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Impact of demonetization on Indian economy and common man

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ABSTRACT

Demonetization is a generations' 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 Its effect will be a telling one because nearly 86% of currency value in circulation was withdrawn without replacing bulk of it.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. In this paper, the author has discussed about the various impact of demonetization on Indian economy and common man.

Keywords: demonetization, Indian economy, common man, notes, impact.

INTRODUCTION

Demonetization is the act of stripping a currency unit of its status as legal tender. In an important move, the Government of India declared that the five hundred and one thousand rupee notes will no longer be legal tender from midnight, 8th November 2016. The RBI will issue Two thousand rupee notes and new notes of Five hundred rupees which will be placed in circulation from 10th November 2016. Notes of one hundred, fifty, twenty, ten, five, two and one rupee will remain legal tender and will remain unaffected by this decision. This measure has been taken by the PM in an attempt to address the resolve against corruption, black money and counterfeit notes. This move is expected to cleanse the formal economic system and discard black money from the same.

With demonetization effort 86% of India's currency was nullified that aimed to wash the stock of 'black market's cash supply' and counterfeit notes out of the economy and convert it into the licit, banked and taxable, part of the economy. To reduce the impact of sudden commercial collapse, a 50 day period ensued where the population could (ideally) exchange their canceled cash for newly designed 500 and 2,000 rupee notes or deposit them into bank accounts. Irrespective of the widespread anguish and household disturbances, an optimistic sentiment shown in favour of the decision.

Absence of intermediate denominations like Rs 500 and Rs 1000 will reduce the utility of Rs 2000. Effectively, this will make Rs 2000 less useful as a transaction currency though it can be a store value 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. In this context, the exercise may produce following short term/long term/, consumption/investment, welfare/growth impacts on Indian economy. The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks.

With exchange of the old currency notes coming to an end, many people are forced to open accounts to save their money. It is estimated that banks have opened about 30 lakh (and still counting) new accounts since the demonetization drive began on November 8. India's largest bank, State Bank of India (SBI), with its 17,097 branches -- half of which are in the rural and semi-urban areas – is opening 50,000 accounts a day. The leading consumer internet companies in India (Flipkart, Snapdeal, Shopclues, CCAvenues, Ola and Oyo Rooms) have applauded the move, saying it will pave the way for digital payments, aid the process of financial inclusion and the overall transformation in the economy will translate into long-term benefits for the industry. Payments companies Paytm and Freecharge saw a surge in adoption of their digital wallets. According to market experts, the growth of digital payments and wallets is the first phase of the impact and will give big boost to lending and credit as the digital records of merchants will expand and create more demand in the second phase.

IMPACT ON THE INDIAN ECONOMY

In this work, 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.

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.

Indeed, some think tanks and research institutes such as Ambit Research have given even more dire assessments with their projections of growth figures tending to be in the less than 3% range. Of course, the consensus view among many economists is that while there would be indeed a noticeable slowdown in the economy for a "quarter or two", most of them seem to agree that growth would indeed bounce back and the Indian economy would regain its momentum as well as turnaround with a renewed sense of vigour due to higher tax revenues.

Having said that, one must keep in mind the fact that as per the recent estimates by some economists, **nearly 90% of the total cash in circulation has come back into the banking system** and hence, the stated purpose of the Demonetization exercise which was to "extinguish" black money and enable the RBI to lower its liabilities thereby providing the government with a huge dividend seems to have been belied. Of course, there are some who now argue that the Indian Banking System is now "flush with cash" and this has enabled the government to "nudge" the RBI to cut rates as well as to allow banks to pass on the benefit of ample liquidity to consumers by lowering lending rates.
However, the flip side of this has been that banks have cut their deposit rates as well which is natural considering that any cuts to lending rates have to be accompanied by cuts to deposit rates. This has resulted in a situation where banks with enough deposits seem to be encouraging spending more than saving and this can indeed create demand in the system since more money with consumers means more spending thereby leading to an uptick in sales of goods and services and which has the "multiplier effect" of resulting in more growth.

On the other hand, **with more taxes being collected due to higher deposits in banks that can be taxable as well as increased compliance due to greater scrutiny and oversight by the IT (Income Tax) Department**, the government too might be tempted to announce lower rates for taxes and other aspects of what are known as fiscal measures. In this context, it is worth remembering that fiscal stimulus which is by lowering taxes and providing more incentives to consumers as well as producers by boosting supply can be complemented and supplemented by the monetary stimulus which is by boosting demand for goods and services by lowering lending rates thereby putting more money in the hands of consumers.
As economic theory states, both fiscal and monetary stimulus can be implemented in isolation or taken together and hence, the Demonetization or the DeMo as it is being called might indeed act as a catalyst for growth. Having said that, one must remember that India is primarily a cash transaction based economy and hence, removing 86% of the money in circulation is indeed a "brave" move since there are reports that large sections of the informal economy have come to a grinding halt.

Moreover, **there are also reports of farming sector taking a hit due to lack of cash as well as sales of automobiles and other capital goods falling even though inventories are building up**. Thus, it remains to be seen as to how the growth figures for the next quarter and the overall financial year turn out to be. Given that mainstream economists tend to debate and argue both sides with equal passion and vigour, it is the case that as the cliché goes, the "proof of the pudding is in the eating" and hence, the actual growth figures have to be watched.

