

Demonetization: Impact on Rural India

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ABSTRACT

Demonetization is a tool of Government to eliminate the currency. It is used in very adverse situations. There are multiple reasons why nations demonetize their local units of currency. Some reasons include to brush-off inflation, to brushoff corruption, and to dispirit a cash system. The process of demonetization involves either introducing new notes of the same currency or completely replacing the old currency with new currency. Indian government adopted demonetization on 08 November 2016 to tackle with black money and make India a cashless digital economy. As per the yearly report of Reserve Bank of India of 31 March 2016 that total currency notes in circulation is 16.42 lac crore of old Rs. 500 and Rs.1000 banknotes. As per the report of RBI dated on 14-12-2016, the total amount of old notes of value of Rs. 12.44 lac crore has been deposited by the customers till 10-12-2016. Banks started accepting deposits from 10 November but within a period of 15 days approximately half money has been received by the banks.

Key words- Demonetization, Cashless Transactions, Cash Crunch, Digital Economy.

I. INTRODUCTION

The „demon“ in demonetization is in the beginning. Any Government withdraws the legal tender rights of any denomination of currency, it is known as demonetization. On November 8, Indian Prime Minister Mr. Narandar Modi announced in a broadcast to the nation that Rs. 500 and Rs. 1000 currency notes would no longer be recognized legally as currency. The total currency in circulation in India was Rs. 16.42 lac crore (US\$240 billion) of Rs. 1000 and Rs. 500 notes. The government believe that this demonetization is required for the four main reasons first reason is for stopping the funding of terrorism, second reason for facing the problem of fake Currency, Third reason for making the black money worthless and fourth reason for reducing the corruption, etc. The need for the government to keep the move a secret because the tax evaders would not be aware before the announcement of demonetization took place. For Modi, this is work in progress. In his speech to the nation, he highlights what his government has done so far. Narandar Modi has prompted it will take 50 days for people to adjust to the change. This announcement appears to be the most important change made by the Narandar Modi's government to date, says Girish Vanvari, partner and head KPMG in India. A decision like this can result in the sweeping up of a system for which many trust that it could not be done, as earlier attempts did not have rich impact. However, the decision by Prime Minister Mr. Narandar Modi is one the most historical steps in India. A decision like this can help control inflation, recapitalise banks, minimizing the interest rates and making the economy vibrant, with capital inflows. India is the second most populated country in the world with nearly a fifth of the world's population. Out of the total 121 crore Indians of Indian population, 83.3 crore of population live in rural areas while 37.7 crore stay in urban areas, said the Census of India 2011. As a rural populated country most of the rural population are engaged in agricultural activities as most of the population of rural areas depends on agriculture. Agriculture forms the backbone of the country's economy. The agricultural sector like forestry, logging and fishing accounted for 17% of the GDP contributes most to the overall economic development of India. it is the largest employment source and a important piece of the overall socioeconomic development of India The states of Uttar Pradesh, Punjab, Haryana, Madhya Pradesh, Andhra Pradesh, Telangana, Bihar, West Bengal, Gujarat and Maharashtra are key contributors to Indian agriculture.

II. OBJECTIVES

1. To study the impact of demonetization on agricultural sector and farmers of rural India.
2. To study the impact of demonetization on economy of India.

III. REVIEW OF LIETRATURE

Ansari (1982) examined the impact of real per capita GDP, the size of overseas trade and density of population on the tax revenue by making an inter country comparison. Data was collected for the period 1972 to1976 from IMF publications, earlier studies and World Bank publications relating to 79 62 countries. The author employed regression analysis on the basis of two equations. In the first equation real per capita GDP and size of trade were taken as independent variables and tax revenue as dependent variable. In the second equation population factor was also

included as independent variable to assess the impact of all three factors (GDP, size of overseas trade and density of population) on tax revenue. The study concluded that real gross domestic product and foreign trade were positively correlated with tax revenue, whereas density of population was negatively correlated with tax revenue.

