

A STUDY OF ECONOMIC AND SOCIAL IMPACT DUE TO DEMONETIZATION

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ABSTRACT

The parallel economy, for which no reliable size estimates are easily available, has become an increasingly serious problem over the years. This poses not only macroeconomic management challenges but distortions in the economy as well. Author in this paper studied the economic impact in respect of agriculture and manufacturing, reduction in interest rate, demonetization affected badly to micro, small and medium companies, deflation, unemployment, slowdown in economy and investment, reduction in hoarding of black money and social impact in respect problem related to marriage issue, issue faced by farmer, problems faced by tourist, terrorism, issue related to common man and wastage of quality time of people standing in a queues. Apart from turning out to be the biggest economic reform in independent India, this revolutionary measure is making it incumbent upon everyone to embrace and promote digital platforms for money transactions. Cashless Economy combats black money and ensures tax compliance. Macro Economic issues like unemployment, price stability, economic growth, still needs to be addressed.

Keywords: *Interest rate, Deflation, Unemployment, Economic growth, Terrorism*

I. INTRODUCTION

India has amazing potentialities to surpass every developing and developed nation. It has everything in terms of resources and minds. It is the responsibility to embrace willingness to change. The epoch-making revolution unleashed in India by the recent announcement of Demonetization and the replacement of high denomination currency by the government is being perceived by everyone as the next wave of change and growth. Demonetization, the act of stripping a currency unit of its status as legal tender is expected to alter the nation's conduct and will infuse more formal savings into financial markets instead of dead assets. Demonetization, is a bold decision that paves the way to put an end to black money, hawala transactions and fostering terrorist activities. There comes a time in the history of a nation when a major shake-up has to be effected by taking a momentous decision to bring about a tectonic shift in the attitudes of the people, especially those who have been exploiting and milking the loopholes in the system for begetting illegal and tainted wealth. Attempts to strike at hoarders, the corrupt and terrorists are laudable, but the method adopted was fraught with grave consequences. The immediate cash crunch and everyday difficulties are not without a positive fallout. Nobody can deny that there is pain due to rationing and paucity of currency notes, but there is surely some progress and this decision has been hailed by most countries. This one decision has ensured that a lot of money has come into the banking system, a lot of informal savings have become formal now, and therefore, the tendency to invest these more formal savings in instruments that you keep an eye on is also increasing. This move would enable banks to channel these to productive assets and offer differentiated interest rate to borrowers while lowering the risk of bad loan. India remained a cash based economy hence the circulation of Fake Indian Currency

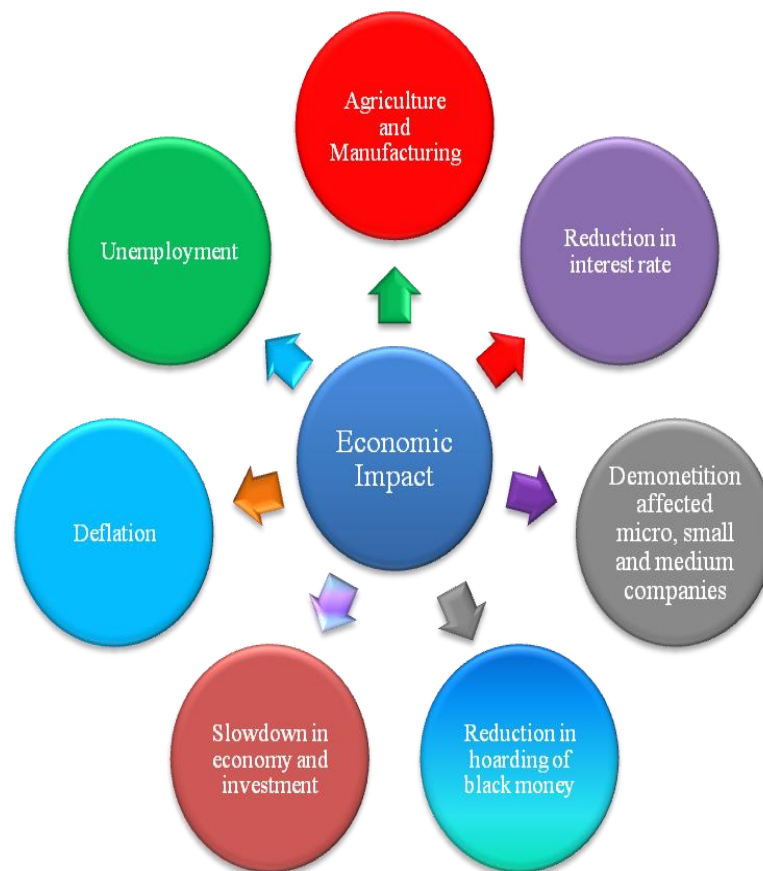
Notes continued to be a menace. Moving to an economy with lower amounts of cash in circulation will help the country to reduce its fiscal deficit and increase budgetary allocations for defence and rural infrastructure.

