

Impact of Demonetization in India

Dr.P. Thilagavathi,

Assistant Professor, PG and Research Department of Commerce, Sri Vasavi College, Erode.

I. Impact of Demonetization In India

The demonetization of Rs. 500 and Rs. 1,000 banknotes was a policy enacted by the government of India on 8th November 2016, ceasing the usage of all Rs. 500 and Rs. 1,000 banknotes of the Mahatma Gandhi series as legal tender in India from 9th November 2016. The term demonetization is not new to the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the Rs 10,000 note in 1938 and again in 1954. But these notes were demonetized in January 1946 and again in January 1978, according to RBI data.

Demonetization is done for the overall economic development for India. There are various advantages and disadvantages of the demonetization drive. The question that arises is why demonetization was required at this point of time. Demonetization is surely hampering the current economy and will continue to do so in the near term and will also impact India's growth for the coming two quarters but will have positive long lasting effects. Here is the short term and long term impact of government's move to make India a cashless economy.

II. Short-Term Impacts

Since our economy is heavily dependent on cash, as only less than half the population uses banking system for monetary transactions, demonetization has hit trade and consumption hard. With people scrambling for cash to pay for goods and services, the move is likely to take a big toll on the country's growth and output during the current fiscal. The small businesses will be affected at least in the shorter run. This move deeply impacts the working sections of society: drivers, maids, cooks, electricians, plumbers and anybody who provides services in the informal sector and depends on monthly or bi-monthly cash payments. Immediate impact is expected to be negative all round. In the short term it will be a logistical nightmare to manage the cash replacement in banks and smooth functioning of the banking system. Slowdown in consumer spending due to limited cash availability. Severe liquidity issues in cash based sectors like Real Estate and Jewellery. GDP growth is to be negatively impacted by 0.5-1% due to drop in consumption. Inflation is likely to come down due to low demand owing to liquidity problem. With Banks flush with cash, interest rates may come down in the short-term.

III. Long -Term Impacts

In the short and medium term the impact of this decision will mostly be may have negative on all sectors especially those in the unorganized business, in the long term such a move will have a positive impact on the economy. The banking sector will be greatly benefited as more money will enter the banking system. Inflation would come down as the circulation of money in the market is reduced. Other sectors such as real estate and jewellery will also stabilize in the long-term, with certain amount of price correction. With likely increase in the size of formal economy, tax collections would improve the country's fiscal situation.

It is safe to assume that from the third quarter FY17 to fourth quarter FY19, the share of the informal economy in India could shrink from 40 percent to 20 percent. This shrinkage of the informal sector is likely to result in a short-term adverse effect as the informal sector. However, as the informal sector shrinks, the formal organized sector is likely to gain market share. The formal sector accounts for 60 percent of India's GDP today. Ambit Capital assumes that from FY17 to fourth quarter FY19, the share of the formal economy in India could expand from 60 percent to 80 percent

In the long term, the economy will benefit from the reduction of the black money, which will lead to higher tax collection, better business environment, less corruption & transparency. It will improve the situation of Fiscal Deficit of the Country and hence reduce the fiscal deficit.

As money lying idle comes in the main economy it would move to higher yielding and liquid assets. Money is likely to move to financial assets from gold, precious metals, real estate and plain cash. Equities might reflect the panic in the economy in the short term, but the move is will be beneficial in the long run say most of the broker's report and expert comments.

Though there are still few who believe that with Rs 2000 currency note it would be much easier to hoard cash, going forward the government will make it more difficult to spend cash and make it mandatory to

produce PAN Card in high value transactions, so people would have little choice to break rules. Also, the current demonetization will create an everlasting psychological fear in the mind of people.

Fake Indian Currency Notes (FICN) network will be dismantled by the demonetization measures. Taking out 500 and 1000 rupee notes out of circulation will have a lasting impact on the syndicates producing FICN's, thus affecting the funding of terror networks in Jammu and Kashmir, North-eastern states and Naxalite hit states.

Demonetization comes at an important as the country heads to a new tax regime with the implementation of GST. Demonetization would increase the tax net and along with GST result in reduction of black money generation. Along with GST, demonetization will lead to a higher GDP ratio,

IV. Moving Towards Digital Payments

Demonetizing the five hundred and thousand rupee notes hopes to flush out considerable amounts of black money as well as to encourage a switch to cashless state within the mainstream economy. Therefore, this new move will definitely have a huge impact on the digital marketing horizon in India. It encourages people to be involved in fewer cash transactions and to use the electronic or plastic money.

Apart from the most obvious boosts in terms of tax income, financial analysts reckon this move will have many benefits in the Indian economy. Some of the obvious beneficiaries of demonetization are banks, micro-financing companies, NBFCs and digital financial operators. Modi's demonetization initiative has been a boon for India's e-payment providers. Paytm reported a three-times surge in new users -- tacking on over 14 million new accounts in November alone. While Oxigen Wallet's daily average users increased by 167% since demonetization began.

With cash transactions facing a reduction, alternative forms of payment will see 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 increases in demand. This should eventually lead to strengthening of such systems and the infrastructures required.

There will be an urgent need for debit cards, electronic transfers and mobile payment platforms to be widely adopted. It is very difficult for more than half the population who are not well versed with the card transactions. Behaviours change slowly, especially for those set in their ways. Institutional support from financial institutions, telecom platforms and payment interfaces will have to rise to the occasion and fill the supply gap. They will have to adapt to the ways of all, particularly those that are new to formal financial transactions. But there is more hope than ever before.

