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Demonstration Instrument: A Blow and Outcome on the Indian Populace

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Abstract: The argument post in favor of demonetization is that the cash that would be quenching "black money" and hence, should be lawfully put out to set right the perverse incentive arrangement in the economy. This article has made an attempt to assess impact as well as consequences occur during demonetization and how the tool of Demonetization can be used to exterminate parallel economy. Demonetization is one of the big steps initiated by Government in addressing the various issues like black money, fake currency, corruption, terrorism etc. History of demonetization in India and around the world is addressed. Lesson from historically demonetization direct us how to redefine financial system of country by overcoming the previous causes for failure. Demonetization obliviously brings a lot of inconveniences to ordinary populace but it is for only short term. However the long term benefits of demonetization overrides the short term challenges.

Keywords: *demonetization, Indian economy, black money, parallel economy, tax evasion, counterfeit currency, corruption*

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I. Introduction

Money is the life blood of every financial system. With the growth of society and mankind, the needs of human beings increased. In order to fulfill humans unlimited wants barter system came forward. But over a period of time, the invention of money became a strong pillar to build an economy. Money exchange appears to be more convenient than barter because it obviates the "double concurrence of wants" and is capable of supporting relatively complex economy. Money exchange facilitates simply of doing business, make easy taxation and national integration such as production, trade, distribution, services etc. form an economy.

The Indian Economy which was well thought-out as the "fastest growing major economy" in the world and the "only bright spot" with promising Markets gives the thought to have slowed down before the latest "surprise treatment" of "demonetization. While this is certainly cause for concern with projected growth figures revised downwards from 7.6 % to 7.1% for the 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 (reputed economist too) that the current and ongoing attempt to flush out black money would cut off a good 2% of the Gross Domestic Product.

Demonetization is to take steps of stripping a currency unit of its position as legal tender. Demonetization for us means that RBI has withdrawn the old Rs 500 and Rs 1000 notes as a certified mode of payment. On 28 October 2016, the total circulated currency in India was Rs. 17.77 lakh crore (US$260 billion). As per the annual report of RBI of 31 March 2016 stated that total bank currency in flow valued to Rs.16.42 lakh crore (US$240 billion) of which almost 86% (i.e. Rs. 14.18 lakh crore (US$210 billion)) was 500 and 1000 rupee notes. In terms of volume, the information stated that 24% (i.e. 2,203 crore) of the total 9,026.6 crore bank currency were in circulation.

In a significant move, the Government of India declared to take away 500 and 1000 rupee notes from 8th November 2016 midnight. The RBI issued 2000 rupee notes and new notes of Five hundred rupees which were placed in circulation from 10th November 2016. Rest other Notes were stay behind as legal tender. This measure has been taken by the PM in an attempt to address the resolve against corruption, black money and forged notes. This move is expected to rinse out the formal economic system and remove black money.

II. Demonetization in India:

Similar measures have been taken in the past.

• The Reserve Bank of India, introduced Rs 10,000 notes (largest currency denomination) ever printed for the first time in 1938. In the year 1945 all three notes were reintroduced. In January 1946, currency notes of 1000 and 10,000 rupees were withdrawn and new notes of 1000, 5000 and 10,000 rupees were introduced in 1954.

• In 1977 Wanchoo committee (set up in 1970s), a direct tax inquiry committee, suggested demonetization as a measure to unearth and counter the spread of black money. The Janata Party had again demonetized notes of 1000, 5000 and 10,000 rupees on 16 January 1978 as a means to curb forgery and black money. Historically, previous Indian governments had demonetized bank notes.

• On 28 October 2016 the total banknotes in circulation in India was Rs.17.77 trillion (US$260 billion).In terms of value, the annual report of RBI of 31 March 2016 stated that total bank notes in circulation valued to Rs.16.42 trillion (US$240 billion) of which nearly 86% (around Rs.14.18 trillion (US$210 billion)) were Rs.500 and Rs.1, 000 banknotes. They were taken out of circulation from 2016.

Demonetization is the most important and necessary when there is a change of national currency. There are both pros and cons of demonetization in the Indian economy. The reasons for demonetization are to control counterfeit notes that could be contributing to terrorism, and to undermine or eliminate the "black economy". There are some potentially ways in which the pre-demonetization money supply will stand altered.

There would be agents in the economy who are holding cash which they cannot explain and hence they cannot put in the banking system. This part of this legal tender will be extinguished since it would not be replaced in any manner.

