



Demonetization And Indian Economic Growth: An Analysis

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Abstract: -Demonetization is an act to declare the old currency notes and coins as non-legal tendered for transactions in an economy and replaces the old currency notes with new currency notes. November 8, 2016 became a historic date in Indian economy. On that day, the Centre Government took a step to demonetize the Indian currency notes of Rs. 1000 and Rs. 500. This step is also called a heroic step to fight against black money, illegal transactions, terror funding and activities. The present paper aims to discuss about the objectives of demonetization in Indian economy. The present study is descriptive in nature which is based on secondary data collected from different sources i.e. govt. reports, central statistical organization and Reserve Bank of India reports etc. The present study is carried out to find out the answers of certain questions like whether the step of demonetization is really a heroic step to clean the Indian economy from black money and illegal activities and what are the initial effects on GDP and Government Tax revenue of economy?

Keywords: Demonetization, Economic Growth, Black Money, GVA

Introduction:

Indian economy is one of the fastest growing economies of the world. Since independence, Indian economy has gone through many major economic reforms i.e. nationalization of banks in two phases in 1969 and 1980, new economic policy in 1991, now demonetization in 2016 and Goods and Services Tax in July, 2017. Under different circumstances, all these economic reforms have their own objectives and impact on different sectors of economy. The objectives of nationalization of banks and new economic policy were to increase the financial inclusion of citizens of India and to extend the banking services in rural areas. Than through the process of globalization and privatization, the Indian economy was opened up for rest of the world and for private businessmen respectively. As a result of these reforms Indian economy become the fastest growing economy of the world. From last few decades, it is observed that there is a big parallel economy in the form of uncounted money which is called black money. It is also observed that black money is also a source of corruption in system. Illegal transaction and funding of terror activities are being done with this black money. There is also a common perception in people's mind that black money is hard cash that corrupt bureaucrats or officials, politicians and businessmen hoard till they are either used for purchases of luxury goods or converted into other assets. To curb these activities Central Government of India took a step to demonetize the Indian currency notes of Rs. 1000 and 500. Sometime this action is also called "Surgical Strike" against black money (Economic Survey 2016-17). In India, demonetization is not done first time in 2016. Before 2016, the first demonetization has been done in January

1946, when Indian currency notes of Rs. 1000, Rs. 5000 and Rs. 10000 were taken out of circulation. These higher denomination currency notes were reintroduced in 1954 and again demonetized in 1978. In 1978, Central Government of India had passed a specific act called the High Denomination Notes Act, 1978 (Nag. A, 2016). After demonetization in 1978, Rs. 100 notes became the highest denomination notes in circulation for about a decade. In October 1987, RBI issued Rs. 500 bank note due to higher transaction needs arising from inflation. After that in November, 2000, note of Rs. 1000 was also reintroduced (Shetty & Rajkumar, 2016). At that time of demonetization in 1946 and 1978, the public and politicians did not pay much attention about this action. Because at that time demonetization had little impact on daily working activities of the people and at political level situations were different. In 1977-78 only 0.6 percent high denomination notes of Rs. 500 and Rs. 1000 and Rs. 5000 were in circulation. In which 0.4 percent were Rs. 1000 and 0.1 percent was Rs. 5000 notes. But in 2016, 86 percent currency notes were in circulation having the denomination of Rs. 500 and Rs. 1000 (Shetty Rajkumar). As per RBI Annual Report 2016-17, about 99 percent of these notes have been submitted back to the RBI which means that the perception of the government and public, that black money exists in the form of hard cash was wrong.

The present paper aims to discuss about recent demonetization in November, 2016. What are the initial effects of demonetization on different sector of Indian economy? The present study is descriptive in nature which is based on secondary data collected from different sources like, govt. reports, central statistical organization and Reserve Bank of India reports etc.