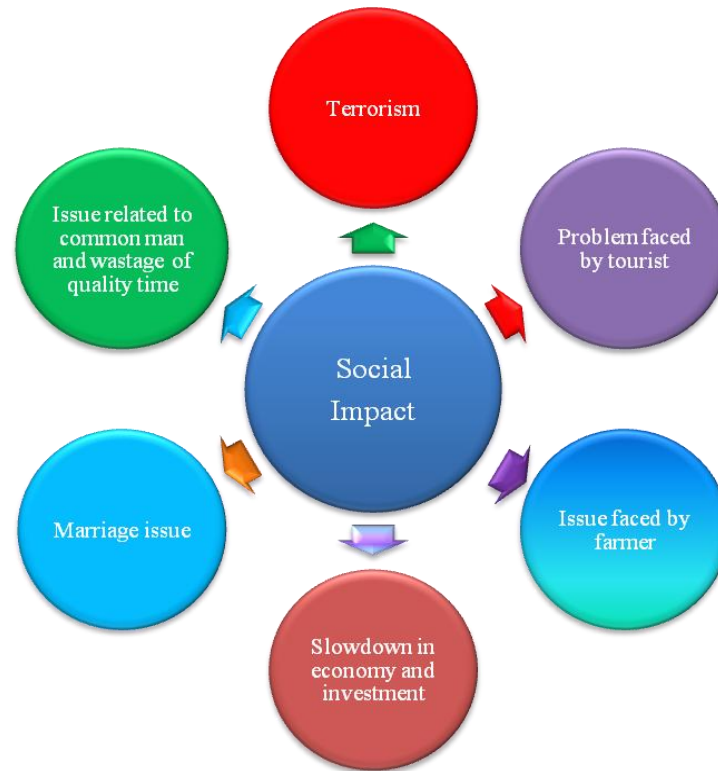
II. NEED OF THE STUDY

Demonetization has been used as a macro - economic policy by the government to regulate or modify the economic affair of the country in keeping certain objective to tackle issues affecting the economy like a parallel economy, counterfeit currency in circulation and terror financing, corruption, hawala transactions, etc. Government attempt to assess the behaviour of the economy as a whole and to seek ways in which its aggregate performance might be improved. Due to demonetization various economic and social impact aroused which was not ascertained before the implementation of Demonetization.

III. OBJECTIVE OF THE STUDY

The objective of this paper is to study the Economic impact in respect of agriculture and manufacturing, reduction in interest rate, demonetization affected badly to micro, small and medium companies, deflation, unemployment, slowdown in economy and investment, reduction in hoarding of black money and social impact in respect problem related to marriage issue, issue faced by farmer, problem faced by tourist, terrorism, issue related to common man and wastage of quality time of people standing in a queues.





