Original Research Paper

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Demonetisation and its impact on Indian Economy

Economics

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ABSTRACT

The implementation of the demonetization process has created a chaotic situation across the nation with people punished to stand in long serpentine queues to deposit, exchange and withdraw money. Anil Bokil and his team who had suggested the demonetization drive to slash black money and fake currency, has criticized the implementation as reported by the newspaper Mumbai Mirror. Talking to media, Bokil said that was held in July a proper plan was laid out for implementation and the government only picked two out of 5 points that he had but before. Bokil claimed that his organisation had made a roadmap regarding demonetization. He claimed if his team's roadmap would have been undertaken, there wouldn't have been chaos. His organisation 'Arthakranti Pratishthan' has been working on this from the past 16 years since the birth of it and would have ensured a peaceful climate in the demonetisation drive.

Introduction:

Demonetisation is very bold decision taken by Indian government for curbing all black money the objectives this demonetisation is make India cashless society. Demonetisation is a process by which a series of currency will not be legal tender. The series of currency will not be acceptable as valid currency. Demonetization is a deep psychological strike on black money. Demonetization move has killed the very motivation of those people who have the ability to generate black money. A person who had black money has already paid more than the effective tax rate just to convert his black money into legally tender-able currency / assets. Such people are in a state of shock as though they have already paid tax at a higher effective tax rate but still their black money has not got converted into legitimate income.

Objectives of the study

The paper aims at resolving following objectives

- To study the causes of demonetisation
- To know the background of the demonetisation
- To understand the impact of demonetisation

Methodology

To carry out the elaborate research the secondary data was collected and used from different journals, newspapers, and government websites.

Rationale Demonetisation

Terrorism is a frightening threat, but who funds these terrorists? Our enemies they use the fake currency to sponsor terror-this was proven many a times. Corruption and black money are the major obstacles in our country. It is weakening the efforts to remove poverty. Our country is rapidly increasing in terms of growth and we are in No.1 position in terms of growth but we are ranked 76 in Global Corruption Perception ranking. It clearly shows how corruption and black money have spread their tentacles.

Impact of Indian economy

The following are some of the significant impact of demonetisation and its impact on Indian economy

1. Inflation: It will cause deflation in the market as people who have earned money through illegal ways would be afraid to declare the money as they may be prosecuted by the Income tax department on the legitimacy of their income.

2. Reduction in Monetary Circulation: This will lead to reduction of money circulation in the economy leading to deflation. Value of money will be increasing which we have because the total money supply will be going down but the commodities and things available in the market have not gone down. It will lead to inflation slowly but not overnight.

3. Cash Deposits in Banks: A lot of cash which are legally earned will be deposited in the banks and now the banks with more deposits will be able to do more lending.

4. Easy Loans: Loans will become easier and interest rates may come down. As banks will have more money so more loans will be given out which will increase the money supply in the market and it will create inflation.

5. Impact on money supply, short term and long term

With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to reduce in the short run. To the extent that black money (which is not counterfeit) does not re-enter the system, reserve money and hence money supply will decrease permanently. However gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pick up.

6. Impact on banks

Since, the 500 and 1000 Rupee notes which now cease to be legal tender are to be deposited or exchanged in banks (subject to certain limits). This will automatically lead to more amounts being deposited in Savings and Current Account of commercial banks. This in turn will enhance the liquidity position of the banks, which can be utilized further for lending purposes. This will definitely enhance the cash flow for the banks and markets both.

7. Impact on Prices

One major impact of this is going to be seen in cases where the goods are priced on the basis of demand. Price level is expected to be lowered due to moderation from demand side. This demand driven fall in prices could impact two major categories i.e; Consumer goods and Real Estate. Consumer goods prices are expected to fall only marginally due to moderation in demand as use of cards and cheques would compensate for some purchases. Real Estate and Property prices in this sector are largely expected to fall, especially for sales of properties where major part of the transaction is cash based, rather than based on banks transfer or cheque transactions. In the medium term, however the prices in this sector could regain some levels as developers rebalance their prices (probably charging more on cheque payment).

8. Impact on Demand

Now that we have seen the impact on prices due to changing demand, the overall demand is expected to be affected to an extent. The demand in following areas is to be impacted particularly for sectors like Consumer goods, Real Estate and Property, Gold and luxury goods where people used to use cash for transactions.