Of course, there are other indicators to keep track of as well in the form of various Indices such as the PMI or the Purchasing Managers Index which tracks industrial activity as well as the rates of investment and the credit pickup as well as the Inflation figures. Having said that, one must also note that given the lack of communication about some of the economic indicators from the government is indeed worrying given that Demonetization has been billed as the "Biggest Monetary Experiment" in recent times in the entire world.

The point here is that any such "disruption" must be both communicated and implemented well and given some of the concerns expressed in this regard by many commentators, one must indeed look for "straws in the wind" to make sense of the economic impact of Demonetization on the country.

Merits / Advantages:

- Fake currency and terrorism funding will be controlled.
- Hit on black money / parallel economy currently having adverse impact on economy.
- Banking Sector will be benefited with cash inflows / higher deposits which directly had impact on lending rates and acts as economy booster in log run.
- Country's Trade deficit will be reduced i.e. higher GDP (Gross domestic product) growth indicator of future growth prospects.
- Currency Transactions will be more transparent and identifiable
- Expansion of Govt. Tax structures and reach to every earning individual which not only acts as generation of additional govt. revenues but also simplifies future tax regime.
- Country's overall rating in global scenario given by recognized rating agencies like CRISIL etc will be improved, criteria for FIIs (Foreign Institutional investors – imp. for Banks /NBFCs/Mutual funds etc as it is additional mode of sourcing funds).
- Banks Lending % will be enhanced with lower cost of capital and interest rates, key contributor of economy growth.

De-merits / Disadvantages in current scenario:

- Cash / Liquidity crunch in market. If this is not controlled in near term will had adverse impact on economy esp. in short term viz. higher inflation, Mismatch of demand and supply as dealings /exchanges would be in recognized currency notes only etc .
- New currency flows needs to be improved esp. in village / interior areas of cities / villages effecting life of both common man and economy as a whole.
- Although it benefits E- mode of payments but it largely for educated people, No specific provision for uneducated / village people living in interior areas of cities / villages.
- Provision required for common man having no bank A/cs and exchange required. Although currency limit exchange is 2 K reduced from 4.5 K per day, now completely closed.
- Banking Sector is not well equipped with such demonitisation move affecting its day to day functions although govt. is taking adequate steps in this regard.
- Banking Asset funding quality will be effected in shorter period as EMIs / Payment will be hampered /effected.
- Banking reforms required esp. when deposits are withdrawn once new currency circulated / Withdrawal limits raised else had adverse effect on both market liquidity and lending rates.
- There are other forms of Black Money also Eg: Investments in Real Estate, Cash funding to Election parties with no proper records etc this needs to be duly monitored and regulated if we need to attain sole objective of complete erosion of black money from Indian economy as demonetisation of 500 Rs and 1000 Rs notes alone will not erode black money completely.
- After demonetisation closure, Govt. reforms required esp. in Real Estate sector and MSME else it will had adverse impact on both employment and economy.

IMPACT ON COMMON MAN

The main motive behind the approach is to bring a huge amount of cash notes that are in unaccounted wealth into mainstream economy and reduce the usage of fake currency. However, we know that about 50% of India's economy largely depends on cash transactions run by small & medium sized organizations. According to economists, the approach will have an impact on these enterprises and could lead to the knock-on effect on the growth of the economy. Let us see how the ban of these currency notes will affect the lives of common people:

Merits / Advantages:

- Purchasing power will be improved, directly correlated with inflation (Rise in prices) i.e. controlled prices will directly impact on common man and had much purchasing power.
- Banks Interest rates will be reduced making it easy for common man to avail fresh loans in other words we can say lending would be much approachable for common man.
- Govt. had scope of introducing new schemes for welfare of common man.
- Lesser TAX Liability , Boost for savings and consumption
- New Employment opportunities in place

De-merits / Disadvantages in current scenario:

- Currency crunch in market having its direct impact on demand and supply esp for common man .
- Current currency exchange restrictions making it life difficult for common man, Although Govt. is regularly changing rules for better adherence.
- Difficulty in cash deposits / exchange of Old currency notes esp. for ones with no bank a/cs although same is their hard earned money.
- Frequent changing currency rules getting day to day activities affected both for common man and banking institutions.
- Promotion of illegal activities till OLD Currency completely stopped in system.
- Higher cash deposits in Nov. & Dec-16 attracts income tax authorities for verification even it is earned through proper taxable income disclosures and same needs to be justified else additional tax will be levied .
- Dealings in cash adversely effected esp. for small retailers /dealers etc
- Fear of unemployment in MSME and other small manufacturing/ unrecognised sectors where majority is cash dealings as same is largely affected /Temporary closed due to liquidity crunch.

CONCLUSION AND FUTURE SCOPE

Demonetisation of Rs 500 and 1000 Rs notes will benefit the economy in long run but it is imp. to reduce its mentioned demerits / ill effects in existing /shorter version else will had adverse impacts on economy (GDP) and its benefits /merits will also affected taking into account current economic scenario , now it's all depends on govt. policies and strategies how well they are planned and executed esp. at ground level. This process would also forcibly bring in huge amount of money from the informal sector, which was unaccounted for. This will help in the growth and therefore GDP would not face a negative impact.

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