IV. ECONOMIC IMPACT

Demonetization is a generations' memorable experience and is going to be one of the economic events of our time. One of the most important objectives of macro – economic policy in recent year has been the rapid economic growth of an economy. Economic growth implies raising the standard of living of the people, and reducing inequalities of income distribution. Economic growth is a desirable goal for a country. Demonetization is used as a macro-economic policy to address the issue like tax evasion, counterfeiting and corruption etc. The parallel economy, for which no reliable size estimates are easily available, has become an increasingly serious problem over the years. Demonetization affects the economy through the liquidity side. 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. Under this head we are studying the economic impact in respect of:

4.1 AGRICULTURE AND MANUFACTURING

Considering both agriculture and manufacturing sectors, India is largely dependent on cash transactions. The cash transactions in our economy are far more than the total number of electronic transactions done on a daily basis. This move had hampered the growth of all the three sectors in terms of Slow Down in Sales, Monopoly creation of Big Houses and it lead to destroy the emerging competitor, Unemployment, Conversion of Black Money into white by

dumping the old currency in account of North eastern state as their income is exempt from any source in Income Tax Act 1961, Liquidity crunch (short term effect). The daily wage earners, other labourers, small traders etc

who reside out of the formal economy uses cash frequently. These sections will lose income in the absence of liquid cash. Cash stringency will compel firms to reduce labour cost and thus reduces income to the poor working class. There will be a trickle up effect of the liquidity chaos to the higher income people with time. Small farmers, sellers, merchants, daily wage labourers and traders are suffering because of lack of proper planning, intelligence and foresight such as recalibration of ATM machines. Small and marginal farmers in the fruits and vegetable category typically require off-loading of their produce in the wholesale market in cash and could see an immediate impact. Sectors that relied heavily on cash transactions, including real estate, construction, gold, gems and jewellery as well as the informal sectors are expected to suffer a near-term decline in consumption demand. India's companies have been more conservative with their investment plans given the slowdown in the economy as well as their bad debt problems, a drop in consumption would push growth lower unless compensated by gains in fiscal spending and trade gains. Consumption will be hit when liquidity shortage strikes, it is the consumption that is going to be adversely affected first.

Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓

V. REDUCTION IN INTEREST RATE

The policy has at least a short-term positive impact on India's banking sector because withdrawal limits allow the deposit base to grow quickly as cash is deposited. In the longer term, improved liquidity could support lower deposit and lending rates. This move by the government is likely to have long term benefits for the economy on deposits and lending rates because of reasons such as High deposits in the banking system, Deposit rates slashed, Attractive borrowing rates, Disinflationary cash crunch.

The extinguishing of the major proportion of unaccounted currency would reduce the liabilities of the government and would add to its finances. This can have very strong implication as the government would get money to spend without borrowing from the market. This would mean that while interest rates can be low, the government spending on large infrastructure projects would kick-start, CAPEX cycle and push economic growth higher in the medium term. The move is also likely to have a habit changing impact in the Indian populous and there could be increased belief of keeping cash in the banks rather than keeping at home and use formal banking channels for their spending needs. With a large part of the cash moving through the banking channels, the banking sector is likely to be flush with funds in the near term and this would help them reduce cost of funds for such period. Also with more money being kept in the banking channel, some of these low cost deposits may be sticky and improve the medium to long term Current Account and Savings Account (CASA) ratio of the banks. Further Banks are offering low interest on fixed deposits due to demonetization of high denomination currency. Small savings schemes like PPF and NSC, are known to give higher returns than bank fixed deposits. This means the banks have more liquid funds and more money to lend. Many banks have also slashed their deposit rates including SBI, ICICI Bank, HDFC Bank.

