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Demonetisation of Legal Tender Money in India: Boon or Bane to the Parallel Economy; A Hypothetical Inquiry

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ABSTRACT

Parallel economy has witnessed an antagonistic change with the declaration of demonetization of legal tender currency on 8th November 2016. This is an effort to tackle the issues of corruption, black money and counterfeit currency and thereby restricting the survival of parallel economy. The 500 and 1000 rupee notes in India is no longer legal tender as it has been scrapped out by the Indian Government. Henceforth the existing currency has been substituted with new 2000 and 500 rupee legal tender currency. Consequently, it has an impact on the economy as it affects the demand and supply of all goods and services produced in a country. The research paper brings forward the pros and cons of demonetization on the general public, especially on parallel economy.

Keywords: Demonetization, Parallel Economy, Counterfeit Currency, Legal Tender Money.

1. INTRODUCTION

Demonetization is a process through which a particular denomination of currency ceases to be legal tender. The Government of India has taken a decision to take out all 500 and 1000 currency notes in circulation and reinstate it with new 500 and 2000 currencies. In an immediate effect, this has created a shortage of currency. Parallel economy is an economy ruled by black money and fake currency which creates a big threat to the Indian economy. The parallel economy needs to be curbed out of the nation, as it reduces the revenue in the form of tax and also it is an atrocity to the economy.

Objectives of the Study

This research paper focuses on the following concepts:

- To review the impact of Demonetisation on parallel economy in India

- To study factors influenced the Government to impose such a regulation in India
- To study the pitfalls in the implementation of Demonetisation in India

Scope of the Study

Indian economy has been damaged by the existence of grey market and informal market forces. The imposition of Demonetisation in India has brought forward quite a few ups and downs in the economy as a whole and in particular the informal economy. It has proved to be beneficial to the economy in the long run even though the general public had to go through numerous hassles in the short run. The study analyses the impact of Demonetisation on parallel economy in India.

Research Design

This study is thoroughly descriptive in nature and the research paper analyses the effect of Demonetisation on parallel economy by studying the economic variables such as GDP, Growth Rate, Bank rates and interest rates, Information technology usage, Demand and supply etc. For this purpose, several literature reviews has been conducted and studied in detail.

Data Collection

Data was collected from secondary sources such as, credit rating agencies' reports, analysis conducted by financial institutions, newspaper reports, etc.

2. LITERATURE REVIEW

Parallel Economy

Parallel economy may be implied as an economy based on black money or unaccounted money. Black money is the money earned from activities which are not reported to concerned authorities, thereby government does not have any control over such system and as these black money hoarders are not paying taxes on such unauthorized income, it is a huge loss to the Government revenue, which otherwise can be a great boon to the economy.

Demonetisation

On 8th November 2016, Narendra Modi government declared cancellation of the 500 and 1000 rupee currency notes and introduction of new 500 and 2000 rupee notes. After this date the old 500 and 1000 rupee notes became invalid and is no longer legal tender. This method used by the government may be called as "Scrapping out" the currency from the economy as new currency will be replacing the existing ones. This process was employed the Government to boost the formal economy of a nation.

The main **objectives** of Demonetisation are as follows:

- To fight against inflation

As one of the major issues faced by India today is Inflation, Demonetisation would be an appropriate answer to the same. Inflation reduces the purchasing power of currency of a nation.

By reducing the circulation of currency, this issue of inflation can be controlled to a great extent. This has been used by several other Governments in India and abroad in the past to fight against inflation.

- To suppress the parallel economy

Parallel economy can be subdued by introducing new currency in the market, by virtue of which the old currency hoarders may find it difficult to account all the money hoarded by them.

- To encourage DIGITAL INDIA mission, which encourages a cashless economy

Digital India Mission is a movement launched under Narendra Modi Government on 1st July 2015, where all the rural areas will be connected to a digital network thereby increasing the usage of internet all over the country. This will not only enable the country to be a cashless economy but also boost up the IT sector in the country.

- Increase in International trade

Withdrawal of money from the black market as a result of Demonetisation, will certainly improve the export-import of India at least in the long run.

