

## **Demonetization: Impact on the Economy**

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**Abstract:** *Demonetization refers to withdrawal of a particular form of currency from circulation. Demonetization is necessary whenever there is a change of national currency. Due to demonetization, the corruption shall be done to a great extent. It will bridge the gap between haves and have not's. Demonetization will flush out black money. It motivates cashless transaction. The main effect is the cash economy will contract. This paper elucidates the impact of demonetization on the economy.*

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**Objective:** The following are the objectives at which demonetization has been implemented in our country by the central government.

1. To tackle counterfeit notes.
2. Curbing black money.
3. Restricting finance for terror as well as other subversive activity.
4. It will encourage people to disclose all incomes and start paying taxes on it.
5. Moving country towards a cashless economy.
6. A parallel black economy will collapse.

### **I. Impact of Demonetization on Indian Society**

We shall see a great impact of this move of the Central Govt on Indian Society and Economy. The first impact shall be that people will have lower expenditure power. With that they will not be able to purchase luxurious things. There shall be no ostentatious expenditures on marriages and other ceremonies. So the society will grow lesser materialistic and people more prudent. With the fake money destroyed, Indian economy will see a big boom and the so far booming real estate sector shall fall on the ground. The things shall be cheaper. Indian Currency shall get respect at the international market. There shall be a great check on the terror-related funding and therefore on terrorist activities. Corruption shall be down to a great extent as people will stop the tendency of accumulating money using wrong means.

It will bridge the gap between the haves and the have-nots. However, there may be some difficulties for a couple of months. But this inconvenience shall be temporary and for short-term. Demonetization is intended to flush out the black money and encourage a move to a cashless (or less cash-based) state and bring the parallel sector into the mainstream economy.

### **II. Impact On Economy**

Financial exclusion imposes a very high cost on people. In India, 98 percent of people use non-banking channels such as hawala, and pay exorbitant costs to remit or receive money from their family members living in other regions. A survey of Indian migrant workers showed an average commission of 4.6 percent when transferring money through informal routes, whereas money transfers in a formal banking system come with little or no cost. Similarly, a meager 10 percent of Indian avail themselves of loans from banks. A person who is economically poor and does not have a bank account must access micro-finance – many times at usuriously high rates of 50 percent or more – and store money in the form of cash, livestock, or jewelry. The value of cash withers with inflation, jewelry runs the risk of theft, and livestock is perishable.

How well these inflows will be utilized toward economic growth remains to be seen. Access to formal banking will increase saving rates, which will enable capital investment in sectors such as roads, ports, and railways. India needs to invest over \$400 billion in infrastructure. As capital is scarce, a perfect capital market will ensure a higher return for each additional dollar of saving invested for building India's infrastructure. Importantly, access to banking will increase the productivity of micro, small, and medium enterprises (MSME), and aid the Make in India initiative. It is worth noting that only 5 percent of MSMEs have access to institutional finance, underscoring the need for financial inclusion to drive India's inclusive growth agenda.

People are reluctant to try new things unless it becomes necessary. The demonetization will nudge a larger number of individuals to lessen their dependence on cash transactions and resort to digital payments. Downloads of Paytm wallet (a mobile e-commerce company with a user base of over 150 million) has tripled

since November 9. The earlier attempts of the Reserve Bank of India – which has granted permission to 11 Indian companies such as India Post, Reliance Industries, Airtel, Vodafone, etc. to venture into the payment banking sector – came with limited success.

For a populous country like India, any future strategy for financial inclusion will call for technology to reach the bottom of the pyramid. To facilitate use of Internet and digital transactions, the government can consider forming a Digital Sevak Dal – a network of young people to educate and support the Indian public in cities and rural areas to transition to a cashless economy. The Student Police Cadet scheme in Kerala is an example where schoolchildren visit the homes of poor and the elderly and help with e-literacy and digital transactions. Given the large number of unemployed, and that it requires minimal investment in education, the initiative can create major positive spin-offs.

Meanwhile, the Ministry of Telecommunication can join hands with the Ministry of Road Transport and Highways to facilitate the laying of fiber cables to achieve greater digital inclusion. The initiative can pay for itself, since bringing people onto digital banking platform will prevent leakages from subsidies. A study by McKinsey finds online payment of social benefits can save \$22 billion per year. India's demonetization could be the push the country needs to move to digital banking, but it will take more concerted government efforts to promote a long-term transition.

### **III. Long-term benefits of demonetization**

The demonetization programme has been evaluated in the context of its short-term costs and long term gains. Short term losses include loss of welfare for the low-income people and decline in GDP growth. On the long-term gain side, a large number of benefits are identified which will appear with time. Spread of cashless transaction culture, growth of the formal economy, registration of new income tax payers, linking or accounting physical asset investment to PAN, cleansing of the real estate sector, conscience about avoiding black income transactions, etc., are supposed to be the major long term gain. All of these necessitates additional or supportive policy measures by the government as well.