In the banking world, when deposit rates are cut, it generally means the lending rates will also be slashed down. Since banks are paying lower deposit rates to customers, this allows them room to charge lesser on loans. Once interest rates

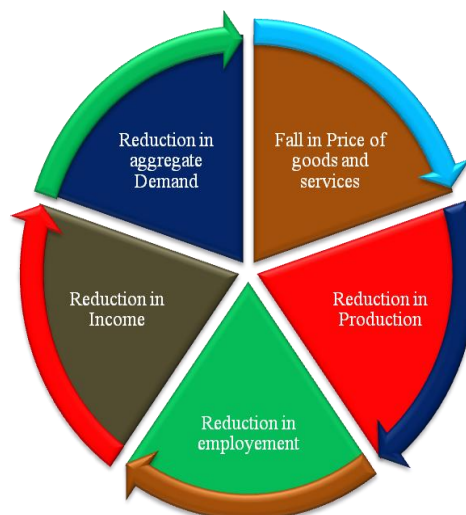
come down, this would translate into a lower EMI. The RBI then introduced a new regime of the Marginal cost of lending rate (MCLR) in which banks are required to change their interest rates periodically. If loan is under the MCLR scheme, then you might stand to benefit from the demonization if your bank slashes its lending rates however if it is under a fixed rate of interest, it will not be affected by the demonization.

VI. DEMONETIZATION AFFECTED BADLY TO MICRO, SMALL AND MEDIUM COMPANIES

The micro, small and medium company are those companies which provide employment at large scale in different sector in labour market. These companies are contributing to GDP and economic growth. They are emerging as competitor and threat for large scale industries. Maximum transaction of micro and small scale industries are undertaken in cash. Due to demonetization, there is shortage of cash, which badly affected these companies. They are facing the problem in getting quotation and contract due to decline in demand in market. Further raid of income tax and excise department threaten these emerging entrepreneurship who close down their business. Due to the close down of business not only affected the economic growth and employment but also eliminate the competition in market and create the situation of monopoly for big houses.

VII. DEFLATION

Huge amount of black money and parallel economy will get adversely affected due to demonetization. The supply of money will get reduced causing the price of commodity to fall leading to deflation. Person with fixed income such as worker, salaried worker, pensioner, etc gain because the value of money rises with falling price. On the other hand, all type of producers such as industrialist and farmer lose with falling price. Deflation affects adversely the distribution of income and wealth. When price are falling, the purchasing power is increasing. Businessman, Industrialist, traders, real estate holders and others with variable income are hit hard and their profits decline with deflation. Deflation affects adversely production. With falling price, production falls because income and employment are also declining and the aggregate demand is on decline. Commodities start accumulating, profits fall, Small firm close down, unemployment spread. This vicious circle of fall in demand, production, employment, income and aggregate demand leads to depression.



VIII. UNEMPLOYMENT

It is a one of the macro economic issue which is to be address by the macro economic policy. Due to demonetization it is presumed that unemployment get increased due to shut down of those business which are running totally on cash. It will not affect jobs unless the employer is running businesses completely based on unaccounted money and wealth but if former is the case, then the business owner will run bankrupt and will be forced to change the way he/she does business which might affect jobs of people working under them. Employment in organized sectors will be largely unaffected if the demonetization is handled adroitly by the govt. and does not take too long. Total liquidity squeeze on the purchasing power of people extending into quarter IV will lead to a slowdown in sales of every product and service. For the unorganised sector the effect on employment has been terrible. A large part of the unorganised sector deals only in unaccounted cash. This has come to a grinding halt and chances are it is a permanent halt. The vacuum left by this type of enterprise will be filled by mainstream enterprise but the switchover will take a long time. The poor will bear the brunt since unemployment will lead to a contraction in wages. If the demonetizing leads to huge extinguished obligation of the govt in the form of old currency not tendered for exchange or credit, then the govt. will have the leeway to alleviate the problems and unemployment through heavy investment in rural infrastructure for enough employment to offset the effect of demonetization. The turnover of the parallel economy part of which will merge into mainstream economy will keep stock markets buoyant and increase potential future sales of products and services.

