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Demonetization and its Impact on Indian Economy

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Abstract: ***This paper discuss about the step of demonetization taken by the central government on 8 November, 2016 and its impact on economy with reference to the digitalization tax and black money. The paper is based on secondary data collected from newspapers and various online sources, mentioned in references.***

Key words: Demonetization, Effect of demonetization

I. INTRODUCTION

Money is a life blood of any economy with the growth of civilization and mankind wants of human being increased to fulfil that want barter system came into existence but over a period of time invention of money become a strong pillar of an economy .Money exchange facilitates ease of business transaction facilitates taxation and national integration but there is other side of the coin also with the use of money some issues like parallel economy counterfeit currency and corruption also cropped up to curb these issues demonetization can be an effective tool.

Demonetization is act of stripping its currency units of its status of legal tender. It is an act where old unit of currency get replaced by the new unit of currency.

II. EMERGENCE OF PAPER CURRENCY IN INDIA

Until 18th century people of India use gold and silver coins to carry out their day to day business transactions but then some European companies established their own banks to carry out their business transactions in India like Bank of Hindustan in Kolkata they were the first to introduce paper notes. However it was only after the paper currency act of 1861 , the British colonial government actually got involved in producing paper notes establishing paper currency as we know it today .money now to be issued by state alone not banks.

Demonetization in India before 2016

The act of Demonetization is not new for India it had happened twice before in the year 1946 and then in the year 1978 .In January 1948 Rs 10000 ,1000 bank notes were withdrawn but same Rs 1000 ,5000,10000 were reintroduced in the year 1954 and again demonetized in the year 1978.

The second demonetization took place in the year 1978 by Janta party government, it had decided to withdraw Rs 1000,rs 5000 and Rs 10000 notes by issuing an ordinance on the morning of 16 January, 1978 .The main objectives behind the demonetization policy is reduction in black money ,corruption ,etc

Demonetization –November 2016

On 8th November 2016 Prime Minister Narendra modi announced demonetization of 500 and 1000 rupees notes with effect from mid night making these notes invalid major reasons behind this are

- ✓ Digitalisation/cashless economy
- ✓ To check Tax evasion
- ✓ To check black money

Analysis of the Objectives

III. EFFECT OF DEMONITIZATION ON CASHLESS ECONOMY

Digitalization of economy

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Digitization of transactions or cash less economy is a system where transactions takes place not in the form of cash but through transfer of digital information among the transacting parties (usually using electronic representation for cash)like debit cards credit cards UPI NEFT

Digitization of transactions or cash less economy is one of the stated goals of demonetization According to NITI AYOG interim report digitization of transactions is the need of the hour.

Initially post demonetisation period digital transaction volumes increases by 42% i.e.672 million in 2016 to 958 million in 2016 but then shows a gradual decline of 20% It amounts to 763 million in the month of February 2017 making it difficult for the government to achieve its target of 25 billion digital transaction in the year 2017-18 A description of select categories of electronic payments system is presented in the table.

Table : Growth in Select Electronic Modes of Payments
(y-o-y growth in per cent)

Category		Oct-2016	Nov-2016	Dec-2016	Jan-2017	Feb-2017
NEFT	Volume	16.2	23.3	39.0	38.0	34.5
	Value	37.6	38.3	40.8	60.2	49.5
CTS	Volume	-1.1	23.0	58.4	52.7	20.2
	Value	2.9	8.6	13.0	19.3	0.8
IMPS	Volume	116.7	89.6	157.2	177.7	150.4
	Value	150.7	135.9	186.6	196.7	184.2
NACH	Volume	53.0	30.8	58.3	19.8	-0.9
	Value	89.8	76.3	116.7	22.8	54.2

Source: RBI Bulletins and Press Releases on Electronic Payment Systems - Representative Data

The latest pick-up in digital payment activity is better reflected in the sequential growth in the months following demonetisation. The pattern of digital transactions in February 2017 over November 2016 shows that the growth rates surged in both value and volume terms compared with the corresponding period of last year for most electronic modes of payment, even as there was some decline in the use of digital payments after December 2016.

