPTUAL FRAMEWORK ON DEMONETIZATION

Demonetization steps a biggest Economic Reform

After the taken decision of Prime Minister Narendra Modi on the demonetization there are various changes on the Indian Economy, like: Rate cuts, good liquidity, positive demand-supply situation and improving Indian macros over last couple of years have been big drivers of returns in duration funds. Investors who had stayed invested in funds, such as Reliance Dynamic Bond Fund, for a reasonable period of time had reaped the benefits, despite intermittent volatility (such as mid-2013). This was largely possible due to the dynamic fund management mandate of the fund, which allows for dynamically varying the duration and asset profile of the fund, while not diluting the quality of the portfolio.

In last few years, we have seen positive developments in the bond market:
- Global events along with regime change both at central government as well as RBI also had positive ramification ondomestic macros;
- Consumer Price Inflation (CPI) has fallen to sub 5% level, Government’s fiscal discipline & Current Account Deficit (CAD) is largely under control.
- Though the bond yields moved in a volatile band of 200-250 bps with 10 year benchmark GSecs making a low of 6.70-6.80% and high of 9.25-35% due to various global and domestic events, Indian bond markets have largely been benefited by improving fundamentals.
The recent historic demonetization move by the government is seen as a war on parallel economy, corruption, money laundering and to stop financing aid enjoyed by the terrorists. We believe this move would have a far-reaching impact on Indian economy. It might have short-term pain but sure long-term gains. Apart from flushing liquidity in the banking system, demonetization could create short-term disruption in consumption and lead to behavioural changes in household’s saving and consumption demand.

If there is increase in investment in the economy, the demand for capital goods rises. If output can expand in this sector, there would be an expansion in the income generation and in demand for goods and services. Sectors that are not operating with excess capacity cannot meet the expanded demand with increased output, leading to increase in prices. This would hold for agriculture as well as any industry with long gestation lags to investment. In other words, in the short run there is a possibility of increase in inflation.

With increase in GDP, since imports are supposed to be related to the size of the economy, it is expected that imports will rise, but the same cannot be said about exports. In other words, the balance of trade could worsen. This could result in pressures on the rupee towards depreciation. Any increase in inflationary pressures too could augment these pressures.

IMPROVEMENT IN GOVERNMENT’S FISCAL POSITION GOING FORWARD
The implication for the fiscal deficit is a clear positive, as the government could gain windfall assuming large number of unaccounted currency does not make its way back into the banking system. Also incrementally we might see tax reporting discipline and hence the increase in tax collection through better reporting and audit.

A. Higher benefits for the Government if lesser currency notes come back into the system
The high denomination currency which has to be demonetized accounts for 85.2% of total notes which is nearly Rs. 15 trn worth currency in the economy. Conservatively, we assume that 80% of this old currency (Rs. 12 trn) will be deposited back in banks in order to get the new currencies in exchange. RBI will have to replace this Rs. 12 trn old currency with new currencies, which will be part of RBI’s liability. The balance amount (unaccounted part of the demonetized currency) to the tune of Rs. 3 trn will not be deposited back in the banks will reduce RBI’s liability to that extent as these notes may cease to exist.

This windfall could Arguably be a net gain for the government. It can have far reaching positive implications on the fiscal deficit next year. At the very least, this will lead to added flexibility for the government on fiscal and market borrowing, while allowing it to pursue accelerated infrastructure and banking sector related spending.

B. Increase in Tax Reporting leading to better revenue hence better fiscal
Going forward an increase in tax collection through better reporting and audit is likely. Once cash holdings are deposited into the banks to exchange new currencies, understating true income for tax purposes will be very difficult. This may potentially lead to better compliance, thereby increasing the tax base and revenues of the government.

C. System Liquidity to increase going forward
Banking system liquidity will get a major boost with deposits increasing and currency in circulation growth reducing going forward, as unaccounted cash money is flushed out of the system and future cash transactions also reduce. Despite an expected improvement in banking sector liquidity, we do not expect credit growth to improve meaningfully going forward. In fact credit growth could slow down in the short term as loans to the retail sector, NBFCs and services slow down further due to the adverse impact of demonetization in these segments. We expect banks to continue investing in government securities as part of their mandatory SLR requirements as well as an improved inflation and fiscal outlook will likely provide them with a greater opportunity in GSecs. The additional SLR demand over the next 6 to 12 months could be in vicinity of Rs 1 trn, purely on account of this move.
D. Inflation expected to fall further

The move is likely to have a strong disinflationary impulse. The real estate sector, where a sizable proportion of transactions were conducted in cash (and often with black money), will be the worst affected followed by an expected slowdown in consumption demand. In our CPI forecast, we have assumed in housing inflation as well as slowdown in consumption demand, which has the potential to reduce CPI inflation average to 4.3% - 4.6%, from our current forecast of 4.8%.