XI. SLOWDOWN IN ECONOMY AND INVESTMENT

Economic growth can be defined as “the process whereby the real per capita income of a country increases over a long period of time”. In wider aspect economic growth implies raising the standard of living and reducing the inequalities of income distribution. A widespread cash crunch following the withdrawal of high denomination currency notes has slowed the economic activity. There is a belief that innovation tends to increase productive technology of both capital and labour over time. Production might not increase further due to the lack of demand which may retard the growth of productive capacity of the economy. Loss of Growth momentum, India risks its position of being the fastest growing largest economy in terms of reduced consumption, income, investment etc. At this time, the economy is struggling with slowdown. There is demand sluggishness in the economy leading to practically no private sector investment and stagnant industrial growth. The decision of investment in a new capital asset depends, when the expected rate of return on the new investment is greater than the rate of interest to be paid on the funds needed to purchase this asset. In the present scenario investment seems very difficult due to liquidity crunch. There are several other factor which affect the investment like (a) *Consumer demand*, The present demand and the future demand for the product greatly influence the level of investment in the economy. Due to the demonetization, the current demand and future demand of product is expected to fall and both will influence the level of decision. (b) *Level of Income*, If level of Income rises in the economy through rise in money wage rates the demand for goods will rise which will, in turn, raise the inducement to invest and vice versa.

XII. REDUCTION IN HOARDING OF BLACK MONEY

Black money is a menace to our society that we needed to eliminate. It deserved to be extinguished using all the firepower at our disposal. Demonetization was a targeted strike at only those suspected to be in possession of ill-

gotten, unaccounted money in our country. Black money is generated through evasion of taxes on income from lawful activities and money generated from illegal activities. In the absence of steps to curb the generation of black money, demonetization is a futile exercise.

➤ **SOCIAL IMPACT**

1. PROBLEM RELATED TO MARRIAGE ISSUE

The month of November and December are considered to be auspicious for marriages and Demonetization created a chaos among families where weddings were due. The wedding season is the time of the year when traders do most of their business but lack of liquidity has led to problems. People are not even in the position to pay the advance. Cancellations of orders have been jumped at peak after the announcement of withdrawal of High denomination currency. Thus, those who have deposited money in the banks following demonetization are now feeling cheated as they are not being able to withdraw the money even if they have sufficient balance in their account. Even as the government has allowed withdrawing of Rs 2.5 lakh for those who have weddings ahead in their homes, what seems to ease the currency crunch in the need of the hour is not serving its purpose. The long list of documents and certain rules has failed to spread happiness in several families. There are many customers who are being asked by the bank authorities to furnish all the details as to where all they would be using the money. Likewise, those who are coming to bank for withdrawing money for marriages are being asked to submit PAN card, the beneficiary will also have to submit the receipts of all the purchases and payment made from the money withdrawn from the bank. Only those account holder, who have marriages before December 30 can withdraw money. Yet, banks should encourage families to incur wedding expenses through non-cash means viz. cheques /drafts, credit/debit cards, prepaid cards, mobile transfers, internet banking channels, NEFT/RTGS, etc. as per RBI guidelines. Therefore, members of the public should be advised, while granting cash withdrawals, to use cash to meet expenses which have to be met only through cash mode.

2. ISSUE FACED BY FARMER

The currency crunch resulted by the Centre's demonetisation move is set to hit farmers, agriculture produce market committees (APMCs) and farm produce transporters ahead of a bright Rabi season, forcing the government to plan measures to tackle the impending crisis due to demonetization. Due to sudden decision of the Government of India, farmers were facing difficulties for sowing in the Rabi crop season. They were facing difficulties in arranging seeds and fertilisers. The farmers were also not able to utilise the earnings of the Kharif harvest and put it to their use and faced with severe crisis due to the demonetisation decision. Co-operative banks, where most of the farmers' savings lie, are unable to exchange or accept deposits being made by the farmers in scrapped notes, and also cannot give them loans. Because of this the farmers cannot buy seeds for the next season and another situation of food shortage seems to be on a row. Most of the farmers are not depositing cash in the bank and are trying to exchange the notes at higher rates. Due to the cash crunch, they could not purchase any raw material and their daily life has been affected.