GROWTH PATTERN OF VARIOUS DIGITAL transaction mode

Table : Recent Growth in Digital Modes of Payments

Category	(Volume in million, Value in □ billion)					Change (%)	
		Nov-16	Dec-16	Jan-17	Feb-17	Feb-17 over Nov-16	Feb-16 over Nov-15
NEFT	Volume	123	166	164	148	20.4	10.4
	Value	8808	11538	11355	10878	23.5	14.3
	Average ticket size (□)	71583	69376	69159	73397	2.5	3.5
CTS	Volume	87	130	118	100	15.3	18.0
	Value	5419	6812	6618	5994	10.6	19.2
	Average ticket size (□)	62236	52395	55873	59677	-4.1	1.1
IMPS	Volume	36	53	62	60	65.2	25.1
	Value	325	432	491	482	48.5	23.2
	Average ticket size (□)	8982	8183	7870	8071	-10.1	-1.4
UPI	Volume	0.3	2.0	4.2	4.2	1346.1	-
	Value	0.9	7.0	16.6	19.0	2001.2	-
	Average ticket size (□)	3150	3565	3995	4577	45.3	-
USSD	Volume	0.007	0.102	0.314	0.225	3091.9	-
	Value	0.007	0.104	0.382	0.357	4789.4	-
	Average ticket size (□)	1037	1015	1215	1589	53.2	-
Debit and Credit Cards at	Volume	206	311	266	212	3.3	3.9

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POS &	Value	352	522	481	391	11.1	-5.6
	Average ticket size (□)	1714	1679	1812	1844	7.5	-9.2
PPI #	Volume	59	88	87	78	32.8	4.3
	Value	13	21	21	19	41.9	15.2
	Average ticket size (□)	224	242	241	239	6.8	10.4

source:Card transactions of four banks.
-: Comparative data not available
#: Post Paid Instruments issued by 8 non-bank issuers for goods and services transactions only.
Source: For FY16, full data from DBIE, RBI; For FY17, RBI Daily Press Releases on Electronic Payment Systems - Representative Data.

UPI: There is sharp increase in the upi transaction level a flagship product of npci though on a low base .THE number of transaction had been increased from 0.3 million in November to 2 million in December and further to 4.2 million in January and February .the value of transaction have increased more than 20 times that is from 0.9 million in November 2017 to 20 million in February 2017

Impressive level of growth can be seen *99#services which work on USSD though the growth rate was moderate in the month of February but the average ticket size continued to grow

PPIs has also shown a great level of pickup in transaction value that increases from 13 million to 19 million, an increase of 42% over the three months however the growth rate had slightly declined in the month of January and February due to Demonetization

Use of debit card and credit card also showed a great pick up in month of November and December but gradually the growth rate slowed down in the month of January and February due to demonetization.

IV. IMPACT ON TAX

Increase in Tax Revenue

Tax revenue collection is substantially high this fiscal year 2016 -17 both the direct and indirect taxes showed an increasing trend Direct tax doesn't tell us all that much about the effects of demonetisation. But indirect collections do. If there had been some awful collapse in the economy between November and now then that would be reflected in a similar collapse of indirect tax receipts over the same time period. That tax revenues have grown shows that we didn't have such an economic collapse. Finance minister Arun JAitley in his budget speech had quoted that India is predominantly a Tax non compliant society and pre dominance of cash in the economy is the major reason which help people to evade tax He further added in his speech that after demonetisation, the preliminary analysis of data collected in respect of deposits made by people in old currency open a revealing picture. "During the period 8 November to 30 December 2016, deposits between Rs2 lakh and Rs80 lakh were made in about 10.9 million accounts with an average deposit size of Rs5.03 lakh. Deposits of more than Rs80 lakh were made in 1.48 lakh accounts with average deposit size of Rs3.31 crore. This data mining will help us immensely in expanding the tax net as well as increasing the revenues, which was one of the Aim of demonetisation,"

According to the Finance secretary (revenue) Hasmukh Addhia Net Indirect Tax grew at the rate of 16.9% compared to corresponding month last year with growth rate in net collections for Customs, Central Excise and Service Tax at the rate of 10.1%, 26.3% and 9.4% respectively January, 2017. The Net Direct Tax collections up to January, 2017 are at Rs. 5.82 lakh crore which is 10.79% more than the net collections for the corresponding period last year.

