Research Article

A comprehensive study of Demonetization Challenges & its impacts on Indian Economy

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Abstract

Demonetization is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency. Some economists say demonetization will adversely impact India’s economic growth even as others believe the disruption is unlikely to be significant. The big challenge is that demonetization can curb small business; there may be low transaction by middle class and lower class people and off course more roles for commission agents to exchange old and new currencies etc. The objective of this study is that which kind of challenges occur due to demonetization and how it affects to Indian economy.

Keywords- Currency Stripping, NOBW, Curb Economy.

Introduction

Demonetization is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency: The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency. (1-4) Thus Demonetization is the withdrawal of a particular form of currency from circulation or it is a process by which a series of currency will not be a legal tender. The objectives of demonetization are abolishment of parallel black economy, to fight with corruption, Crackdown on terrorism and Naxalism, Boost the economy.

Demonetization has a big impact on Indian market and citizens like you and me. People flocked the banks to changed their currency and stood in long lines in front of bank and ATMs for hours to draw money also bank employees overworked with all their might so that each individual can take a sigh of relief. Surely, we have problems in but we also need to understand the importance of it. Demonetization can also be used to promote the “Cashless Economy”. We might not be a completely cashless society soon but at least we can be “Less Cash Economy”. On another side, we can see a positive reaction from all over the world. Other countries who want to invest in India think that Indian government trying to solve Indian red tape and corruption. It will draw more foreign investment in the country which will help Indian government to become a business-friendly country. Everything on this planet has good and bad sides and demonetization is not an exception. The first and most important issue was its implementation. It is debated that
implementation was not good, not all stakeholders were consulted in this project. But kind of secrecy this project demanded it was not possible to some extent to consult all stakeholders. This brought up various problems later like adjusting the ATM machines to the new notes configuration, printing enough money and its distribution. But it did prevail its secrecy which was a paramount success factor for demonetization.

**Review of Literature**

The demonetization nullified 86% currency in circulation worth 15.5 lakh crore on November 8, 2017. National Organization of Bank Workers (NOBW), an affiliate of Bharatiya Mazdoor Sangh, in a letter to the Prime Minister said, "Bank employees have worked 12 to 18 hours a day during the last 50 days. Only few banks have considered overtime for extra working. Kindly advise the management to consider the overtime for beyond working hours worked by bank employees." It also called for stepping up recruitment activities and said that banks are understaffed for implementing all schemes. NOBW vice president Ashwani Rana also pitched for a decent salary hike in the wage revision due in November this year. (8)

Arpit Guru and Shruti Kahanijow (2010) researcher analysed the black money income? Need for amendment in DTAA &ITEA and analyses that black money is spread everywhere in India up to a large extent which continuously stashed towards abroad in a very large amount. The researcher also identified how black money had caused menaces in our economy and in what ways it is used. Sukanta Sarkar (2010) conducted a study on the parallel economy in India: Causes, impacts & government initiatives in which the researcher focused on the existence of causes and impacts of black money in India. According to the study, the main reason behind the generation of black money is the Indian Political System i.e. Indian govt. (15) just focused on making committees rather than to implement it. The study concludes that laws should be implemented properly to control black money in our economy. Tax Research Team (2016) in their working paper stated in favour of demonetization its main objective is to analyze the impact of demonetization on Indian economy. This paper shows the impact of such a move on the availability of credit, spending, level of activity and government finances.

**Demonetization’s Retrospect in Indian prospective**

India has demonetized before: First time on 12 Jan 1946 (Saturday), second time on 16 Jan 1978 (Monday), Third time on 8th November 2016 (Tuesday).

In the first time, The first was when Rs1,000, Rs5,000, and Rs10,000 notes were taken out of circulation in January 1946, a year and a half before the country won independence from the British. (5-7) The Rs10,000 notes were the largest currency denomination ever printed by the Reserve Bank of India, introduced for the first time in 1938. All three notes were reintroduced in 1954. (14)

the measure did not succeed, as by the end of 1947, out of a total issue of Rs. 143.97 crores of the high denomination notes, notes of the value of Rs. 134.9 crores were exchanged. Thus, notes worth only Rs.
9.07 crores were probably ‘demonetized’, not having been presented.

January 1978: Notes of Rs 1000, Rs 5000, and Rs 10,000 demonetised

The Janata Dal demonetized high currency notes of Rs 1000, Rs 5000 and Rs 10,000 in a second such historic move, again with a view to curb black money transactions. It was termed as “an Act to provide in the public interest for the demonetization of certain high denomination bank notes and for matters connected therewith or incidental thereto.”

November 2016: Notes of Rs 500, Rs 1000 demonetized

November 8, 2016 announced that the notes of Rs. 500 and Rs. 1000 would be deemed invalid as legal tender from the midnight of November 9, 2016.

