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IMPACT—ASSESSMENT OF DEMONETIZATION IN INDIA

Deepa Soni*

Indian Government took a revolutionary step on 8th November 2016 by demonetizing their high denomination currency notes of Rs. 500 and 1000 which constitute about 86% of the total currency in circulation with the objective to curb the corruption and black money, improve digitization, to counterfeit the fake currency and counter terrorist activities. There was a mixed review of various academicians and policy makers and economists regarding its implications on Indian economy. Present paper is an attempt to evaluate the spill over benefits and impact of November 2016 demonetization on Indian economy. Analysis of the data shows that demonetization lead to deterioration in the growth of national income. Prices (especially capital Goods) and employment fell down significantly leading to deflationary situation in an economy. There has been some widening in the country's tax base, an increase in digital payments and a drop in fake notes but the hike in price of various sources of blackmoney like Gold, Residential property and foreign outflow suggest that people were successful (especially Blackmoney holders) in converting their black money into these sources, resulting in failure in weeding out black money in India. The cost of demonetization outweigh its benefits.

INTRODUCTION

demonetization is an act of stripping currency note from its legal status i.e. particular currency note (which is demonetized) will no longer remain a legal tender. It is not a new phenomenon; India faced demonetization three times since independence. First time the demonetization was taken place in 1946 when the Indian Govt declared the note of 500, 1000 and 10,000 notes as out of circulation. Second time, the demonetization of currency in 1978 and the third time demonetization took place on 8th November, 2016.

OBJECTIVES OF THE STUDY

- To analyse the impact of demonetization on various macro economic variables of India.
- To analyse the impact of Demonetization in curbing black money
- To assess the impact of Demonetization on tax revenue in India.
- To analyse the impact of Demonetization on Digitalisation in India.
- To draw conclusion and give suggestions based on the overall study.

Impact of Demonetization on Various Macro-Variables

Looking towards the trend of Gross Value Added (at 2011 prices) it can be observed that growth in GDP was declining at the earlier pace before demonetization and it continues to persist and even declining after the demonetization resulting in a recessionary trend (Table 1).

* Assistant professor, Deptt. Of Economics, Mohanlal Sukhadia University Udaipur (Rajasthan).

Table 1: Real GDP Growth Rate (base year 2011–12)

Financial Year	Quarter	Quarterly	Yearly
2015–16	Q1 (April–June)	7%	8%
	Q2 (July–September)	7.40%	
	Q3 (October–December)	7.20%	
	Q4 (January–March)	9.10%	
2016–17	Q1 (April–June)	7.90%	7.10%
	Q2 (July–September)	7.50%	
	Q3 (October–December)	7%	
	Q4 (January–March)	6.10%	
2017–18	Q1 (April–June)	5.70%	6.50%
	Q2 (July–September)	6.30%	
	Q3 (October–December)	7.20%	
	Q4 (January–March)	7.60%	
2018–19	Q1 (April–June)	7.70%	
	Q2 (July–September)	8.20%	

Source: RBI

Although the other components of GDP were significantly affected by the demonetization especially investment which shaved down to 2 per cent in 2016–17 as compared to about 7 per cent in 2015–16. Private final consumption expenditure and Net saving also slowed down which reflects deficiency of demand. There was a loss of jobs and decline in wages due to demonetization, particularly in the unorganized and informal sectors. Migrant workers were adversely affected by demonetization.

Data of various price indices shows a mixed picture. Consumer Price Index (CPI) and wholesale price index (WPI) show an inflationary trend for consumer and primary food while the Industrial Price Index (IIP) shows decline in the prices especially, capital goods.

In order to ascertain whether structural break arise due to demonetization on economic growth we apply the A simple regression with time as an independent variable on GDP and Prices using the quarterly data series. Further to evaluate the impact of demonetization, data was split into two sub-groups. One is pre-Demo. Period (2014 to November 2016) and second is post-demonetization (from 2016 to 2018).

Table 2: Coefficient of Time

Variables	Pre-demonetization	Post-demonetization	Difference
GDP	0.29	-0.26	0.55
CPI	-1.7	0.11	1.8
WPI	0.77	1.4	0.7
IIP	2.4	-0.55	-2.95

Source: Own calculation

Result suggests that demonetization lead to decline in the GDP growth by about 55 percentage per quarter (2.20 per cent annually).