The government also announced incentives for encouraging non-cash transactions. These included waiver of service tax on card transactions and discounts on railway ticket purchased through digital modes. It has also set up a committee to encourage digital payments. "If these moves by the private sector and government are successful, the scaling up of digital and mobile remittance channels could bring down remittance costs, especially for domestic remittances."

Even retail chain operators who primarily gave cash to their stores are now switching to cards and online payments for their day-to-day petty cash expenses and vendor payments. Consulting companies, hyper local businesses, and so on, with employees on the road, are also going digital.

Demonetization also increases use of electronic and bank-based payment systems, which will make record-keeping easier and more common, allowing government better to track and tax the proceeds.

V. Steps To Make India A Cashless Economy In The World

The process of making digital payments in India is not easy, and is time consuming. Making digital payments is costlier either for the merchant or the customer, or both. Digital payments can lead to major security risks. It requires many pre-requisites such as,

- Technological literacy, technological developments and policy measures through government intervention;
- Availability, quality and strong telecom network, constant investment of banks and related service providers in technology,
- Availability of user interface in regional languages across devices, expansion and easy adoption of the system of digital payments.
- All government related transactions from buying forms in government office to registration of property everything should be made compulsory to use digital transaction or cashless
- Bringing down the cost of transactions is crucially important. High cost of electronic transaction is a major stumbling block in the growth of the payment system. Cost will go down if the volume increase coupled with innovations in the system.
- Giving an indirect tax rebate for using cashless methods of payment, which brings parity between cash and cashless. Even online, merchants can be incentivized to charge less for digital payments, and more for cash on delivery.

- Digital Payments businesses have tried their hand with cash backs, and lower rates for digital purchases have already encouraged digital payments. Incentives could be given to businesses, which they can transfer to customers.
- People should be educated to use these services also the cost of devices used for this should reduce and internet or any service needed for this should be of sufficient speed and economical only then this can work and we can move to cashless easily in about 4–6 years at earliest
Former UIDAI chairman Nandan Nilekani said “The more important thing is when the economy becomes formal, when everybody’s financial transactions are digitized ..India is going to go from data poor to data rich and that will make it more and more difficult for people to do dishonest things or to be outside the system. It will reduce the amount of black money in the system,”

VI. Conclusion

Although the comprehensive long term impact of these demonetization measures cannot be fully ascertained at this stage, the overall economy is expected to benefit from a decrease in unaccounted cash transactions and an elimination of counterfeit currency notes, leading to more effective tax collection and increased transparency in ascertaining transaction costs. An increase in transparency is also likely to improve attractiveness for foreign investors, while higher bank deposits and formalizing large hitherto unaccounted for income streams is expected to improve the fiscal deficit of India.

Niti Aayog Vice-Chairman Arvind Panagariya said the government's demonetization drive will leave a "very positive" impact on the economy in the long term as more people will move towards digital transactions. The advantages are much dominating and it will be in the long term interest of our country comfortably outweighing the disadvantages. In the long run, this is a significant positive shock to the Indian economy and society. If substantially implemented, this will send a strong signal about India’s anti-corruption drive and is very likely to improve the country’s reformist stance. It also provides a boost to the government’s financial inclusion drive, pushing more households towards efficient banking and payment infrastructure. In the immediate run, we are likely to witness larger bank deposits, price corrections and better tax collection possibilities in the economy. Black money hoarders will definitely lose out, eventually boosting the formal economy in the long run. Short term fall in real estate prices might benefit middle class citizens. This move by the Government along with the implementation of the GST will eventually make the system more accountable and efficient.

References

- [1]. <http://www.letslearnfinance.com/demonetization-advantages-and-disadvantages.html>
- [2]. <http://economictimes.indiatimes.com/markets/stocks/news/demonetisation-and-its-side-effects/articleshow/55678393.cms>
- [3]. <https://www.easypolicy.com/knowinsurance-a/possible-effects-of-new-currency-change-in-india>
- [4]. <http://rajasacademy.com/demonetisation-international-trade/>
- [5]. <http://www.governancenow.com/news/black-money/demonetisation-impact-mal-remittances-could-be-significant-expert#sthash.DuGZMe4M.dpuf>
- [6]. <http://www.businesstoday.in/current/economy-politics/demonetisation-long-term-and-the-short-term-impact/story/241439.html>
- [7]. <http://www.firstpost.com/business/is-the-govt-preparing-ground-for-introducing-cash-withdrawal-tax-in-this-budget-3203860.html>
- [8]. <https://www.easypolicy.com/knowinsurance-a/possible-effects-of-new-currency-change-in-india>
- [9]. <http://data.conferenceworld.in/IFUNA18DEC16/P290-300.pdf>
- [10]. <http://www.squirepattonboggs.com/~media/files/insights/publications/2016/11/the-impact-of-indias-demonetization/252122020the20impact20of20indiac2b9s20demonetization20alert.pdf>
- [11]. <https://www.gbim.com/demonetisation-affects-digital-economy-india/>
- [12]. <http://www.medianama.com/2016/11/223-cashless-india/>
- [13]. <http://jklu.edu.in/blog/is-it-easy-for-india-to-become-a-cashless-economy/>