

Demonetization: Impact on Indian Economy

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Abstract-- The argument posited in favour of demonetization a “Surgical Strike on Black Money”, i.e., the cash that would be extinguished would be “black money” and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. Therefore, it is imperative to evaluate the short run and medium-term impacts that such a shock is expected to have on the economy. Further, the impact of such a move would vary depending on the extent to which the government decides to re-monetise. This paper elucidates the impact of such a move on the availability of credit, spending, level of activity and government finances.

I. INTRODUCTION

Demonetization for us means that Reserve Bank of India has withdrawn the old Rs 500 and Rs 1000 notes as an official mode of payment. Demonetization is the act of stripping a currency unit of its status as legal tender. On 28 October 2016, the total currency in circulation in India was Rs. 17.77 lakh crore (US\$260 billion). In terms of value, the annual report of Reserve Bank of India of 31 March 2016 stated that total bank notes in circulation valued to Rs.16.42 lakh crore (US\$240 billion) of which nearly 86% (i.e. Rs. 14.18 lakh crore (US\$210 billion)) was 500 and 1000 rupee notes. In terms of volume, the report stated that 24% (i.e. 2,203 crore) of the total 9,026.6 crore banknotes were in circulation. 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.

II. DEMONETIZATION WILL HIT THE ECONOMY

The demonetization of the 500 rupee note and the 1,000 rupee note—the two highest currency denominations available in India—will likely hit the economy hard in the short term. The surprise move is expected to grind the consumption activity in the Indian economy to a virtual halt. The service sector, which dominates economic activity and involves a sizable chunk of cash transactions, will likely be hit the hardest.

III. 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.

Food item inflation, measured by changes in the Consumer Food Price Index, accounts for 47.3% of the overall CPI. Due to 86.4% of the value of the currency notes in circulation going

out of the financial system and re-monetization being slow, the supply and demand of food items fell. It will exert more downward pressure on inflation.

IV. POSITIVE IMPACT OF DEMONETIZATION

It will help the government to fight Black money, corruption, terrorism and counterfeit currency with one single decision.

Arms smuggling, espionage and terrorist related activities will be choked due to lack of funding.

Counterfeit currencies are being used for financing terrorism which is being run by the enemy in India. Now Government has taken a bold move which enables them to fight counterfeit currency/terrorist funding activities.

V. NEGATIVE IMPACT OF DEMONETIZATION

The demonetization that has been in effect since November 9 is expected to have a negative impact on inflation. Consumer spending activity fell to a near halt. Consumers are refraining from making any purchases except essential items from the consumer staples, healthcare, and energy segments. Activity in the real estate sector, which includes a lot of cash and undocmented transactions, slowed down significantly, Metropolitan and Tier 1 cities reported up to a 30% fall in house prices.

1. With significant parts of Indian population not having their own bank accounts, or even valid identification what measures have been advocated by the government to ensure people in this category can efficiently exchange their lifetime's earnings in the short period of time? There have been significant announcements regarding limits of withdrawals, but not much to provide measures of ensuring nobody loses any money.
2. Under huge strain, banks have been unable to cope with demands like opening of bank accounts especially with incomplete identification (which many Indians lack). For instance, If a housemaid doesn't have a bank account. Her kids were registered under a government scheme last year, but the bank didn't allow to put her money into kid's account. These type of incidents aren't isolated and is a huge source of stress for people like her.
3. Emphasis on cashless economy ignores the point that not many people have smart phones in the first place. The government needs to take concrete steps to ensure the vegetable seller on the streets or small store don't lose considerable business over a long period of time to the richer franchises who have facilities for PayTM / card readers. It's one thing to lose business due to competitive disadvantages and another to lose them due to structural disadvantages introduced by sweeping government changes.

Many person (supporters) who supports, claim that the demonetization policy's problems are a result of inept implementation. But the truth is that its design was fundamentally flawed. There was no “policy skeleton,” no cost-benefit analysis, and no evidence that alternative policy options were considered. Judging by the blizzard of policy tweaks since

the announcement, it seems clear that no impact study was carried out. Moving India to an entirely “cashless society” is not possible at some circumstances because,

1. 90% of financial transactions in India are conducted in cash.
2. more than, or that over 90% of retail outlets lack so much as a card reader.
3. over 85% of workers are paid in cash.
4. more than half of the population is unbanked.

