



## DEMONETIZATION AND ITS IMPACT ON EMPLOYMENT

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### ABSTRACT

The demonetization was done in an effort to stop the counterfeiting of the current bank notes suspected to be used for funding terrorism and for cracking down on black money in the country. Following the announcement by the Prime Minister and Governor to the Reserve Bank of India (RBI), Urjit Patel made a press release with details on the procedure for exchanging the 500 and 1000 rupee notes that are currently in circulation on 8<sup>th</sup> November, 2016, other than the notification that this denomination will be discontinued. The present study has been deals with the announcement of demonetization of currency notes (500, 1000) its importance and challenges faced by the society. Government took this step of demonetizing the

currency as a tool to fight against black money and corruption in Indian Economy. This paper highlights the Impact of demonetization on Indian GDP and its Consequences.

**KEYWORDS:** Demonetization, currency notes, RBI, Exchange of Currency, Black money.

### INTRODUCTION

Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit. The government has implemented a major change in the economic environment by demonetizing the high value currency notes – of Rs 500 and Rs 1000 denomination. These ceased to be legal tender from the midnight of 8<sup>th</sup> of November 2016. People have been given upto December 30, 2016 to exchange the notes held by them. The proposal by the government involves the elimination of these existing notes from circulation and a gradual replacement with a new set of notes. In the short term, it is intended that the cash in circulation would be substantially squeezed since there are limits placed on the amount that individuals can withdraw. In the months to come, this squeeze may be relaxed somewhat. The reasons offered for demonetization are two-fold: one, to control counterfeit notes that could be contributing to terrorism, in other words a national security concern and second, to undermine or eliminate the “black economy”.



There are potentially two ways in which the pre-demonetization money supply will stand altered in the new regime: one, there would be agents in the economy who are holding cash which they cannot explain and hence they cannot deposit in the banking system. This part of the currency will be extinguished since it would not be replaced in any manner. Second, the government might choose to replace only a part of the currency which was in circulation as cash. In the other words, the rest would be available only as electronic money. This could be a mechanism used to force a transition to cashless medium of exchange.

As mentioned above, among all implications of 'demonetization', its impact on employment is important, particularly in a situation when majority of wage payments are made in cash form. Given the nature of huge informal employment, more than 95 percent of total transactions in India are in cash form (Live Mint, January, 01, 2017). The decision of sudden 'demonetization' therefore led the labor market dynamics changed significantly by rendering millions of workers exposed to increased uncertainty in employment; they resorted to 'reverse migration'. For employment growth, economic growth is one of the important factors. In a situation, when the recession phase caused by global crisis of 2009 had hardly dimmed away, the recent move of 'demonetization' will push growth downward as predicted by most economic agencies including RBI and IMF. The prediction of decline in GDP ranges from 0.5 percent to 2 percent. Theoretically, a unit decline in growth rate results a decline in employment growth rate, \*pawankumar@ramjas.du.ac.in a concept called as employment elasticity (EE) of output. So, labour market, particularly informal in nature, will be most affected by the move. Before, evaluating the employment impact of the recent move of 'demonetization', it is imperative to summarize the labour market in India. Following the Report on Fifth Annual Employment and Unemployment Survey (2015-16), a couple of points are worth mentioning. First, among all, very few households (20 percent) with monthly income less than or equal to Rs. 10,000 have bank account. Second, majority of workers belong to this income group only; 82 percent among self-employed, 60 percent among regular or salaried workers, 87 percent among contract workers, and 96 percent among casual workers. Third, majority of workers, in all category of employments have no written contract, 65 percent (regular workers), 68 percent (contract workers), 95 percent (casual workers). Fourth, majority of workers (71.2 percent) receive no social benefits. Fifth, 60 percent of workforce belongs to just six states, Tamil Nadu, Maharashtra, Andhra Pradesh, Gujarat, Karnataka and Uttar Pradesh.

### OBJECTIVES

- To know the importance of demonetization.
- To study the impact of demonetization on Indian GDP
- To focusing on the problems of society.
- To provide suggestion regards to demonetization.

### IMPACT OF DEMONETIZATION

The first change, i.e., cash being extinguished, to the extent it was being used as medium of exchange, would result in a compression in incomes, employment and consumption in the economy. On the other hand, the effect of the second change, i.e., cash being only partially replaced in the system would have the opposite effects of expansion in potential credit creation. The potential credit creation would translate into actual credit creation provided there is sufficient demand for credit.

If the demand for credit in the economy is large enough, the potential credit can be realized. Of the credit created, other things remaining the same, it can be expected that at least a part of the credit, will be

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for productive purposes. This would mean expansion in investment in the economy and subsequently an increase in GDP and employment.

If there is increase in investment in the economy, the demand for capital goods rises. If output can expand in this sector, there would be an expansion in the income generation and in demand for goods and services. Sectors that are not operating with excess capacity cannot meet the expanded demand with increased output, leading to increase in prices. This would hold for agriculture as well as any industry with long gestation lags to investment. In other words, in the short run there is a possibility of increase in inflation.