Analysis of Growth Rates:

As per the RBI report 99 percent of old currency notes are back to the central bank. During this period common people face many problems particularly those rural people who don't have bank accounts. But this act of demonetization affects the whole economy in many ways. Gross value added (GVA) at basic price decrease by 2 percent from Quarter-1 in financial year 2015-16 to Quarter- 4 in financial year 2016-17. Table-1 and Figure - 1 shows the GVA growth in different quarters of 2015-16, 2016-17 and 2017-18.

Table 1: Quarterly Growth Rates of Gross Value Added

(Growth Rates in Percentage)

Sectors	Financial Year 2015-16				Financial Year 2016-17				FY 2017-18	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Agriculture and Allied Activities	2.4	2.3	-2.1	1.5	2.5	4.1	6.9	5.2	2.3	1.7
Industry	6.8	6.4	9.0	7.6	7.4	5.9	6.2	3.1	1.6	5.8
Manufacturing	8.2	9.3	13.2	12.7	10.7	7.7	8.2	5.3	1.2	7.0
Services	9.0	9.4	9.4	9.0	9.0	7.8	6.9	7.2	8.7	7.1
Total GVA	7.6	8.2	7.3	8.7	7.6	6.8	6.7	5.6	5.6	6.1

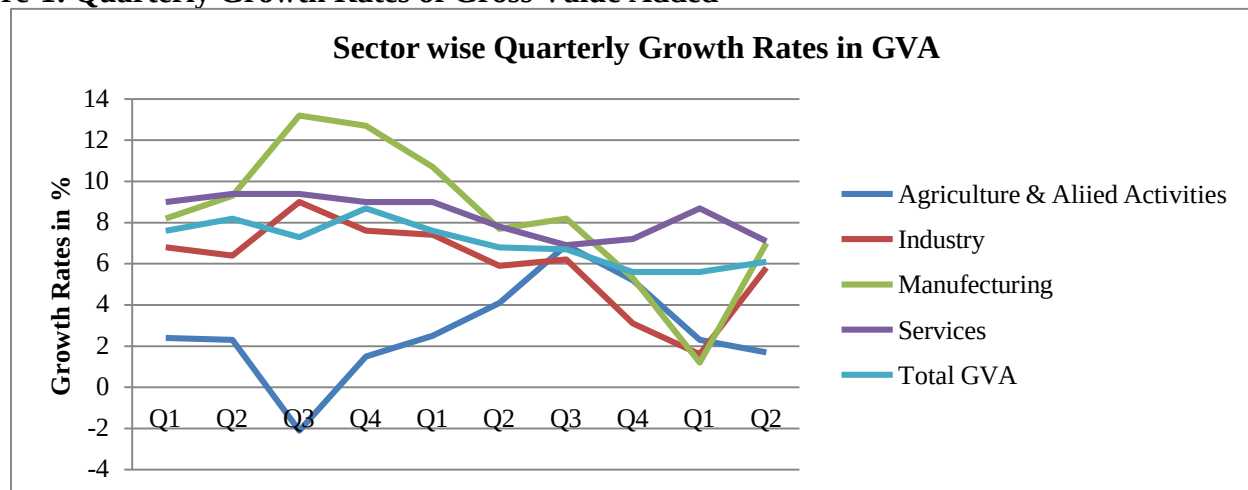
Source: GOI, Economic Survey 2016-17 & 2017-18.

RBI, Handbook of Statistics on the Indian Economy 2016-17.

If one compares the growth rates of every sector except agriculture and allied activities of the economy in 3rd or 4th quarter of financial year 2015-16 to the next financial year, it has been clearly seen that the growth rates of 3rd and 4th quarters in 2016-17 were lower than the growth rates comparable period of 2015-16. After the

demonetization in 3rd quarter of financial year 2016-17, growth rate in Gross Value Added (GVA) in every sector has declined. The annual growth rates of GVA in different sectors of the economy (Table-2 and Figure -2) shows declining trends in all sectors except agriculture sector after demonetization. Advanced estimation of growth rates in 2017-18 for different sectors also shows lower growth rates in comparison with 2015-16. There is a huge decline in the growth rate of manufacturing sector from 10.8 percent in 2015-16 to 4.6 percent in 2017-18.