Table 3: Correlation Coefficient

	GVA		CPI		M3		Credit		Interest		Reer	
	pre-Demo	post-Demo	pre-Demo	post-Demo	pre-Demo	post-Demo	pre-Demo	post-Demo	pre-Demo	post-Demo	pre-Demo	post-Demo
GVA	1	1	-0.116	-0.553	-0.336	-0.645	-0.082	-0.114	0.13	0.066	-0.008	0.75
CPI	-0.12	-0.553	1	1	0.215	0.772	0.161	0.353	-0.34	-0.538	0.022	-0.1
M3	-0.34	-0.645	0.215	0.772	1	1	0.105	0.777	-0.22	-0.34	-0.189	-0.51
Credit	-0.082	-0.12	0.161	0.353	0.1049	0.777	1	1	-0.02	-0.27	-0.262	-0.22
Interest	-0.133	-0.066	0.342	0.538	-0.222	-0.337	-0.024	-0.27	1	1	-0.467	-0.07
Reer	-0.01	0.7473	0.022	-0.118	-0.189	-0.506	-0.262	-0.215	-0.46	-0.073	1	1

A strong degree of correlation during the post demonetization between GVA, Money supply and prices as compared to the pre demonetization period. As supply of money decreases, price also goes down while interest rate and REER goes up as a result GVA decline during the post demonetization period.

The supply of money decreases after the post demonetization, it leads to deflationary situation in the economy. Interest rate goes up (as it shows the negative relation with price). However the weak association between interest and REER and Price and REER shows that demonetization does not have much impact on foreign trade.

Impact of Demonetization on Black Money

Black Money is also called parallel or unaccounted money. It adversely affects the economy. Various committees constituted to estimate the black money in India suggest that 20–30% of total national income in India is black money. To curb the black money is one of the major goal of Modi's voting manifesto which was practically implemented by taking the bold step of demonetization. In order to ascertain the impact of demonetization on black money various sources of black money like gold, residential property, foreign outflow are analysed.

Table 4: Growth of Gold Rate

Year	(per 10 gram)			
	April	July	October	January
2015–16	1.94	-4.24	1.25	3.08
2016–17	0.08	3.94	-3.61	3.51
2017–18	0.87	-2.29	-1.32	3.72
2018–19	1.84	-2	3.06	3.08
2019–20	-1.18	4.14	NA	NA

Source: RBI

Table 5: Residential Property Price Index Growth Rate

Year	April	July	October	January
2016–17	—	1.58	2.37	4.43
2017–18	6.65	6.36	4.34	2.53
2018–19	2.02	0.51	1.76	2.47
2019–20	1.09	—	—	—

Source: RBI

Table 6: Growth the Net FDI Outflow

Years	FDI net Outflow (% of GDP)	Years	FDI net Outflow (% of GDP)
2013-14	0.573	2016-17	0.418
2014-15	0.357	2017-18	0.419
2015-16	0.22		

Source: RBI

It is evident from the above analysis that there was a spike in the prices of both Gold and residential property index which implies that people are ready to convert their money by purchasing Gold and Property even at high prices. Sales of gold increased post-demonetization, with an increase of 20 to 30% premium surging the price as much as Rs. 45,000 from the ruling price of Rs. 31,900 per 10 grams in Gujarat and Delhi. Further increase in the foreign outflow of Indian currency also show that people stashed out their money to abroad (increase in REER). According to data from income tax probes, black money holders kept only 6% or less of their wealth as cash, suggesting that targeting this cash would not be a successful strategy. The government estimated that approximately 20% of the demonetized banknotes would be permanently removed from circulation. However, according to the RBI report 2018 approximately 99.3% of the demonetized banknotes i.e. Rs. 15.30 lakh crore out of the Rs. 15.41 lakh crore had been demonetized and being deposited with the banking system. Hence, the banknotes that were not deposited were only worth Rs. 10,720 crore.

Impact of Demonetization on Taxation

The impact of demonetization has been felt on collection of taxation. As filing of the return by assessee is done for the previous year. Thus in order to capture the impact of the demonetization financial year 2018 is to be taken into consideration. According to the CBDT data number of income tax fillers during the financial year 2018 was 7.41 crore as compared to the income tax personal income tax. Its collections are high in Financial Year 2018-19 (till 31-10-2018) compared to the previous year by 20.2 per cent.