3. PROBLEM FACED BY TOURIST

Cash-crunch triggered by demonetisation of high denomination currency notes is not only causing inconvenience to people in the country, but foreign tourists visiting here are equally troubled as they are unable to use smaller

denominations. In various regions spread across India, many Indian tourists who rely on cash while travelling domestically are stranded and suffering from long queues and due to non-functioning ATMs causing a serious scarcity of cash. Foreign tourists facing problems due to lack of awareness. Most foreign tourists were unaware of the government decision and its intricacies. Tourists faced problem exchanging currency as with both banks and Automatic Teller Machines (ATM) shut. Tourists have cut short their trips as they are facing problems with long queues at the banks and ATMs not coughing up enough money to cover their expenses. Many travellers have cancelled their trips at the last minute due to non availability of cash in the market.

4. TERRORISM

Due to demonetize the high denomination currency has completely choked the illegal Pakistani hawala funding of the Kashmiri separatists and as such the terrorism industry they had created with black money has suddenly crumbled. Not only has the move to demonetize the higher currency note dealt a massive blow to the Kashmiri terror industry, it has also stunned the dubious 'human rights activists and civil society groups' acting as apologists for terror activities who will now face a tough time in explaining the sources of their income and assets. The modus operandi of the terror industry was simple. The money was then spent on training, purchasing of arms and ammunition and sent to local militants in Kashmir, and thus Kashmir saw a massive upsurge in the recruitment of local in militant outfits in the past few years. With de-monetization of the big currency notes, not only has such funding being blocked, the cash in hands of terrorists and their agents have been rendered worthless. There are four essential elements needed by terrorists and organised crime groups to achieve its objectives – mobility, logistic bases, communications and financing. In a developing country like India, only the communication aspect is within the surveillance capability of law enforcement agencies and it is fairly easy to obtain and leverage the remaining three without detection. Changing national currency is an extremely expensive exercise, so this is not a move that any government can implement frequently to purge out fake currency from its economy. Even though demonetisation will undoubtedly deal a severe blow to the black economy, corruption, inflated pricing and tax evasion. The masterstroke by the government will also lead to a major shift in the terror infrastructure management and change the character as well as nature of terror funding in the country. Lack of hawala money inflow will majorly hit activities of Maoists and other insurgent groups in the north-eastern states. They will be also be hit hard as the stocked currency has become useless and availability of new high-value notes is not in abundance.

5. ISSUE RELATED TO COMMON MAN AND WASTAGE OF QUALITY TIME OF PEOPLE STANDING IN A QUEUES

Welfare loss for the currency using population: Most active segments of the population who constitute the 'base of the pyramid' uses currency to meet their transactions. The real issue is how the common man been affected by the drive. The current demonetisation has adversely affected the poor, wage labourers, small businesses, farmers and other minorities. Often these small income earners save cash for a rainy day. The incidence of bank accounts and bank transactions will be extremely low among these groups. These are the communities who do not engage in the formal banking sector too much. Rather they save their daily or weekly wages in cash, often in large denominations. It is these groups who have been hit the most by the demonetisation drive. Harassed people queuing for hours. The largest adversely affected group, numerically, is the working class. Casual workers are at the bottom of the working-class

hierarchy. Their incomes are the lowest and least secure. They spend the money as they earn it. Meanwhile, they would have had no money to buy food, medicines or other essentials, and God help them if they had a medical emergency. Next, there are the medium-skilled blue- and white-collar workers in the unorganized sector and contract workers in the organized sector. Finally, there are the regular organized-sector workers, the most skilled and the best paid. All of these wage/salary recipients would have received their wages shortly before the demonetization. They too would have had to miss work and queue up at banks or ATMs to convert their money. Without conversion, they would have had no usable money for food, medical expenses and other essentials. Transportation of currency and its security was a challenge at initial stage as effective management of logistics was the key in this cash crunch, to serve the nation best. Non Availability of Cash at central bank and complications in its disbursal created money in the economy scant. Problems related to management and calibration of ATMs to make them suitable for the disbursal of new currency. Productive man hours being lost as people are still waiting to exchange or deposit old currency during working hours.