Arpit Guru and Shruti Kahanijow (2010) researcher analyzed the black money income. Need for amendment in DTAA & ITEA and analyzed 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. 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 favor 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 and level of activity and government finances.

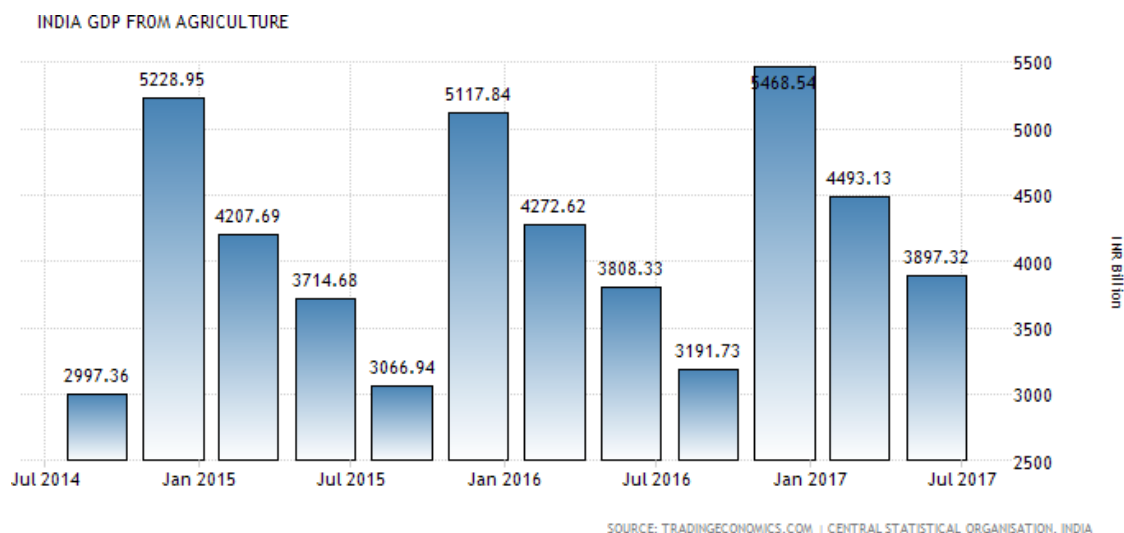
IV. RESEARCH METHODOLOGY

The paper is based on secondary data. The data has been collected from internet and articles.

V. THE IMPACT OF DEMONETIZATION ON AGRICULTURAL SECTOR

Agriculture plays an important role in the Indian economy. Over 70 % of the rural households depend on agriculture. Agriculture is the backbone of Indian economy as it contributes about 17% to the total GDP and provides employment to over 60% of the population. It also provides raw materials to leading industries such as cotton textiles and sugar industries. The number of various agricultural commodities like tea, coffee, spices and tobacco constitutes our main items of exports. This amounts to almost 15% of India's total exports. Hence agriculture provides foreign exchange which helps us to purchase machines from abroad. It also maintains a balance of payments and makes our country self-sufficient. Agriculture has brought fame to the country. India holds first position in the world for the production of tea and groundnuts, Indian agriculture has registered speedy growth over last few decades.

The following graph shows GDP from Agriculture of India:-



Demonetisation has affected every Indian, but it has hit the agricultural sector badly. Agriculture in India accounts for 50 percent of the workforce. Farmers, who are the backbone of our economy, were severely affected by the note demonetization of 8 November 2016. Agriculture is impacted through the input output channels as well as price and output feedback effects. Sale, transport, marketing and distribution of ready produce to mandis is dominantly cash-dependent. Farmers suffered a setback due to nationwide cash shortage and a fall in the demand for vegetables in wholesale markets. . Farmers were not able to purchase inputs like seeds from market. They were using old seeds from the last year harvest and not purchasing new quality seeds from market. In northern Indian states, the crop of rice was prepared. Some of the farmers have sold their crops, and some was in the process. It is true that almost crops are sold in cash the transaction which has been done is cash is to be deposited in the banks and can be withdrawn accordingly. The consumers of rural farmer is not as advance as the urban middle class, which can be easily managed with a very little amount of cash. The problem of the demonetization is largely associated with the rural areas of the country have lesser number of banks and ATMs compared to the urban areas and semi-urban areas. The problem was not the inaccessibility of the banks and ATMs, but the limit on cash which can be withdrawn. A farmer can take a day out from his busy