An effective measure to gauge the impact of demonetization is the tax compliance buoyancy. Tax buoyancy for each year is measured by dividing growth in tax collection by the nominal GDP. Data from CBDT shows that tax buoyancy picked up in the post demonetization specially personal tax which spark to more than double to 1.84 in 2017-18 as compared to 0.95 in 2015-16. Total direct tax buoyancy hiked to 1.81 in 2017-18 from 0.80 in 2015-16.

Table 7: Direct Taxation

Financial Year	Number of Tax Payer (in crore)	Direct Tax GDP Ratio	Corporate Tax	Personal Tax	GDP Growth Rate	Corporate Buoyancy	Personal Buoyancy	Total Buoyancy Factor
2013-14	52,793,542	5.62	—	—	12.28	—	—	1.16%
2014-15	57,158,811	5.55	8.32	9.00	10.45	0.80	0.861	0.86%
2015-16	61,523,699	5.47	5.51	7.90	8.25	0.67	0.95	0.80%
2016-17	69,273,834	5.57	6.75	19	12.43	0.54	1.56	1.17%
2017-18	74,127,250	5.98	16.37	18.37	9.96	1.64	1.84	1.81%

Source: CBDT

However, data show a substantial increase in the tax collection but its whole credit cannot go to the demonetization rather the government schemes like Income disclosure scheme 2016, Benami property act, also have significant positive impact on revenue collections. If adjusted for it, then increase in the direct tax would not be extraordinary.

Impact of Demonetization on Digitization

Cashless is a word which literally means having no cash but in today's world, it refers to using digital form of payments instead of cash, for payment of various expenses or transactions done by an individual. Cashless Economy can be defined as a situation in which the flow of cash within an economy is non-existent and all transactions must be through electronic channels such as credit cards, debit cards, electronic clearing, and payment systems such as Immediate Payment Service (IPS), National Electronic Funds Transfer (NEFT) and Real Time Gross Settlement (RTGS) in India. The effect of demonetization was twofold – a large number of Indians are forced go cashless, whether by debit card or via e-wallet, or by PayTM or Mobikwik. Secondly, the convenience of e-wallet transactions via mobile phones made the customers and merchants educate themselves, out of necessity about how the system worked. Cashless transaction is a secured and convenient way of making payments. Cashless transactions are the gateway to technological advancement in the field of world economy.

Digital payments to GDP ratio in India has been traditionally low but after demonetization it has taken long strides in terms of introduction and promotion of various instruments of cashless payments which have resulted in a significant increase in digital payments transactions. There is a concomitantly increased in per person digital payments, both in terms of value and volume. The share of card payments in terms of volume has been declining while in terms of value, payments through Real Time Gross Settlement (RTGS) and Clearing Corporation of India Ltd. (CCIL) dominate.

CONCLUSION AND SUGGESSTIONS

Indian Government took a revolutionary step on 8th November 2016 by demonetize their high denomination currency note of Rs. 500 and 1000 which constitutes about 86% of the total currency in circulation with the objective to curb the corruption and black money, improve digitalization, to counterfeit the fake currency and fund for terrorist activities. There was a mix review of various academicians and policy makers and economists regarding its implications on Indian economy. It was found that demonetization lead to deterioration in the growth of national income (0.55 per quarter) and other components of GDP. Price of capital Goods goes down significantly. It also create deflationary situation indicating the government hasn't been able to put a lid on corruption and generation of black money.

Suggesstions

Before implementing such step its pros and cons should have been taken into consideration. Alongwith it, its short term and long term impact should have been taken into consideration.

Government should adopt Monetary and Fiscal measures to raise the effective demand to curb the deflationary situation in an economy.

Another way to raise the effective demand is to undertake the export promotion measures and to adopt barter system in case of imported goods.

In order to plurge out black money attack should be on the major sources of black money like Gold, Property etc. by implementing strict rules and regulations.

Demonetization is an act not a policy which could easily be implemented. It affects whole sections of the society so these type of steps require long pre-planning about its short term and long term consequences on economy. Demonetization could only attack on cash while the sources

of black money like gold, property etc. remain unaffected from it, so its main aim to weed out black money from economy was not successful. The cost of demonetization has outweighed its benefits.

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