According to the article in Hindustan times

The government has registered the tax collection estimates for 2016-17 fiscal at Rs 17.10 lakh crore. which has exceeded the tax collection estimates of the fiscal year 2015-16

Total net tax revenue grows at 18% which is highest in the 6 years

While direct showed a growth rate of 14.2 percent during the April-March at Rs 8.47 lakh crore, indirect tax kitty increased by 22 per cent over last year to Rs 8.63 lakh crore.

In terms of gross revenue collections, the growth rate in corporate tax was 13.1 per cent while that of personal income tax was 18.4 per cent.

However, after adjusting for refunds, the net growth in corporate tax collections is 6.7 per cent while that of personal I-T collections is 21 per cent.

Refunds amounting to Rs 1.62 lakh crore have been issued during April 2016-March 2017, which is 32.6 per cent higher than the refunds issued during FY 2015-16, the statement added.

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As regard indirect taxes, Central Excise collections increases from 33.9 per cent to Rs 3.83 lakh crore during 2016-17.

Service tax increases 20.2 per cent to Rs 2.54 lakh crore, while customs collections grew 7.4 per cent to Rs 2.26 lakh crore.

Impact of demonetization on black money

The main mission of demonetization is fighting black money .India's economy holds a big parallel economy where unreported income is the norm. According to the World Bank had estimated the size of the black economy to be 23.2% of the GDP in 2007. "Assuming that this proportion has now gone up to 25%, the size of the black economy for FY16 works out to be Rs 33.9 trillion (Rs 33.9 lakh crore) (GDP for FY16 was Rs 135.76 trillion (Rs 135.76 lakh crore)," according to india rating

There are two types of effect of demonetization on black money

Direct Effect: Immediate effect of demonetization come from netting of black money in form of 500 and 1000 rupees notes During the two months of demonetization From November to January government has unearthened uncounted cash worth rupees 513 crore .Of these 110 crore was in form of new currency According to the revenue secretary Hasmukh Adhia "The direct tax collection has jumped from 6% in 2015-2016 to 15% in the year 2016 -2017entirely on account of our action against black money," It was found that this year led to the seizure of rs 1005 crore in cash and 359 crore in jewellery To crack down the black money prevalent in the system government has increased the tax raids ,according to the data provided by Hindustan times there is 132% increase in tax raids and 31% increase in black money unearthened over the last year Black money amounted to 14,697 crore has been unearthed in the April to February period of 2016-17 against Rs 11,226 crore during the entire financial year of 2015-16. While in 2015-16, the tax department raided 447 entities, the number went up to 1037 entities in the April to February period of this financial year. Black money amounted to Rs 5,400 crore was detected during tax raids between November 9, 2016 to January 10, 2017. The complete success of demonetization 2016 in unearthing black money will depend firstly on Benami Act and Pradhan Mantri Gram Kalyan Yojna (PMGKY) receiving large amount of disclosure If PMGKY does not yield declaration running into trillions of rupees yet another option can be explored that is income tax authorities identifying holders of black money who did not take the advantage of PGMKY

Long Term effect:

In long term the success of demonetization policy in controlling black money will depend on how government deploys more measures to depress the shadow or black economy

V. CONCLUSION

Demonetization is a great step taken by Indian government to curb black money and corruption, cashless economy is also one of the agenda of demonetization. It is a very bold step which has helped government to achieve the above mentioned objectives to certain extent .Collection of both direct and indirect tax has shown an increasing trend in the current fiscal year .Government has also succeeded in curbing black money to certain extent, deposits in banks has been increased which has made the country financially strong .Government also succeeded in pushing the economy towards digitalization

Although People had to undergo lots of hardship due to demonetization drive like long queues outside banks and ATMs, business suffers due to lack of liquidity .Both the business owners and consumers suffers. When the government launch demonetization drive it was unable to predict such hardships but it has given several remedies from time to time to the people so that they can face those hardships but this bold step of government has succeeded in making some positive impact in the Indian economy but to see its full impact we have to wait for certain time .Future success of demonetization will depend upon its proper implementation.

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