3. CONTRIBUTORIES

- According to Mr.Suraj B. Gupta, the annual growth rate of India is considerably less than the growth rate of black money market in India.
- As per the study conducted by, Global Financial Integrity Study in 2009, it was publicized that investment in FDI by Indian investors is about INR 70 lakh crore, despite the fact that India's National Income is estimated to be INR 50 lakh crore.
- Swiss Central Bank reported a documentary evidence for Indians depositing in various Swiss Banks around a sum of \$2.5 billion. Indian black hoarders close down their existing bank accounts in home country and deposit the same in profitable havens abroad, thus making it difficult for the concerned authorities to trace out relevant information further.

4. ANALYSIS AND INTERPRETATION

Corollary of Demonetization on Parallel Economy

The introduction of the new financial policy has an important effect on the black money hoarders.

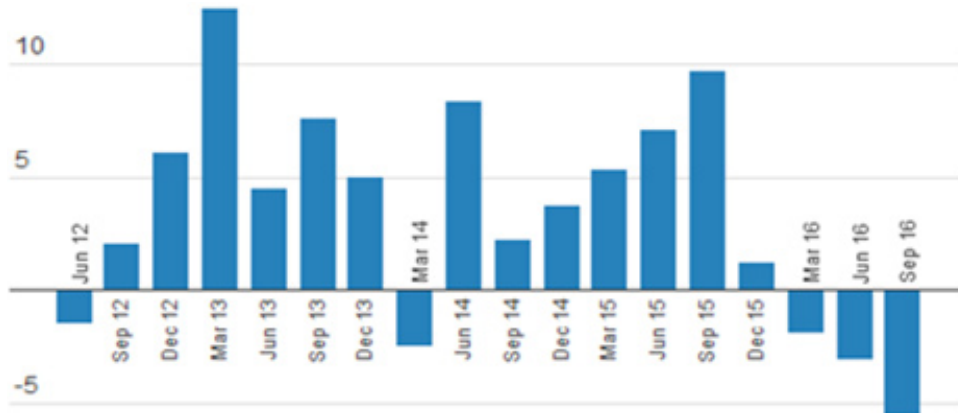
- (a) It takes away the unaccounted money from the economy as the hoarders of such money are not able to deposit such currencies in the banks.
- (b) Pretentious consumption of goods and services.
- (c) Worsened distribution of national income thereby undermining the existence of the society.
- (d) Erosion of the culture and values of the society.
- (e) Investments in anti-social activities such as terrorism, espionage, smuggling etc was also clogged with demonetization.

- (f) Demonetization will lead to deterrence of counterfeit currencies in the economy to a great extent.
- (g) The main area dominated by the parallel economy, Real estate sector, is also undesirably affected by the new fiscal strategy, thereby reducing the exorbitant and overvalued prices of land and such other properties. Hence, in the long run it will benefit the middle class society.
- (h) With the advent of new fiscal policy, all the monetary transactions of black money dealers will be accounted, which leads to an escalation in total revenue of the Government.

India before Demonetisation 2017

The main target of Demonetisation in 2017 was to curtail corruption and the accretion of black money. Even after being the fastest growing economies in the world on the basis of GDP rates, India was facing several issues hounding the economy as well as the people. Some of the issues were:

- Destitute investment demand in the nation
- As per the latest CSO reports, the GFCF was estimated as -0.2%, which is the least rate in the last five years; depicting that only a poor percentage of the GDP is being contributed towards fixed capital investment of the country rather than for consumption purpose.
- Leaving out Government consumption from the total GDP, contribution of GDP towards other sectors are very less, showing that private sector is still not on the same page with government sector.
- Manufacturing sector in India was also lagging behind the growth rate when in comparison with developments in other allied sectors.



Figures 1: Indicate percentage change in Gross Fixed Capital Formation
Source: CMIE Economic Outlook

India after Demonetisation 2017

The short term handicap of Demonetisation will be flabbergasted by the benefits gained in the long-term Demonetisation policy along with the two acclaimed policies of, Goods and Service Tax (GST) and Digital India will take India to a higher altitude. The measures of Demonetisation includes:

1. Remonetisation of fresh notes into the economy.
2. Tax reforms helping the low and middle class society.
3. Bringing land and real estate sectors to the purview of GST.
4. Reducing tax rates and stamp duties on several sectors.
5. Over-zealous tax administration will be lightened.