The government might choose to replace only a part of the currency which was in circulation as cash. In the other words, the rest would be available only as electronic money. This could be a mechanism used to force a transition to cashless medium of exchange.

The experiential level 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, as will be explored below.

III. Need for the Study:

1. The fake Indian currency notes in higher denomination have increased.

2. Unaccounted money, often used in any form of corruption and illegal activities.

3.The Financial Action Task Force that looks at the criminal use of the international financial system, notes that high-value bills are used in money laundering schemes, racketeering, etc.,

4.In the United States, the highest denomination bank note is $100 and United Kingdom, the utmost denomination bank note £50.

5. The uppermost denomination note is essentially 50-100 times the smallest denomination note of one dollar or one pound.

6.In India, up until now the uppermost denomination note was Rs 1,000 and this was 1,000 times the smallest denomination note of Re 1 (Note: Re 1 notes are issued by the ministry of finance).

IV. Objectives of Paper

• To analyze the current the immediate (Short and medium term) impact of demonetization on Indian economy;

• To work out the probable consequences of the demonetization.

V. Research Methodology

The paper is based on derived data. The data has been composed from internet, research papers, books and newspapers etc.

VI. Procedure Adopted For Exchange Old Notes

The Reserve Bank of India laid down a detailed procedure for the procedure for the exchange of the demonetized banknotes with Mahatma Gandhi New Series of Rs.500 and Rs.2000 banknotes and continued with old Rs.100 banknotes. Following are the key points:

• Citizens was allowed to tender their old bank currency notes till 30 December 2016 at RBI or any bank branch and credit the value into their respective bank accounts.

• Cash withdrawals from bank accounts were limited to Rs.10, 000 per day and Rs.20, 000 per week from 9 November 2016 till 24 November 2016.

• For instant cash needs, the old banknotes of value up to Rs.4000 per individual could be exchanged for the new Rs.500 and Rs.2000 banknotes as well as Rs.100 banknotes over the counter of bank branches from 10 November 2016 by filling up a requisition form along with a valid ID proof.

• All ATMs were dispensed bank notes of only 100 rupee denominations. Banks offered all money withdrawal transactions at their ATMs free of cost to their customers till 30 December 2016. Cash withdrawals from ATMs were limited to Rs.2000 per day per card up to 18 November 2016 and the limits were raised to Rs.4000 per day per card from 19 November 2016.

However, exceptions be given to petrol/CNG pumps, hospitals, train and airline booking stations, ration shops, and permitted to accept the 500 and 1000 rupee notes until

14 November. International airports were also informed to allow an exchange of notes amounting to a total cost of Rs.5, 000 (US$74) for overseas tourists and out-bound passengers.

VII. Instant blow of demonetization on Indian economy

Very short-term impact-- By taking out 86 per cent of the notes in circulation has resulted in a very severe tightening in money supply in the economy. This economizing, by wiping out cash balances in the economy, was eliminated a number of transactions for a while, since there is not enough of a medium of exchange available. Since income and consumption are basically related to transactions in the economy, the above would mean a harsh contraction in income and consumption in the economy. This effect would be more severe on individuals who earn incomes in cash and spend it in cash.

In terms of the sectors in the economy, the sectors to be adversely affected are all those sectors where demand is usually backed by cash, especially those not within the organized retailing. For instance, transport services, kirana, fruits and vegetables and all other perishables, would face compression in demand which is backed by purchasing power.

Short-term effect with absolute substitution -- The short-term effect on the economy would depend on the speed with which and the extent to which the cash is replaced by the authorities. Few sectors were likely to be seriously affected. To give an example from two sectors which are supposed to have large employment effect on the economy, we can talk about agriculture, and construction.

This is the sowing season for the Rabi crop in some parts of the country and the harvesting season for the Kharif crop. Most of the purchases and sales in this segment of the economy are carried out through cash. With the elimination of cash from the economy, sale of kharif crop would be difficult unless the crop is sold on the promise of payment in future. Given the limited bargaining power of the farmer, the price they can realize for the crop can be adversely affected. Thus, in spite of a good monsoon in large parts of the country, the farmer might not get the benefits.

The second sector which could be adversely affected would be the construction sector. The sector, it is often argued, works with a significant amount of cash. Payments to workers as well as a variety of purchases might be carried out in cash.

Medium-term effects--In the medium term, the effects would be related to the extent to which the currency is not replaced within the economy. The currency that is placed in the banks but not withdrawn, it is argued, would generate an expansion in deposits in the economy. In the discussions on demonetization, there is a consistent reference to the resultant increase in credit creation in the economy. Like Finance Minister Arun Jaitley says, “Bank deposits will increase and they will have more capacity to support the economy.”