Challenges of Demonetization

1. In the country where 90% of transaction takes place in cash in the market, where only 40% have bank account in that country government banned those notes which had 86% of share in the market which led to great hustle in the market.

2. The bulk of black money is not in money at all so such step of demonetization has affected the middle class tax payers.

3. Demonetization had an adverse effect on farmers and villagers who did not have bank account and had mostly the demonization of 500 and 1000 rupee notes after the sale of their crops.

4. Due to the demonetization many people lost their life either because of standing in long queues or denial by hospitals to give treatment in exchange of old currency notes which led to death of many people.

5. Small business faced the major loss and people also had to skip their work in order to withdraw money from ATMs by standing in serpentine queues.

6. There was poor coordination between the banks and the government.

7. The frequent changes of the policy gave the idea about the lack in preparation of the government for such change.

8. This off-guard step was greatly criticized by the oppositions where many rally were taken out in protest of such change.

9. Families which were having marriage ceremony were greatly affected as they had withdrawn cash which were mostly in the currency notes of Rs500 and Rs1000.

10. The challenge in going cashless is that there is no other close alternative to cash. Thus, digital payments account for only 10 percent of the transactions whereas cash payment makes up the other 90 percent.

Impact of Demonetization on Indian Economy

Real Estate

Since Real Estate is driven by the black economy, this was the sector that was probably the worst hit of all the sectors.

The Nifty Realty index gapped down after the day of the demonetization move and corrected -25% (as indicated in the chart below, the NIFTYREALTY bounced of the Auto-SR very strong support of 152.5 on a weekly chart) before recovering a bit. It is still down almost -16% from 8th Nov.
Consumer Durables
This sector is primarily driven by cash and hence has also been hit hard. It is down by almost 11.7% since the demonetization announcement.

Infrastructure
The infrastructure sector is driven by massive investments from government as well as loans from banks. One of the health effects of demonetization is to increase the liquidity in the banking system as well as increase the funds that the government has for spending on items like infrastructure, welfare etc, so the Infrastructure is an obvious beneficiary of that. The fact that the NIFTYINFRA index has not been affected much

Information Technology
The IT sector has been largely unaffected by the demonetization as it is export oriented and hence relatively better positioned to handle shocks in the Indian economy. Moreover it is probably also largely a cashless sector and hence also not affected due to the cash being taken out of the economy. (9-12) The NIFTYIT chart below shows that the IT sector is actually doing better than from what it was on Nov 8th

- **Effect in the Cash Economy** – The currency of the aforementioned denominations constitutes around 87 percent of the total value of aggregate value of currency in circulation. Thus this is just a short-term inconvenience; things will ease out in the months to come.
- **Rise in Tax Collection to GDP ratio** – India’s tax to GDP ratio is 16.6 percent, according to Economy Survey 2015-16. This is lower than the average for emerging markets, which is around 21 percent.
- **Lowering of GDP in short term** – For a short period, the GDP is expected to go down due to reduced consumer demand stemming from compromised cash flow.
- **Reduced Debt Yields** – With an influx of money in banks, the demand for government bonds and other high rates bonds are expected to increase, leading to reduced bond yields. (13) This can lead to price increase for old bonds and hence profit for Long Term Bond Funds & Tax Free Bonds
- **Cement and Steel to turn credit negative in the short-run** – The construction and real estate sector is strongly linked to sectors like steel and cement, which can turn credit negative for a short period.
- **Effect on Interest Rates** – High Liquidity in banking system will result in central bank cutting down Interest Rates.
- **E-wallets set to rise** – The recently launched UPI (United Payments Interface) and e-wallet players like Pay TM & Free charge are going to benefit tremendously
- **Real Estate prices to go down** – While there is not going to be much of an impact on the primary residential market, where houses are bought in the form of bank loans and mortgage; there is going to be a discernible impact in transactions which deal in cash. Overall, the residential market may witness drop in prices, correcting to an average of 10 to 20 percent.
- **Benefit to the Equity Markets** – Equity market is expected to be volatile in short term because of
uncertainty and slow down in economy.

Foreign Direct Investment: FDI inflow is affected for very short only because it is based on expectation of investor. It can be shown as following.

Conclusion
We can probably summarize the effect of demonetization on the overall economy as follows:

1. In the short term, GDP will be down for at least a 1-2 quarters before recovering.
2. A lot of black money will be converted to white and be deposited into the banks which will in turn help in the NPA problem that banks are facing.
3. In the longer term, reducing of black money economy in the future should
4. bring more people in the tax net and hence lower taxes as well as interest rates which will bode well for the overall economy.
5. Curb financing of terrorism through the proceeds of Fake Indian Currency Notes (FICN). Curb the use of FICN funds for subversive activities such as espionage, smuggling of arms, drugs and other contrabands into...
India, and 6. for eliminating Black Money which casts a long shadow of parallel economy on our real economy

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