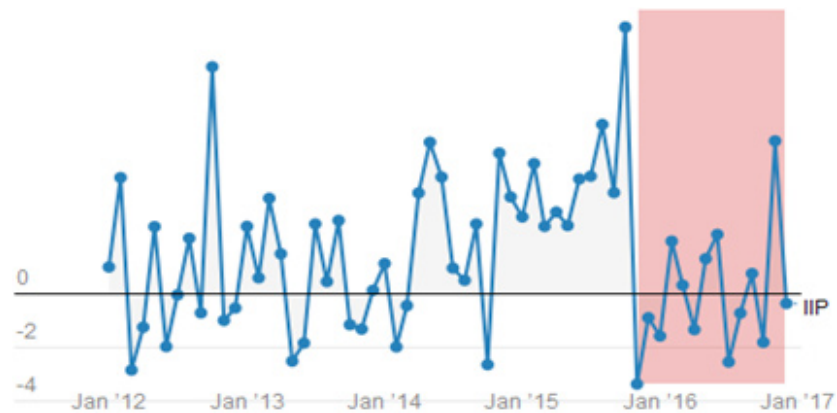


Figure 2: Depicting a percentage change in Industrial growth in India (Index of Industrial Production) post Demonetisation
Source: CMIE Economic Outlook

5. CONCLUSION

As per IMF reports, Indian economy is expected to show a steep rise in growth rate of GDP to about 7.2% in FY 2018 followed by a still higher percentage in FY 2019, thus removing all the holdups faced by the country and the people after Demonetisation. A report by Bank of America Merrill Lynch (BAML) states that, GDP is estimated to increase by 25-30 percentage, as an impact of Demonetisation on India's flourishing Shadow economy. With the introduction of GST under Narendra Modi Government, the black economy may show a considerable reduction in the consumption pattern as an instantaneous effect. The impact of Demonetisation in India can be summarized as follows:

- Future Indian economy will witness a change in the status of the parallel economy, where the black money hoarders will be thrown out of the economy there by enhancing the formal economy of the nation.
- Growth in private sector is hindered by the existence of parallel economy. With Demonetisation along with Digital India Campaign, all the monetary transactions are transparent and monitored by Govt. of India thus creating trust among the foreign investors; hence pooling foreign investments to India.
- A huge portion of the currency was held back as black money till Demonetisation; which was circulated in the economy after Demonetisation.
- Introduction of Digital Money concept, thus introducing a cashless economy.
- Reduction of fake notes

- Terrorism is an important issue faced by India these days. Demonetisation helps in controlling the flow of fake and unaccounted currency to India to promote terrorism.
- Increased tax revenue in the economy, as the money hoarders will deposit their unaccounted money in banks after Demonetisation.

DELHI TOPS RECOVERIES OF FAKE INDIAN CURRENCY NOTES

States	2013-14		2014-15		2015-16	
	No. of notes*	Face value**	No. of notes	Face value	No. of notes	Face value
Delhi	2,15,092	10,35,86,240	1,83,405	9,09,80,880	1,90,686	9,31,13,960
Maharashtra	1,04,621	6,07,17,475	96,431	5,98,43,020	38,622	1,44,73,530
Uttar Pradesh	70,221	2,88,10,310	77,814	3,01,23,140	86,298	3,28,60,790
Gujarat	49,480	2,90,02,540	55,084	3,21,66,390	48,972	3,01,80,920
Andhra Pradesh	75,944	3,57,42,390	53,699	2,38,69,040	37,954	1,90,73,530
Tamil Nadu	58,800	3,78,15,110	49,614	3,08,40,350	41,661	2,19,50,450

Figure 3: Showing the statistics of recovery of fake Indian currency notes
Source: As per the recent statistical reports presented in the parliamentary meeting

In the long run the change undergone in the financial structure of the country may be well accepted among the people and the economy and this will uphold the value of such a change to the economy as a whole, notwithstanding the initial glitches in this system.

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