**1. Rise of the cashless economy:** Spread of the digital payment culture will start the 'formalization' process in the economy. It will reduce the use of physical cash as well. Once bulk of the economic transactions is digitalized it will result in revealing the expenditure made by individuals to the tax authorities especially big transactions.

**2. Growth of the formal economy** will be another associated long term gain. If additional measures like cleansing the real estate sector and bringing all traders under the digital payment system, the unorganized sector transaction will be made accountable. Even if it is a slow process, bringing the informal sector into the formal economy will reduce black money.

**3. Social shake up:** Black money can be eliminated only if we eliminate the deep rooted social mentality that dealing with black money is economically rewarding and legally feasible. Demonetization may bring a social shake up in the country by destroying this mentality. It will spread an attitude against black money. People will be averse to deal with black money if they know that they are easily traceable and harder legal steps are initiated against them. Such an awareness and conscience can reduce the area available for the activation of black money.

**4. Demonetization will reduce the circumference available for the activities of parallel economy:** Demonetization is not an isolate arm or not the only one against black money. It may be complemented by several other steps. One such supportive step is making PAN compulsory for high value transactions up to Rs 10000. Similarly, PAN documentation should be made compulsory against all investment in physical assets like gold, land etc. If these happens, parallel economic activities can be reduced substantially.

**5. Large number of new tax payers may appear with demonetization.** This is because demonetized money will reveal their income size and tax officials may check them in future, compelling to pay tax.

**6. Cleaning of the real estate sector will be associated long term gain of demonetization.** Modification of stamp duty structure is badly needed to provide energy to the sector at the same time, making it accountable.

**7. Rise in financial savings:** At present, more than 50% of household savings are in physical savings like gold and land. Significant portion of these are in black money. Now with the low reward in the real estate and gold holdings, people may tempt to save in financial forms like bank deposits, mutual funds etc.

As the country says goodbye to the old 500 and 1,000 rupee notes and with restrictions on exchanging money and taxation on high amounts of deposits, Indian economy is going through some serious churn. But how is this going to affect the economy in the short run as well as the long run?

#### **Cash crunch**

The 500 and 1,000 rupee notes were the largest denomination of money, which made up for 14 lakh crores in circulation. Demonetization has a direct impact on sectors dealing with cash—vendors, auto rickshawwallahs, taxi drivers, daily wage earners and small traders. The Indian system mainly functions on cash, and so, less cash

means disruption in the flow. Even sectors like real estate, which deal with illegal cash transactions, will go through a rough patch leading to fall in profits.

### **Interest rates**

When money is deposited in the bank, one earns interest for the same. After the announcement of note ban, there have been huge cash deposits in banks. In fact, some of the leading public and private banks have reduced the interest rates on deposits. Depositors might get lesser interest on their deposits, but the good news is that it will have a long-term positive effect on the economy as the lending rate (interest rate on loan) will fall. This will boost credit and investment, to recover the slumping economy.

### **Inflation**

Total cash available, and by this we mean the supply of money, has fallen, which may lead to deflationary pressures (general price level becomes lower). In effect, it implies less cash compared to the supply of goods. But as the price levels in India have been high due to high inflation, fall in money supply can actually help in bringing down inflation. With unaccounted money being wiped out, we can expect lesser pressure on demand. Fall in inflation will help the common man, because goods will now become cheaper.

### **The tax effect**

Deposits above Rs 2.5 lakh that have not been justified or declared to the income tax department will be penalized and taxed 200 per cent. This can help bring black money into the white money fold, making it legal. This can also provide revenues for government, which can be used to pay the deficit in the budget estimation. If economic activity is slow, then the indirect taxes (tax on goods and services) will be lesser than estimation. It all comes down to which is more, collection of penalties and taxes, or the fall in indirect taxes. Demonetization could be the first step in creating a ripple in the taxation policy before the Goods and Service tax (GST) rolls out.

### **Growth**

The gross domestic product, which is a parameter to measure growth in the economy, will take a hit. Research firms have already cut growth estimates by 0.5 per cent. India's economy could shrink as there are many sectors run by cash. There are a lot of businesses in the non tax-paying sector, which will now be formalized. They will have to give up their market share to the organized sector. This will cause shrinking of the economy and a fall in the growth. On the other hand, though there may be a fall in consumption due to shortage of cash, growth won't take a hit as high demand and consumption during the recent festival time would offset the effect of fall in consumption and compensate for the fall.

## **IV. Conclusion**

Due to demonetization the corruption shall go down to a great extent. The main objective of demonetization is to destroy the black money to develop the economy of India. Though the people had suffered a lot in que in front of ATM's and Banks this demonetization have made an entry for the usage of digital payments among the people. It will take a quite long time to implement the digital economy completely in our country as it is highly heterogeneous in nature. But still there is a chance that if the growing younger generation is made practiced to use with digital modes of payment and some efforts are taken to educate the digital illiterate people then it will be possible to implement complete digital economy in our country in a long turn. This in turn will make our country as super power in economical condition among the world nations.

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