Figure-1: Quarterly Growth Rates of Gross Value Added



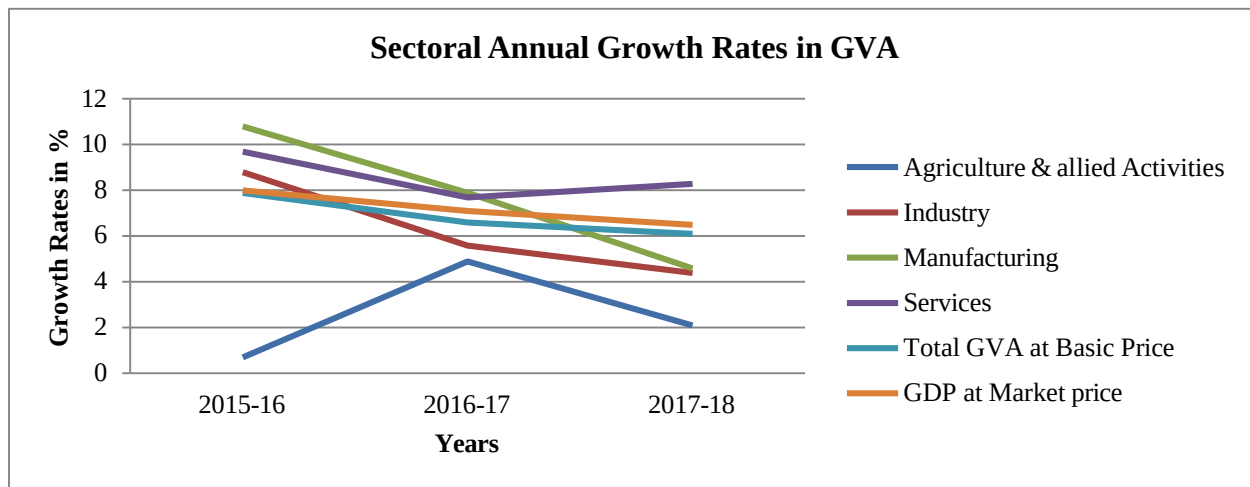
Source: Data of Table 1

Table 2: Sector wise Annual Growth Rates of Indian Economy

Sectors	2015-16	2016-17	2017-18 (AE)
Agriculture & allied Activities	0.7	4.9	2.1
Industry	8.8	5.6	4.4
Manufacturing	10.8	7.9	4.6
Services	9.7	7.7	8.3
Total GVA at Basic Price	7.9	6.6	6.1
GDP at Market price	8.0	7.1	6.5

Source: GOI, Economic Survey 2016-17 & 2017-18.

RBI, Handbook of Statistics on the Indian Economy 2016-17.

Figure 2: Sector wise Annual Growth Rates of Indian Economy

Source: Data of Table 2

The main reason behind sharp decline in growth rates is demonetization because high denomination notes were used as medium of exchange in the economy where almost all the transactions are made in cash. However Central Government had taken many steps to increase the cashless transactions during this period. In spite of government's measures to deal with the situations arisen due to demonetization; growth rate of economy has come down. Despite this, Government of India is confident that demonetization is an unprecedented step with short run costs and long run benefits for the economy.