schedule and manage to go to bank and get the cash back, however the limit on the amount withdrawal forces him to do that again and again and the banks in rural areas are some 20 or 30 kilometres the roads in rural areas can make it look like 50 kms. Repeating that 4 or 5 times in a week can be exhaustive. However, the limit has been exceeded than before and government is taking other necessary formalities which would ensure that the farmer does not have to commit suicide. If the income of peon working in government services and farmers of our country is compared since 1964, the income of peon has increased 1000 % and that of farmers by meagre 19%. Besides those negative effects of demonetization there is also hope of every Indian farmer upon demonetization that this historical step will concrete our economy and also fruitful for our country in future. The various effect of the Demonetisation would be very positive for farmers are:

- With plentiful money, the government become able to complete the incomplete irrigation projects so that more land comes under irrigation and two crops instead of one crop in a season can be taken by farmers. This will double up their income as our Prime Minister Mr Narandar Modi has promised to do.
- The interest rates of banks started falling which could reduce the capital cost and farmers can now go for farm mechanisation.
- Government can build cold storage chain thereby minimize the wastage which are 80, 000 cr annually.
- The intermediaries and commission agents blooming on black money will be minimized and farmers can directly deal with consumers and they can credit instant payments to their bank account.
- The owners of essential commodities like pulses, grains, potatoes onion etc will run out of cash and will not be able to rig the prices. The farmers and also consumers will be benefitted as the price would remain stable.
- The quality of fertilizers will improve in that the nutrients contents will not be depreciated.
- The Government can conclude the pending electricity generating projects so that the farmers who are suffering by lack of proper electricity will get more electricity so that he can run their drip irrigation system and save water.
- The national portal made for farmers of the country will be more effective as the farmers will have wider market instead of local and District mandies. They will get more prices for their production with payment directly in their bank accounts.
- Farming becomes more viable and there will be reverse migration to villages from cities. The smart phone holder children of farmers will not now shy from working on farm in future.

VI. IMPACT OF DEMONETIZATION ON ECONOMY

Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc. In this context, the exercise may produce following short term/long term/, consumption/investment, welfare/growth impacts on Indian economy. The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks.

Following are the main impacts.

1. Demonetization is not a big disaster like global banking sector crisis of 2007; but at the same time, it will act as a liquidity shock that disturbs economic activities.
2. **Liquidity crunch (short term effect):** liquidity shock means people are not able to get sufficient volume of popular denomination especially Rs 500. This currency unit is the favourable denomination in daily life. It constituted to nearly 49% of the previous currency supply in terms of value. Higher the time required to resupply Rs 500 notes, higher will be the duration of the liquidity crunch. Current reports indicate that all security printing press can print only 2000 million units of RS 500 notes by the end of this year. Nearly 16000 mnRs 500 notes were in circulation as on end March 2016. Some portion of this were filled by the new Rs 2000 notes. Towards end of March approximately 10000 mn units will be printed and replaced. All these indicate that currency crunch will be in our economy for the next four months.
3. **Welfare loss for the currency using population:** Most active segments of the population who constitute the „base of the pyramid“ uses currency to meet their transactions. The daily wage earners, other labourers, small traders etc. who reside out of the formal economy uses cash frequently. These sections will lose income in the absence of liquid cash. Cash stringency will compel firms to reduce labour cost and thus reduces income to the poor working class. There will be a trickle up effect of the liquidity chaos to the higher income people with time.
4. **Consumption will be hit:** When liquidity shortage strikes, it is consumption that is going to be adversely affected first.
Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓
5. **Loss of Growth momentum:** India risks its position of being the fastest growing largest economy: reduced consumption, income, investment etc. may reduce India's GDP growth as the liquidity impact itself may last three -four months.
6. **Impact on bank deposits and interest rate:** Deposit in the short term may rise, but in the long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest. It will

be converted into active liquidity by the savers when full-fledged new currency supply take place. This means that new savings with banks is only transitory or short-term deposit.. They may reduce interest rate in the short/medium term. But they can't follow it in the long term.