VI. IMPACTS AMONG COMMON MAN

Our PM came to power in 2014 promising to boost growth, create jobs for India’s youthful population, and encourage investment. His poorly conceived demonetization has made a mockery of these objectives, while bruising his reputation as an efficient and competent manager. India’s previously booming economy has now ground to a halt. All indicators – sales, traders’ incomes, production, and employment – are down. Former Prime Minister Manmohan Singh estimates that India’s GDP will shrink by 1-2% in the current fiscal year.

But, as is so often the case, the impact is not being felt equally by all. India’s wealthy, who are less reliant on cash and are more likely to hold credit cards, are relatively unaffected. The poor and the lower middle classes, however, rely on cash for their daily activities, and thus are the main victims of this supposedly “pro-poor” policy.

Small producers, lacking capital to stay afloat, are already shutting down. India’s huge number of daily wage workers can’t find employers with the cash to pay them. Local industries have suspended work for lack of money. The informal financial sector – which conducts 40% of India’s total lending, largely in rural areas – has all but collapsed.

India’s fishing industry, which depends on cash sales of freshly caught fish, is wrecked. Traders are losing perishable stocks. Farmers have been unloading produce below cost, because no one has the money to purchase it, and the winter crop could not be sown in time, because no one had cash for seeds.

Despite all of this, ordinary Indians have reacted with stoicism, seemingly willing to heed PM’s call to be patient for 50 days, even though it could be much longer – anywhere between four months and a year – before the normal money supply is restored. The government’s assiduous public relations – which portrays people’s difficulties as a small sacrifice needed for the good of the country – seems to have done its job. “If our soldiers can stand for hours every day guarding our borders,” one popular social media meme asks, “why can’t we stand for a few hours in bank queues?”

But the sacrifice extends far beyond queues. Hospitals are turning away patients who have only old banknotes; families cannot buy food; and middle-class workers are unable to buy needed medicine. As many as 82 people have reportedly died in cash queues or related events. Furthermore, it seems likely that many of the short-term effects of the demonetization could persist – and intensify – in the longer term, with closed businesses unable to reopen. It could also cause lasting damage to India’s financial institutions, especially the Reserve Bank of India, whose reputation has already suffered.

VII. IMPACT ON HOUSEHOLDS

It is an Indian thing in villages and small towns for housewives to keep their saved cash hidden away from their husbands and other family members. Invalidation of Rs 500 and 1000 notes will jeopardize this scheme. Also, general day to day purchase

may be impacted due to lack of cash in hand. People who need money for some urgent work like to see a doctor, pay hospital charges, medical emergency, travelling etc will be in a highly difficult situation as no one will accept their money (even if they have it) if in denominations of Rs 500 or 1000 notes. The ATMs and banks closed for two days, hence they will have no other resort (except of net-banking). Although the government has made provisions to minimize the inconvenience of these people- upto next 72 hours these notes will be accepted at Government agencies. But it may not suffice in majority of situations: in case of emergency, for example, one cannot choose to go to government hospital.

VIII. IMPACT ON AGRICULTURE

The months of November and December are the season for sowing of Rabi crops (in most of India) and Samba crops in Tamil Nadu. This season requires a lot of cash in hand for purchasing seeds, pesticides, fertilizers, hiring labourers etc. All these activities will be severely hampered due to want of required cash.

IX. THE INFORMAL SECTOR

Contract laborers in organised and un-organised sectors are paid their daily-wages in cash. Now the contractors can delay the wage payment for few days till things settle down. These laborers will have to face hardships for coming days since they live a life on hand to mouth earnings.

CONCLUSION

Demonetization process is like a two faces of a coin because one side it will benefit the nation and other side it’s going to create some temporary and long term problems, Most of the business in India has cash transaction with less than 2% business transactions taking place electronically. The scale and logistic challenges faced in a developing economy like India with a rickety infrastructure, a giant population are huge. This move cause severe cash crunch for both the customers and the sellers. Hence slow down the business. The small artisans and street vendors are most impacted. The fast growing e-commerce segment which was made popular due to COD (Cash on Delivery) model will be slow down. To summarize, an idea is only as good as the execution. As long as the government doesn’t specify and implement concrete actions to ensure no citizen loses any money and can be slowly absorbed into the cashless economy, even if some black money is recovered the overarching implementation of demonetization scheme will be a failure.

Reference

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