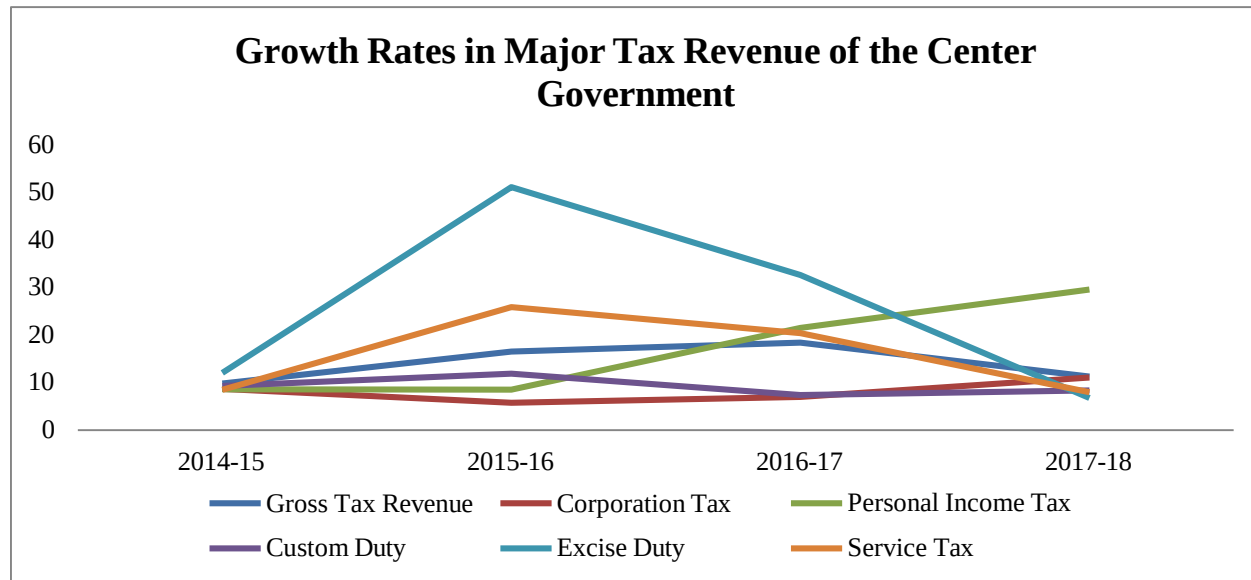
One of the positive things for the Central Government during the post demonetization era is significant increase in growth rates of gross tax revenue and its components. Table-3 shows the growth rates in major heads of tax revenue of the government.

Table 3: Growth Rates in Major Tax Revenue of the Government of India

(Growth Rates in Percentage)

Tax	2014-15	2015-16	2016-17	2017-18
Gross Tax Revenue	9.8	16.5	18.4	11.3
Corporation Tax	8.7	5.8	7.0	11.1
Personal Income Tax	8.6	8.5	21.5	29.6
Custom Duty	9.3	11.9	7.4	8.4
Excise Duty	12.1	51.2	32.7	6.8
Service Tax	8.5	25.9	20.4	8.0

Source: GOI, Economic Survey 2016-17 and RBI, Handbook of Statistics on the Indian Economy 2016-17.

Figure 3: Growth Rates in Major Tax Revenue of the Government of India

Source: Data of Table 3

Table-3 clearly shows that after demonetization there is a significant increase in growth rate of gross tax revenue which increased from 9.8 percent in 2014-15 to 18.4 percent in 2016-17. Tax revenue from corporation tax, personal income tax, excise duty and service tax shows increasing growth rate during the same period. Growth rate of excise duty shows the highest rate of 32.7 percent in 2016-17 followed by personal income tax (21.5 percent), services tax (20.4 percent), custom duty (7.4 percent) and corporation tax (7.0 percent). Increase in revenue from personal tax is mainly due to increase in number of tax payer as compared to pre-demonetization period. After this significant increase in government revenue, it may be assumed that government will allocate more budget for expenditure on development projects, infrastructure, employment creation, poverty eradication and social services i.e. education and health. Banking sector also come forward with low interest rates to boost the private investment in Indian economy.

Conclusion:

There is no doubt that demonetization instantly hit the growth of the Indian economy. Growth rate in GVA is continuously decreased in consecutive quarters from financial year 2016-17. Common men also faced many problems. Still, Central Government ensures that demonetization is done for better future of the economy. A number of actions have been taken to minimize the costs and maximize the benefits of demonetization. These actions would allow growth to return to trend in 2017-18, following a temporary decline in 2016-17 and it could be a better reform for better economy.

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