XIII. EXPECTED OUTCOME/ BENEFIT

There are many benefits that will come with the government's move. The size of the formal economy which the government can manage though its policy actions will increase, perhaps significantly. This step may have positive implications for tax revenues in longer term. There may even be influences on the growth rate of GDP. However, for sectors like real estate, a notorious hotbed for black money transactions, there will likely be disinflationary pressures in short term, with prices being pushed downward before they stabilize in longer term. The government could see tax gains if it succeeds in "unearthing unaccountable money" from the shadow economy. Hard cash held as black money will be brought into the system which is traceable and taxable henceforth thereby increasing the government revenue. To the extent of penalties imposed by the Income Tax department on the illegal conversion of black money into white money, the revenue to the government will increase in the immediate future. Unaccounted monies held as cash which was not productive will become productive as it enters the legal system. Counterfeit money in circulation which was a ongoing menace all over India will cease to exist with immediate effect. Funding of terrorist and other illegal activities will be curtailed as they generally are funded by black/counterfeit money. With huge cash at the disposal of the banks, the borrowing of money will get cheaper providing impetus to economic growth. Government can avail finances at lower rates and speed up the infrastructural spending creating huge job opportunities.

XIV. RECOMMENDATION AND SUGGESTION

1. Demonetization move would bring more transparency in the sector but to prevent illegal transaction, the government must cultivate the habit of "cashless transactions " among the people and print less number of currency notes in future to avoid hard cash transactions ,responsible for creating "unaccounted money" . The government could encourage more widespread adoption of cashless payments in the medium term, it could permanently improve liquidity in the banking system.
2. Screw tightening of NGO and need to bring amendment in Charitable trust and NGO who are running business under head and not paying any tax.

3. Government should have to take another bold step for corruption free, fair, equitable and equal society, then it should frame the rule for digital transaction for all political parties, Electoral trust and Non Government Organization in mandatory nature. Further abolish exemption under taxation rule and regulation and come under the purview of Right to information Act.
4. It has to be matched with a better, more streamlined and integrated tax system. The upcoming move to GST is a measure in the right direction, and the government needs to move forward with implementing the next steps of that reform measure. Widen the net for disclosure by filing Income Tax return. Create e-trails of both incomes and expenditure.
5. Establish identity of persons through PAN Card, Aadhar Card etc, operating in the country – citizens and foreigners.
6. Enable electronic register of assets through electronic land records, digitisation of revenue records.
7. Government should initiate the investigation in the matter like Temple donations, Back-dated FDs in co-operative banks and credit societies, giving loans to poor people, finding Jan Dhan account holders where high cash deposits has been done, Company and Institution Paying advance salaries to employees in cash and transaction undertaken by Jewellers during the period.
8. Government can initiate the work on allotment of single account no. in bank instead of person having multiple account no. Further Government may allot the Aadhaar no. as Account no. after merging the Banks.

XV. CONCLUSION

Demonetization is a historical step will definitely fetch results in the long term but in current scenario is not satisfactory as it discussed above. Micro, small and medium companies were badly affected due to demonetization. There is danger of personal information and data security issues. Moving to cashless transactions is a massive shift for a country where most people depend only on cash to make transactions. Implementing this is going to be a big challenge. Macro Economic issue like unemployment, price stability, economic growth, still needs to be addressed. This move is likely to improve tax collection in near future and significant increase in no. of people for filing of return. In summary, this measure of demonetization is a measure that temporarily brings into the system the unaccounted money and generates additional taxes in the near future. Whether this measure is detrimental or beneficial is based on the amount of black money being brought into the system, not just cash but assets held in various forms. In its efforts to curtail the parallel economy in the country, the government should work on plugging the loopholes in tax administration, and invest in strengthening the mechanisms that will help restrict the outflow of black money to tax havens.

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