VIII. The Likely Consequences of the Demonetization

The following likely impacts on the economy will be observed if an extensive portion of the cash is either reported or devoted in the economy.

Tax: Having closed the voluntary disclosure window for unrevealed money, it has been reported that government will continue a close observe on deposits over Rs 2 lakh in cash. This would mean improved tax net, higher tax collection as well as better tax to GDP ratio. As the money gets accounted and more taxes are collected, government might be tempted to shrink tax rates going ahead.

Rate of Interest: One of the major impacts of demonetization would result in lesser inflation, tempting the central bank to reduce interest rates. But the bigger impact on interest rates will be the liquidity with which banks will be flushed.

GST: Demonetization would boost the tax net and along with GST result in decrease of black money generation. Along with GST, demonetization will lead to a higher tax/GDP ratio.

Fiscal Assets: As idle money lying comes in the main economy it would move to higher yielding and liquid assets. Money is likely to move to monetary assets from gold, valuable metals, real estate and simple cash. Equities might reflect the panic in the economy in the short term, but the move is will be helpful in the long run say most of the broker’s report and expert comments.

Effect on parallel economy: The elimination of old Rs. 500/1000 with new Rs. 500/2000 notes is anticipated to remove black currency from the economy as they will be blocked since the title-holders will not be in a position to deposit the same in the banks, will hault the backing for anti-social elements like smuggling, terrorism, espionage, etc.

Effect on Money Supply: With removal of old currency and add new one, money supply is likely to condense in the short run. However gradually but surely as the new notes get dispersed in the market and the mismatch gets corrected, money supply will pick up.

Effect on Prices: The Price level is anticipated to be lowered due to moderation from demand side. Prices in Real Estate and Property sector are largely expected to fall, especially for sales of properties where foremost part of the transaction is cash based, rather than banks or cheque transactions. In the immediate future, the sector will be in pressure with quantity and number of transactions in land markets considering a sizeable downward trend. This decision of real estate regulatory law, GST and Real Estate Investment Trusts would further pick up transparency and increase investor confidence in this market.

Effect on GDP: The GDP structure could be impacted by this measure, with reduction in the consumption demand. Besides this expected impact on GDP may not be significant as some of this demand will only be postponed and re-enter the flow once the cash situation becomes normal.

Effect on Banks: After demonetization, it is automatically leads to more amounts being deposited in Savings and Current Account of commercial banks. This in turn will improve the liquidity position of the banks, which can be utilized additional for lending purposes. However, household for their urgent situation would be withdrawals at the second stage.

Effect on Online Transactions and alternative modes of payment: With cash transactions facing a drop, Digital operation systems, E wallets and apps, online transactions by means of E banking, usage of Plastic money (Debit and Credit Cards), etc. will definitely see significant increase in demand.

Positives Impacts	Negatives Impacts
1) Payment gateways	1) Agriculture
2) Cards	2) Luxury goods
3) Mobile wallets	3) Real Estate
4) Online retail	4) Commodities Traditional Retail
5) Net and payment banks	a) Consumer durables
6) e-marketplace	b) Consumer non-durables

IX. Conclusions

The demonetization undertaken by the government is a large stun to the economy. The impact of the surprise in the medium term is a function of how much of the currency will be restored at the end of the replacement process and the extent to which currency in circulation is extinguished. While it has been argued that the cash that would be extinguished would be "black money" and therefore, should be correctly extinguished to set right the perverse incentive structure in the economy, this argument is based on impressions rather than on facts. While the facts are not available to anybody, it would be unwise to argue that this is the only possibility.

As argued above, it is probable that these cash balances were used as a medium of exchange. In other words, while the cash was mediating in valid economic activity, if this money is extinguished there would be a narrowing of economic activity in the economy and that is a cost that needs to be factored in while reviewing the impact of the demonetization on the economy and its agents.

It is likely that there would be a spurt in the banking deposits. While interpreting the phenomenon, however, one has to keep in mind that a large part of their deposits were earlier used for transactional purposes. For example, if a small trader deposits 2 lakh Rupees in the Jan Dhan account since the currency in which he held these balances in for transactional purposes has been scrapped, it would be incorrect to interpret this as success of the programme in bringing public who were hiding black money; nor can they be interpreted as extra balances that the banking sector can lend out on the same basis as earlier deposits, since the deposits now would remain in financial statement for much shorter periods that deposits based on savings would be.

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