IS 2017 GOING TO BE STRUCK BY THE DEMON OF DEMONETISATION?

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ABSTRACT

BACKGROUND

After November 8, 2016, there is hardly anyone living in India who is unknown to the term Demonetisation. It hit everyone, from beggar to the bread maker. The two highest currency units generating 86% net worth of currency [15.4 trillion rupees], which were circulating in this 1 billion population, went obsolete. Economists and Financial experts define Demonetisation as the act of pulling away the value or worth given to a unit of currency. It is an act that is said to be necessary whenever new currency needs to be introduced into the economy, in order to curb inflation. This article enables understanding to the aftermath of demonetisation and its effect on the Indian economy till the first quarter of 2017.

KEYWORDS

Demonetisation, SBN, Modi Government, GST Bill.


BACKGROUND

Money is like water in this 21st century lifestyle and everybody needs it to survive. But now it has become the survival of the fittest which is driving the rave of black money in the Indian economy. But why is money BLACK, when it empowers life is the biggest issue to be concerned.

It is all because of the creation of illegal or untaxed earnings. Illegal earning refers to those earnings yielded from illegal activities like bribing, theft, sale of illegal items, illegal money, prostitution and human trafficking.

Knowingly or unknowingly, we all contribute to the creation of black money, from not taking a bill at a local kirana store which goes untaxed, to paying a little bribe to get a job done. This, may not look huge to the naked eye, but has resulted in India being ranked at 4th in Black money outflows as of 2015. (Indian Express, December 9, 2015)

The Indian Government forecasted an exclusive press release by Prime Minister Narendra Modi, where for the first time ever, notes of 2000 denomination were introduced, to curb with the exemption of 500 and 1000 legal tenders. And soon, PINK became the new weapon to conquer BLACK, or was it just replacing it to give rise to a higher rate of corruption?

Did Modi’s Masterstroke Indeed Strike Hard?

The 2000 rupees currency although a bold step, was not planned and thus resulted in unexpected and uncontrollable circumstances. Since its inception four months back, there have been cases of counterfeiting being heard of from all over the country.

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Initially, the Government announced its demonetisation drive in a bid to tackle counterfeiting Indian bank notes, to effectively nullify black money hoarded in cash and to choke terror financing. But afterwards, insisted it to be a solution to push India into a cashless or less cash economy and to curb inflation.

Here too, it was their lack of forethought to the matter that was portrayed as there were mere 27 Million Credit cards & 728 Million Debit Cards (Dalmia Sunil, 2016) operating in the Indian economy, at the end of month November 2016.

Needless to say, millions of lives shunned, as they were unable to buy basic life necessities due to lack of cash at hand. According to RBI records, the rule of withdrawals of Specified Bank Notes (SBNs) were changed 60 times between November 8th and December 10th, which created more havoc.

From the standpoint of Black money, cash might be the most liquid form of all wealth, but it is not the only source of black money generation. Wealth hoarders successfully converted their blacks into other assets rather any asset, as a result of which within the first 25 days of demonetisation over 84% of old notes, proving to be white money, was back in the RBI chest.

Utilising the severe collapse in demand and hence in prices of various commodities, many have stocked up their inventories to forgo the old notes and later shall sell the same at a larger profit; while others paid off monthly wages and invested on long term assets. The macroeconomic effect of Demonetisation has resulted in an increase of holding cost for companies, as although production was not hampered on a large scale but product finishing and transfer of goods was hampered.

Manipulating the situation, an “exchange racket” came into show which exchanged the outlawed currency for legitimate notes, for a 20-75% commission; and a mobile service, named Book my Chotu gained a lot of prominence by allowing people in Indian cities to pay someone to stand in line for them at a bank.

What were its side-effects?
The promulgation of making the 1000 and 500 legal tender obsolete after midnight resulted in many sleepless nights for...
many. The question being, How to survive? And in some cases, Will I survive? From the burning of sacks of old currencies by the roadside, to the fatal death of a hundred, Indian economy had never witnessed such a sight.

In November, ATM queues increased as more than half of the population stood in serpentine lines for hours and spent their blood and sweat to take out a fraction of their legitimate money, and for ATMs to get re-filled.

The Government took quick steps to set up new ATM machines across the nation, but these were configured to only produce notes worth 2000 denomination, which only came into heavy circulation after 16th and was not being accepted at most retail outlets as sellers did not have enough currency notes of lower denomination to provide change for. This is because the Government’s decision to demonetise did not prompt to the increase in supply of 100 rupees notes, so there was not enough currency notes to meet the demand of liquid cash in India. This has been aggravated by the fact that up until December, most people had not seen the new 500 rupee note, which accounted for 17.165 million and was the fulcrum of the Indian currency system. Remonetisation successfully replaced only 60% of the demonetised currency.

In the matter of rationing cash to various Banks, the government showed bias. Many private banks in Tamil Nadu were given more cash as compared to the public sector, whereas the public banks account for 3/4th of all bank branches in Tamil Nadu. By November end, RBI has issued 4,500 Crore to ICICI, 900 Crore to HDFC and 700 Crore to Axis Bank, whereas all the other banks put together received a mere 7,800 Crore. (Sridhar, V., 2016).

The night of demonetisation showed gold rates being lifted, which increased the gold buying rush 3-folds. Price of 10 grams Gold decreased from 31,700 to 29,500 on 9th November. In economics, what affects one, affects all. Hence, the global gold prices also saw a downward trend. But soon after when the government declared the issuance of PAN card over a limited purchase of Gold, gold purchases have been limited and are expected to stay so in the near future as gold has acted as a good hoarder of Black money in the past.

