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Recent Economics Policies and Its Impact on Indian Economy

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Demonetization and Its Impact on Indian Economy

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Abstract:

Demonetization is the act of stripping a currency unit of its status as a legal tender. It occurs whenever there is a change of national currency. The current forms of money is pulled from circulation and new currency is introduced or replaces the old one. The currency has been demonetized thrice in India. The first demonetization was on 12th January 1946(Saturday), second on 16th January 1978(Monday) and the third was on 8th November 2016(Tuesday).It has deeply impacted Indian economy in various ways. But it has been widely acclaimed as positive decisions taken for the benefit of the citizens. This paper traces the positive and negative impact of this move on Indian economy.

Keywords: - Indian economy, demonetization, currency, cashless, impact.

INTRODUCTION:-

Demonetization is going to be one of the economic events of our time and will be considered as a memorable experience by generations to come. Demonetization was sudden and came as a surprise on the night of November 8, 2016 when the Prime Minister OF India, Narendra Modi announced the demonetization of all Rs.500 and Rs.1, 000 denomination banknotes of the Mahatma Gandhi series. Its impact was felt by every Indian citizen. Demonetization affects the economy through the liquidity side. The sudden nature of the announcement- and the prolonged cash shortages in the weeks that followed created significant disruption throughout the Indian economy, threatening economic output.

Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. A situation is created where consumption, production, employment, investment etc. is jammed due to lack of currencies. The panic and discomfort was temporary phase. Government took the initiative and requested people for creating the bank accounts under Jan Dhan Yojna.

- 1) Opportunities provided to citizen so that they can declare the unaccounted income well in advance under the scheme of IDS.
- 2) The time for well-planned and overwhelming turn and a step forward towards nation building.

LITERATURE REVIEW:

- 1) Mr.Sabnavis and MsSawarkar(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.
- 2) HDFC Bank Investment Advisory Group (2016): From an equity market perspective, this move would be positive for sectors like Banking and Infrastructure in the medium to long term. This could be negative for sectors like consumer durables, luxury items, gems and jewelry, rural estate and allied sectors, in the near to medium term.
- 3) ArrendamChanda(2016): Noted some shortcomings in terms of dealing with the shortage. The study described that there were some other criticism such as the near term decline in economic growth particularly when the Indian economy was doing well.
- 4) Tax Research Team (2016): In their working paper stated that in favor of demonetization its main objective is to analyze the impact of demonetization on Indian economy.

OBJECT OF THE STUDY:

- 1) To understand the meaning of demonetization.
- 2) To assess the need for demonetization.
- 3) To examine the overall impact (negative and positive) of demonetization on Indian economy.

RESEARCH METHODOLOGY:

The study attempts to understand meaning and reasons of demonetization. This study also gives an insight into the positive and negative impact of demonetization on Indian economy. The study undertaken is descriptive in nature. The study is based on accessing, compiling, evaluating and

interpreting secondary data mainly collected from sources such as articles in magazines, journals, annual reports, library, and govt. documents and from applicable sites accessible on web.

FINDINGS:

This part is divided into following sub parts as under:

*Various reasons of demonetization.

*Positive and negative impact of demonetization on Indian economy.

It's going to be almost 3 years after the country was wiped out of old currency the effects of NarendraModi's demonetization can still be felt in the Indian economy. It is been regarded as one of most criticized moves by PM Modi and even former PM Manmohan Singh and RBI Governor RaghuramRajan has condemned this move and its effects on the Indian economy. It started as a way to curb the black money from our country/ economy and was later looked upon as a means of making India cashless and giving digital India a boost.

NEED AND OBJECTIVE OF DEMONETIZATION

1. It is an attempt to make India free from corruption.
2. It is done to restrain black money,
3. To control escalating price rise,
4. To stop funds used in illegal activity,
5. To make people accountable for every rupee they possess and pay income tax return.
6. It is an attempt to make a cashless society and create a Digital India.

Three years will pass since Prime Minister NarendraModi announced demonetization on November 8. And now it is time to assess the government's actions and see whether the entire demonetization effort is a success or failure. But before that, we need to identify the objectives of the government's decision to recall Rs 500 and 1,000 notes. The immediate objective of demonetization was to flush out a large amount of black money hoarded in cash, and the long-term objective was to convert our cash based economy into a digital one. This conversion will turn India into an efficient economy with higher tax revenues.

NEGATIVE IMPACT OF DEMONETIZATION

- 1) Since the demonetization exercise kicked off on 8th November, the total deposits in banned currency notes have inched close to Rs. 11 lakh crore, according to some reports.
- 2) As per the RBI, the total value of Rs. 500 and Rs.1, 000 notes in circulation till March 2016 was Rs. 14.18 lakh crore, of this amount 15,707 million comprised Rs. 500 notes and 6,326 Rs. 1,000 notes. This means that Rs.11 lakh crore would comprise nearly 80% of the total banned currency that has entered the banking system. .
- 3) While announcing demonetization the government had claimed that it was aimed at curbing black money. However, the recent calculation is raising doubts over the purpose and efficacy of the entire exercise. The objective will be defeated if 90% of the invalid tender are deposited as this might not indicate that the cash component of the black money has been destroyed. The money deposited in the banks might have been only after foolproof evasive measures by the black money hoarders and thus it might prove to be difficult for the law to get hold of them.
- 4) It was estimated that at least 95% of the demonetized Rs. 15.44 lakh crore had already came back to the banking system. According to the government's argument black money doesn't become white just because it is deposited in a bank account. However, if the purpose was to bring money back into the banking system, the same would have been achieved by slow demonetization.
- 5) Much of the public enthusiasm about demonetization comes from the expectation that those with hoards of cash will not be able to exchange it in the banks for new notes, and will therefore lose their ill-gotten money. This group includes businessman or politicians, or bribe taking bureaucrats. The public will certainly applaud their loss. However, much of this may be laundered.
- 6) Since the notes were valueless after 30th December, holders of undeclared cash were willing to offer 30-40% commission or even more as the deadline approached to offload the cash. Intermediaries had organized large number of individuals who were willing to take smaller

'explainable' amounts of cash to the banks for deposit. Since farm income is free from tax, large number of people claiming to be farmers had made deposits in the banks.