EARLY POSITION FOR POTENTIAL LONG-TERM BENEFITS

According to this definition, it is too early to quantify the direction and magnitude of long term changes. It will take several years to see the impact of demonetization on any developing countries, on black money, and on financial savings. But there are some signs pointing to became changes in near future.

1. Impact of Digitalization

One intermediate objective of demonetization is to create a less-cash or cash-lite economy, as this is key to channeling more saving channeled through the formal financial system and improving tax compliance. Currently, India is far away from this objective: the Watal Committee has recently estimated that cash accounts for about 78 percent of all consumer payments. According to Price water house Coopers (2015) India has a very high predominance of consumer transactions carried out in cash relative to other countries, and there are many reasons for this situation. Cash has many advantages: it is convenient, accepted everywhere, and its use is costless for ordinary people, though not of course for society at large. Cash transactions are also anonymous, helping to preserve privacy, which is a virtue as long as the transactions are not illicit or designed to evade taxation.

Digital transactions face significant impediments in our developing country like improper supply of electricity, multimedia mobile, etc. on the online transaction they require special equipment, cell phones for customers and Point-Of-Sale (POS) machines for merchants, which will only work if there is internet connectivity. They are also costly to users, since e-payment firms need to recoup their costs by imposing charges on customers, merchants, or both. At the same time, these disadvantages are counterbalanced by two cardinal virtues. Digital transactions help bring people into the modern “wired” era. And they bring people into the formal economy, thereby increasing financial saving, reducing tax evasion, and leveling the playing field between tax-compliant and tax-evading firms.

Digitalization can broadly impact three sections of society: the poor, who are largely outside the digital economy; the less affluent, who are becoming part of the digital economy having acquired Jan Dhan accounts and RuPay cards; and the affluent, who are fully digitally integrated via credit cards. One simple measure that illustrates the size of these three categories is cell phone ownership. There are approximately 350 million people without cell phones (the digitally excluded); 350 million with regular “feature” phones, and 250 million with smart phones. In these situations there are some difficult to implementation of fully digital payment but not impossible.

2. Impact on Real estate

Demonetization could have particularly profound impact on the real estate sector. In the past, a huge amount of the black money accumulated was ultimately used to evade taxes on property sales. To the extent that black money is reduced and financial transactions increasingly take place through electronic means, this type of tax evasion will also diminish. While too early to assess whether there will be permanent effects, the weighted average price of real estate in eight major cities, which was already on a declining trend fell further after November 8, 2016. An equilibrium reduction in real estate prices is desirable as it will lead to affordable housing for the middle class, and facilitate labour mobility across India currently impeded by high and unaffordable rents.

3. Impact on GDP

India is a agriculture based country and its most important to understand the analytics of the demonetization effects in the short run. Demonetization is potentially:

• An aggregate demand effect, because it reduces the supply of money and affects private wealth (especially of those holding unaccounted money and owning real estate).
• An aggregate supply shock to the increase that cash is a necessary for input in economic activity (for example, if agricultural producers require cash to pay labour).

• An uncertainty effect because economic agents face the challenges in imponderables related to the impact and duration of the liquidity shock as well as further policy responses (causing consumers to defer or reduce discretionary consumption and firms to reconsider investment plans). With the other survey data abound on the impact of demonetization. But we are interested in a macro-assessment and hence focus on five broad indicators:
  • Agricultural crop (rabi) sowing.
  • Indirect tax revenue, as a broad gauge of production and sales.
  • Auto sales generally, as a measure of discretionary consumer spending, and in the two-wheelers in particular this is the best future indicator of rural and demand of the less affluent.
  • Real estate prices; and
  • Real credit growth.

Contrary to early fears, as of January 15, 2016 aggregate sowing of the two major rabi crops like; wheat and pulses (gram) exceeded last year’s enhancing by 7 percent and 15 percent groth in the farming sector, respectively whether this will lead to a agriculture sector increase in production will depend on the extent to which farmers’ access to inputs; seeds, fertilizer, credit, and labour was impeded by demonetization.

CONCLUSION

In my research paper if we can be said that this is a historical step by the Modi Government and should be supported by all is not hypothesis. This decision of govt. will definitely fetch results in the long term. From an equity market perspective, this move would be positive for sectors like Banking and Infrastructure in the medium to long term. In the present situation we say that this could be negative for sectors like Consumer Durables, Luxury items, Gems and Jewellery, Real Estate and allied sectors, in the near to medium term. This move can focus to enhance the level of tax compliance, much better fiscal balance of country, lower rate of inflation, lower corruption, complete deleted of fake currency and another stepping stone tretegy in Jammu and Kashmir for sustained economic growth in the longer term in country.

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