The unorganised sector, which revolves around the fulcrum of cash, faced an 80% loss in revenue generation as fruit & vegetable sellers and local small businesses did not have many customers to attend to. The 263 million Indian farmers were hit hard as they were unable to buy seeds for sowing winter crops. As many as 4 lakh daily wage earners either lost their jobs or put off work temporarily due to lack of payment. Health of bank employees faced a severe toll as they were compelled to work rigorously and overtime to tend to the never ending queues. The transportation industry where 80% transactions are cash based, has seen a halt due to unannounced demonetisation.

The shares of real estate sector which is a hotbed for unannounced demone without the RBIposed tax on inter-bank service transactions, both public and private banks have declared on making it mandatory for users to maintain a certified thousand and charging on over three digital transactions. This would lead to people stalking up cash, empty ATMs and low rate of ATM transactions in the rural areas, as villagers would not opt for paying a transaction cost.

On the upside, the digital sector has seen a boom as innumerable e-wallets have been introduced into the economy and existing companies like Paytm and MobiKwik have gained a huge customer base. But one cannot ignore the fact that India’s digital infrastructure and extent to education will limit the scope of digital payments nationwide. Also, the possibilities of fraud, identity theft and massive loot possible in online transactions through cyber-crime, is something that most advanced countries are even struggling to control.

The new GST will offer easy business processes to corporations by providing them for the first time ever, a one-time taxation resulting in lower prices of goods and rise in prices of services and increase in sales of e-commerce businesses. Due to this, online transaction of commodities will increase multifold.

Utsa Patnaik, (Rajalakshmi, T.K., 2016) an economics professor at Nehru University commented that the demonetisation drive has artificially induced economic recession. It has reduced output by confiscating the working capital of producers and traders and on the other hand it has reduced mass purchasing power. And a decline in consumption rate, which acts as a big variable in the computation of GDP, will lower GDP rate which has already been visible in the last quarter.

Due to the low interest rates, consumers are likely to withdraw cash from banks and invest in the equity share market, as currently there is low liquid cash in the economy and longterm investments would yield more corporate earnings which would help companies sustain the new GST bill. But due to Demonetisation which has made transaction of cash limited in this cash-starved nation, it is difficult to transfer surplus money or black money into huge investments. And if no significant investments are made today, the long run would fail to show good return.

Although, GST will invoke lower cost of automobiles, it would attract more companies to invest its operations in India. It is likely to be seen that consumer demand for the same to decline, as many of these buyers purchase in raw cash which helps them forgo tax, but demonetisation and remonetisation has made such transactions hard. The issuance of 2,000 has been the biggest support to money laundering, as it will take only four 500 SBs to get them, reducing bank notes by 25 Percent.

As cash gets sucked out of the economy, informal economy and remote areas with poor connectivity will get affected the most. Nearly, 68.84 Percent of the population, that is 833.1 million people, lives in the country’s 640,867 villages and there are 47,445 rural and 37,168 branches of semi-urban branches of commercial banks extending banking services to them. In the absence of an assured transaction mechanism, there is a possibility that people belonging to this sector might migrate to alternative arrangements or, worse, a parallel black economy might emerge and use old, banned currency to invest in Bitcoins and other assets.
With maximum transactions being digitised, there would be ease in tracking consumers which would generate huge amounts of data. Banks under NIFTY has seen a positive growth due to demonetisation, and as banks start posing tax on digital transactions more revenue would be generated and value of money would decrease. Say, a 100 rupees note after passing through various cash transactions would entitle for 100 only. But in case of digital transactions, on each transaction the user has to pay a fraction of their money to the banks, which is deteriorating net cash outflows.

Modi’s announcement on 8th November invalidating notes of 500 and 1000 denomination as a three-pronged attack on corruption, black money and the means of counterfeiting, which goes to fund terror activities, stuck a receptive chord among the urban youth, the middle class and even the poor. This has resulted in BJP’s historic victory in Uttar Pradesh in the recent election results, where it emerged as the single largest party with win in over 300 seats; making it easy for BJP to send a person of their choice to succeed Pranab Mukherjee in the upcoming Presidential election in July.

To wind up, 2017 will show growth of digital markets but fall in growth of rural economy as farmers would feel the peril to make investments. Modi government is likely to strive in the 2019 elections, as the public eye is yet oblivious to the fact that this unplanned surgical demonetisation strike will strike the poor harder, and are only seeing the upper cover of the story. Investments would be limited in the short run, but by the end of 2017 as remonetisation flourishes more and the new GST bill comes into play, more FDI can be expected. Prices of retail commodities which had gone down during the early period of demonetisation will increase as agricultural production will turn difficult, as although the new Budget has made provision for 24% increase in food subsidy, the fertiliser subsidy has been retained to last year’s level. And since rural customers would be heavily troubled for bank loans, the trouble to the poor will propel. Jio telecommunication which has created history by acquiring millions of users in the shortest period would fall into the most advantageous position by providing customers the most basic thing that is rapidly becoming the catalyst of running this economy, digital communication. With a significant increase in online transactions, big technology houses can expect sufficient demand within the economy which might be a blessing after Brexit and Trump’s Presidency. But this would mean that rate of manual employment in the nation will go down and the unskilled and semi-skilled sector will find it extremely hard to earn a living.

REFERENCES