7. **Impact on black money:** Only a small portion of black money is actually stored in the form of cash. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. Hence the amount of black money countered by demonetization depend upon the amount of black money held in the form of cash and it will be smaller than expected. But more than anything else, demonetization has a big propaganda effect. People are now much convinced about the need to fight black income. such a nationwide awareness and urge will encourage government to come out with even strong measures.
8. **Impact on counterfeit currency:** the real impact will be on counterfeit/fake currency as its circulation will be checked after this exercise.

Demonetization as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn't have the digital transaction culture. Overall economic activities will be dampened in the short term. But the unmeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

VII. POSITIVE EFFECTS OF DEMONETIZATION

In what could be termed as the mother of all reforms, Prime Minister Modi's demonetisation move will have far reaching implications. This is not to dispute that the transformative step has brought some hardship for the citizens, but those are temporary and will blow over soon. For the larger benefit of the nation, we the citizens can bear such hiccups with a smile. After all, this is how we as citizens can contribute in policy making and nation building. While bank employees are working overtime to make Modi's ambitious demonetisation drive a success, let's discuss its many-fold impacts.

1. **Black money:** At one stroke the Prime Minister has choked the supply of black money stacked inside the country. Of the Rs 17 lakh crore of total currency in circulation in the country, black money is estimated at mind-boggling Rs 3 lakh crore. Black money is nothing but a plunder of the nation. Black money operators run a parallel economy which shakes the very foundation of the Indian economy. With Modi's demonetisation move, all domestic black money will either be deposited into the banks with heavy penalty or be simply destroyed.
2. **Economy:** Demonetisation will have a huge resultant effect on the Indian economy. The clean-up of illegal cash will help turn around the economy. First, it will bring more borrowings to the exchequer, improve inflation outlook and increase India's gross domestic product (GDP). Second, it will revive investment opportunities and give a fillip to infrastructure and the manufacturing sector. Third, it will help reduce interest rates and lower income tax rate.
3. **Note bank politics:** In the run up to the crucial assembly elections in Uttar Pradesh, Punjab, Goa and Uttarakhand, Prime Minister Modi's demonetisation announcement has come as a shock and awe for the political parties and politicians for whom black money is a lifeline. The pulling out of the old Rs 500 and Rs 1,000 currency notes will help make the election process clean and transparent. But it has brought tough times for the political parties and politicians who believe in the idea of purchasing votes in exchange for notes. That is precisely the reason a rainbow coalition of a galaxy of regional parties and the Congress is building up against Modi, because their political interests are badly hurt.
4. **Real estate cleansing:** It is said that real estate is an industry built on black money. The extent of black money floating around in the sector is huge. According to an estimate at least 40 per cent of real estate transactions in Delhi-NCR are in black. Modi's demonetisation move will curtail the flow of black money into the real estate sector. This will help in making the much needed correction in the sector. The impact: An unexpected dip in land and property prices.
5. **Hawala transactions:** Demonetisation has crippled the hawala rackets. Hawala is a method of transferring money without any actual money movement. Hawala route is used as a means to facilitate money laundering and terror financing. Hawala rackets run again on black money. With black money suddenly being wiped out of the market, thanks to demonetisation, hawala operations have come to a grinding halt. According to an India Today report, one of the hawala operators in Mumbai has destroyed currency notes worth about Rs 500 crores.
6. **Counterfeit currency:** Demonetisation has dealt a death blow to the counterfeit Indian currency syndicate operating both inside and outside the country. Counterfeit currency seriously devalues the real worth of Indian currency. A study conducted by Indian Statistical Institute, Kolkata on behalf of the National Investigation Agency (NIA) suggests that fake Indian currency notes (FICN) amounting to Rs 400 crore are in circulation in the country at any given point of time and around Rs 70 crore fake notes are pumped into Indian economy every year. The estimation is based on recovery and seizure made by various agencies. But the actual figure could be much larger. A One India report, quoting an Intelligence Bureau dossier, says fake Indian currency