With increase in GDP, since imports are supposed to be related to the size of the economy, it is expected that imports will rise, but the same cannot be said about exports. In other words, the balance of trade could worsen. This could result in pressures on the rupee towards depreciation. Any increase in inflationary pressures too could augment these pressures.

It can generate many positive spin-offs. One reason why this segment might get better access to formal sector credit would be if all their transactions move to the digital format, thereby making available to the lending institutions evidence of credit worthiness. However, for this the transactions need to move digital before they can get access to credit. In other words, unless the banking sector is exploring more risky asset categories, they would not be the beneficiaries of the expansion in potential credit.

### **Cash Transactions:**

The SIT has felt that large amount of unaccounted wealth is stored and used in form of cash. Having considered the provisions which exist in this regard in various countries and also having considered various reports and observations of courts regarding cash transactions the SIT felt that there is a need to put an upper limit to cash transactions. Thus, the SIT has recommended that there should be a total ban on cash transactions above Rs. 3, 00,000 and an Act to be framed to declare such transactions as illegal and punishable under law.

### **Cash Holding:**

The SIT has further felt that, given the fact of unaccounted wealth being held in cash which are further confirmed by huge cash recoveries in numerous enforcement actions by law enforcement agencies from time to time, the above limit of cash transaction can only succeed if there is a limitation on cash holding, as suggested in its previous reports. SIT has suggested an upper limit of Rs. 15 lakhs on cash holding. Further, stating that in case any person or industry requires holding more cash, it may obtain necessary permission from the Commissioner of Income tax of the area. With full backing, for the third time, India participated in the process of demonetization. RBI governor, Urjit Patel applauded Modi's "very bold step" which addresses concerns about the "growing menace of fake Indian currency notes".

A better sense of this can be gauged from this graph below. As you can see, the monetary value of Rs500 and Rs1,000 notes in circulation far outstrips any other denomination.

The economic implications of demonetization are many and yield mixed results. First, it would inspire confidence of international community that India is serious about its commitment to fight corruption. This will enhance India's ranking in ease of doing business as well as in various global indices of corruption.

It is rather difficult to predict the impact of demonetization on the economy. The immediate pain in terms of non-availability of required currency notes if not corrected soon, may reflect in reduction of output in agriculture because of its timing being close to sowing season and which may spillover to industry and services. Similarly, in the long run, implications could be uncertain. On one hand, confidence

in efficient management of the economy should lead to positive effect while shock strike at unaccounted economy could lead to shrinkage in production, especially in informal sector including micro, medium and small enterprises. The microfinance institutions, in absence of high denomination notes, could suspend some of their operations for a short time.

### CHALLENGES OF DEMONETIZATION

- ❖ The government should come up with additional economic stimulus to offset the dampening effect:
- ❖ Accelerated reduction in corporate income tax along with withdrawal of exemptions
- ❖ Ending uncertainty on GAAR and retrospective taxation or any other blockbuster measure that they might be working on, that would offset the initial adverse economic impact.
- ❖ Assess Black Money better There's no good estimate for how much of India's black money is in forms other than currency/physical notes such as gold, jewellery, land or any other form of wealth. Therefore, while banning Rs 500 and Rs 1,000 notes will tackle the black money that is in the form of hard cold cash, it won't affect other forms of black money.
- ❖ Prepare for the challenges of cashless economy: The UPI (unified payment interface) system is likely to be fully operations only by January 2017. India was recently hit by one of its biggest financial security breaches compromising hundreds of thousands of debit cards.

### FINDINGS AND SUGGESTIONS

- In India we have only 84% of people depend upon cash and only the meager amount transitions i.e 16% was taken place trough banks.
- Deposits increase for the banks and that means eventually interest rates might come down.
- Curb on black money – corruption, terrorism etc
- Boost to cashless economy with people adopting habits of wallets etc.
- Boost to Jan Dhan Account's relevance for poor people – Would be interesting to factor the surge in new account creation and activity in dormant accounts
- Politics and various elections are known to run on cash. Same is the case with sectors such as real estate. Expect a gradual reform in this area
- Everything else being equal, withdrawal of currency in circulation, in the (very) short-run, might actually drive up interest rates.
- Short-term liquidity grip could be severe and hence economic activity could suffer.
- Sovereign credit rating – possibly no impact. But if there are short-term impacts on economic activity which dampens government revenues and widens deficit, you can expect a short term decline in ratings.
- Cost of printing the new currency (if high) would create another political force.
- Immediate disorder and public turmoil (which will bring out potential issues of execution).
- It requires the pre – preparation for demonetization.
- The technique of task management is to adopt for more effect.

### CONCLUSION

The demonetization undertaken by the government is a large shock to the economy. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency in circulation is extinguished. While it has been argued that the cash that would be extinguished would be "black money" and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy, this argument is based on

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impressions rather than on facts. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. As argued above, it is possible that these cash balances were used as a medium of exchange. In other words, while the cash was mediating in legitimate economic activity, if this currency is extinguished there would be a contraction of economic

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