9. Effect on the GDP

Gross Domestic Product (GDP) is the broadest quantitative measure of a nation's total economic activity. The GDP formation could be impacted by this measure, with reduction in the consumption demand. However with the recent rise in festival demand is expected to offset this fall in overall impact. Moreover, this expected impact on GDP may not be significant as some of this demand will only be deferred and re-enter the stream once the cash situation becomes normal.

10. Increase in Online Transactions and alternative modes of payments

With cash transactions facing a reduction, alternative forms of payment have seen a surge in demand. Digital transaction systems, E wallets and apps, online transactions using E banking, usage of Plastic money (Debit and Credit Cards), etc. will definitely see substantial increase in demand. This should eventually lead to strengthening of such systems and the infrastructure required. This has been seen as one of the driving factors to propose this change

11. Impact on other economic entities

With cash transaction lowering in the short run, until the new notes are spread widely into circulation, certain sections of the society like Agriculture and related sectors, Small traders, SMEs, Services Sector, Households, Political Parties, Professionals like doctor, carpenter, utility service providers, etc. and Retail outlets, etc. could face short term disruptions in facilitation of their transactions. These segments are expected to have the most significant impact post this demonetization process and the introduction of new notes in circulation because the nature, frequency and amounts of the commercial transactions involved with these sections of the economy necessitate cash transactions on more frequent basis.

12. Impact on black money hoarders

The driving force behind this historical decision was to eradicate black money. A recent study had pegged India's black market economy at over Rs 30 lakh crore or about 20 percent of total GDP. This is even bigger than the GDP of countries like Thailand and Argentina. Hence, this historic decision will surely impact the black money hoarders and will surely bring the economy back on track slowly and gradually.

13. Effect on parallel economy

The removal of these 500 and 1000 notes and replacement of the same with new 500 and 2000 Rupee Notes is expected to - remove black money from the economy as they will be blocked since the owners will not be in a position to deposit the same in the banks, - Temporarily stall the circulation of large volume of counterfeit currency and - curb the funding for anti-social elements like smuggling, terrorism, espionage, etc.

14. Effect on Money Supply

With the older 500 and 1000 Rupees notes being scrapped, until the new 500 and 2000 Rupees notes get widely circulated in the market, money supply is expected to reduce in the short run. To the extent that black money (which is not counterfeit) does not re-enter the system, reserve money and hence money supply will decrease permanently. However gradually as the new notes get circulated in the market and the mismatch gets corrected, money supply will pick up.

15. Effect on various economic entities

- With cash transaction lowering in the short run, until the new notes are spread widely into circulation, certain sections of the society could face short term disruptions in facilitation of their transactions. These sections are:
- Agriculture and related sector
- Small traders
- SME
- Services Sector
- Households
- Political Parties
- Professionals like doctor, carpenter, utility service providers, etc.
- Retail outlets
- The nature, frequency and amounts of the commercial transactions involved with these sections of the economy necessitate cash transactions on more frequent basis. Thus, these segments are expected to have the most significant impact post this demonetization process and the introduction of new notes in circulation.

The major decision which is made by the government will help us to eradicate black money, corruption to some extent.

- Due to lack of funding there will be no arms smuggling and all the terrorist activities will also be choked.

- The government has proposed the new limits on ATM withdrawals being restricted to Rs.2000 per day, withdrawal from bank account is Rs.10000 a day and Rs.20000 a week. It indicates that card transactions will slowly replace the cash transactions in our daily prone activities.

- Exchange of money in banks can only be done producing valid identity cards like PAN, aadhar card and electoral card from 10 to 24 November with a daily limit of Rs.4000. By doing so it will be easy for the government to track the money which is being exchanged in banks. There is no limit if the amount which we are exchanging is legal amount.

- Financial Intelligence Unit will track all details of the transactions from the banks. So now it is really difficult to get rid of the black money.

- Real estate industry is totally corrupted and now by this stringent decision the real estate sector will bring in more transparency. By doing it in this way we will have more credibility, making it more attractive to the foreign investors as well as domestic investors.

Long term Benefit of demonetisation

In the long run, Indians would reap several benefits due to this move.

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.

Conclusion

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 would turn into chaos if government takes no necessary steps to circulate money correctly. It will make a massive change in our economy. We congratulate the entire government and those hidden brains of our

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democracy that brought this decision.

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