worth Rs 12 lakh crore has pumped into Indian financial system over the years. Needless to say that most of the fake currencies circulated in India are of Rs 500 and Rs 1000 denominations. With Prime Minister Modi's decision to pull out the old Rs 500 and Rs 1,000 notes and replace them with new Rs 500 and Rs 2,000 series has completely stalled the circulation of counterfeit Indian currency.

7. **Terror financing:** Terror financing is sourced through counterfeit currency and hawala transactions. This is how terror financing works. Fake currency circulation is routed through a multi-layered network of hawala operators which are closely linked to satta (gaming) and smuggling of drugs, opium and arms. Indirectly, they all end up financing terrorism. In addition, the terrorists collect huge donations and then route the money through hawala transactions. With the circulation of counterfeit Indian currency completely stalled and hawala transactions stopped, all windows for terror financing are closed.
8. **Maoism:** Maoist sympathisers call Modi's demonetisation move an "undeclared financial emergency". There are reasons to it. Demonetisation has hit the Maoists and their movement hard. Black money is the oxygen for Maoists. According to an estimate, Maoists manage to raise Rs 300 to Rs 400 crore annually through donations, levy and extortions. The illicit money is used to purchase arms and ammunition, food and medicine and daily essentials, apart from distributing it among the ranks and the cadre. No wonder, with Modi's demonetisation drive, all those illegal money are reduced to paper scrap. Maoists are in a state of coma and Maoist activities see a crippling blow. Ever since the demonetisation announcement was made, no major violence was reported from the Maoist infested states like Chhattisgarh, Odisha, Andhra Pradesh and Telangana.
9. **Kashmir unrest:** The four-month-long unrest in Kashmir valley is on a backburner, thanks to demonetisation. No stone pelting on security forces has been reported in Kashmir ever since the demonetisation announcement was made. An intelligence estimate suggests that Pakistan sends Rs 1,000 crore annually to the separatists for fuelling unrest in Kashmir. The money is transferred through hawala route. With hawala transactions completely choked up, the separatists are now clueless. It won't be wrong to say that "stone pelter" Modi completely shattered the Kashmir unrest with his stone called demonetisation.
10. **North-East insurgency:** Demonetisation has severely affected the multiple militant groups operating in the North-East. According to intelligence estimate the north-eastern insurgent groups together have a corpus of Rs 400 crore annually.

The insurgents source their funding in two ways. They raise funds through levy and extortions like the Maoists do. But unlike Maoists, the leaders of North-East militant outfits do not live in the jungle. Their English speaking high ranking leaders run operations from their dens in Myanmar, Bangladesh and Nepal. From there they also transfer huge illegal money via hawala route to their cadre for running the militancy. With the extortion money stopped completely in the absence of cash inflow and hawala operations coming to a complete halt, all activities of North-East militants have shuttered down

VIII. CONCLUSION

Demonetization is a one step of many steps in fighting corruption, black marketing, and financing insurgency. However preparation for demonetization was lop-sided, and its impacts was terrible on Indian public. If 86% of cash is taken out, with a meagre amount available, all market transactions have been killed. The people, who were targeted, did not come on streets, but common folk are out from their work places as well as homes. , Somebody put a parable on social net. For killing ten crocodiles, government pumped out all water from the pond results killing ten thousand fish in pond but Crocodiles walked off on dry sand. With an intention to rid the country of black money and dig out tax defaulters and black money holders, government has taken step to demonetized Rs 500 and Rs 1000 notes. This move will have major impact on the parallel economy but sudden announcement and failure to prepare in advance has created temporary chaos and discomfort among the general public. Common Men are finding it difficult to buy with no money in pocket, wasting hours in queues which although could have been avoided if planned in advance.

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