- 7) Black wealth held in cash was possibly laundered by purchase of gold and hawala transactions but that assumes that the suppliers of gold and hawala dealers would launder the old notes received before 30th December. Some of this has already happened as evidenced by the sharp rise in gold prices and also the hawala rate for the dollar. Inevitably, higher gold prices encouraged smuggling and diverted foreign exchange that would otherwise had flowed through legal channels to finance gold smuggling.
- 8) Demonetization did not address the core problem of corruption and black money measures like benami properties and undeclared foreign holdings would have been better measures. Demonetization had not prevented fresh black income from being generated in future through continued corruption.

POSITIVE IMPACTS OF DEMONETIZATION

- 1) **Over Black Money:** - Black money is considered as a cancer in any economy. It is a parallel economy, which weakens the foundation of any country. It is estimated that in India, the total amount of black money is Rs.3 Lakh crore. It is huge if we see that the total money in circulation is only Rs.17 lakh crore. With this single master stroke of demonetization all the black money came to account book though some amount of it would probably have been destroyed.
- 2) **Over Fake Currency:** - According to the ISI (Indian Statistical Institute), the circulation of the total amount of fake currency in India is Rs 400 crore at any given point of time. It is also estimated that around Rs.70 crore fake currencies are injected into India every year by our western neighbor Pakistan to sponsor terror activities in our country. These fake currency notes are an attack on the Indian economy as well which increases money supply in the economy ultimately leading to inflationary pressure in the economy.
- 3) **Over Bank Deposits:** - It is a well-known fact that near about 86% currency circulation in India was composed of 500 and 1000 currency notes. And demonetization of these notes made people deposit their money which was in the form of 500 and 1000 Rs notes into the banks. Banks declared that they had received Rs 5.12 trillion worth of deposits until 18th November. India's largest public sector State Bank of India (SBI) said it had received Rs 1.27 trillion worth of cash deposits.
- 4) **Over Lending Rates:** - The huge cash deposit base enabled banks to cut down the cost of funds because higher deposit had replaced the high cost of funds. It was expected that banks would reduce deposit rates by 125 bps over the next six months. The new directives of MCLR (Marginal Cost of Funds based Lending Rates) had instantaneously taken into account the lower cost. That paved the way for a decline in lending rates that expedite the economic activity in the medium term.
- 5) **Over Real Estate Cleansing:** - It is repeatedly said that real estate industry is built on black money. The extent of black money circulation in the sector is huge. According to report at least 40% of real estate transaction in Delhi-NCR was being done in black money. The demonetization move had curbed the flow of black money into the real estate sector.
- 6) **Over Investment Habits:** - Demonetization witnessed large scale cash deposit in bank accounts. However bank deposits offered nominal returns which made investors explore alternative and attractive investment avenues. Equities and mutual funds emerged as preferred investment options. Retail investors are gradually flocking towards MFs with around Rs 5000 crores worth of SIPs every month.
- 7) **Over Stock Markets:** - Due to demonetization BSE Sensex dropped leading to funds flowing from the Indian market which affected the market on an immediate basis. Investors diverted their surplus cash to equities and equity mutual funds. The overall positive sentiment led by various reforms introduced by the government also boosted investor confidence in the market.
- 8) **Over Digital Economy:** - Post demonetization people embraced digital payment channels for reducing their dependence on cash. The government also announced various measures to encourage digital transaction through banking channels. Digital payment industry witnessed a

growth in the range of 40-70 percent. A move towards digital economy will not only make transaction easier but will also create a new market and employment opportunities.

- 9) **Over Financial Initiatives:** - Demonetization along with Jan Dhan scheme has been a great success in the mobilization of saving into the banking system. Almost 30 crores families opened bank account through the Jan Dhan scheme. With expansion in the ambit of Jan Dhan account it has now become easier for the government to pass on the incentives and subsidies intended for the underprivileged section of the society by transferring funds directly to the Aadhaar linked bank account of the beneficiaries.
- 10) **Over Kashmir Unrest:** - If anywhere demonetization has shown its impact very soon it was the Kashmir valley. The turbulence in Kashmir has come to the rest because of the lack of monetary supply. Demonetization also brought peace to the stone-palters in the Kashmir valley. Since demonetization has given a severe blow to the funding of separatists, they were unable to pursue the young people to agitate against the army or the state.

CONCLUSION: -

As one can see from the above that demonetization has both negative and positive impacts on the Indian economy. Demonetization alone cannot fight parallel economy and eliminate black money. Several other measures are required by the government to change the economy for the good. The system is expected to prove positive for the economy in the long run as it encourages the digital mode of payment like E-wallets, online transactions. It is beneficial for the economy in the middle to long term. We should encourage and join together for the mission of India Development.

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