

Short Term Economic Effects of Recent Demonetisation on Rural and Urban Regions: A Case of Lucknow District of Uttar Pradesh

**(SUMMARY)
DISSERTATION**

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SUMMARY

Demonetisation of currency means discontinuity of the particular currency from circulation and replacing it with a new currency. **In the recent context, it is the banning of the 500 and 1000 denomination currency notes as a Legal Tender.** On 8th November 2016, the Government of India announced the **Demonetisation of all Rs. 500 (US\$7.80) and Rs. 1,000 (US\$16) banknotes of the Mahatma Gandhi Series.** The government claimed that the action would curtail the shadow economy and crack down on the use of illicit and counterfeit cash to fund illegal activity and terrorism. The sudden nature of the announcement—and the prolonged cash shortages in the weeks that followed—created significant disruption throughout the economy, threatening economic output. The government's stated objective behind the Demonetisation Policy are as follows; first, it is an attempt to reduce corruption. Secondly, it is done to curb black money, third to control inflation, fourth to stop funds flow to illegal activity, fifth to make people accountable for their income and pay income tax return. Finally, it is an attempt to make a transparent economy and create a Digital India.

Money has played important role in development of economic activities and institutions all across the world. In course of time it took several forms, however, its basic functions remained the same, i.e., providing a medium of exchange, standard of value and a store of value. From ancient time till eighteenth century various forms of money can be linked to 'commodity money' type which carries the real value equal to its face value. However, fiat money, i.e., money/currency based on government fiat or declaration as legal tender, replaced the commodity money in modern time. Economic development and monetary system has been closely linked with each other. Demand for money, in view of the classical economists, e.g., J.S Mill and Irving Fisher, depends primarily on the volume of the transactions in the economy, which in turns is based on the level of national income or GDP. On the other hand, Keynes stressed that people demand money with transaction, precautionary and speculative motives. According to James Tobin, an American economist, individual's behavior shows risk aversion. That is, they prefer less risk to more risk at a given rate of return. The riskiness of bonds has an effect that is similar to the lower rate of interest as it increase the quantity of money

demanded. Similarly, Prof. W. Baumol put forward a new approach to explain the transaction demand for money instead of Keynes's speculative demand for money. However the rate of money supply can be understood by the velocity of circulation of money related concept. The movement of money from person to person for payment of goods and services determines the flow of money.

Demonetisation of currency means discontinuity of the particular currency from circulation and replacing it with a new currency. Many nations have demonetized their currencies in the past. Important countries which have demonetized their currencies included Australia, Zimbabwe, North Korea, Pakistan, Myanmar, Ghana, Nigeria, Soviet Union, United Kingdom, and United States. Furthermore, there were many occasions when Indian government has taken such steps. It was on 12th June, 1946, when currency note of Rs 1000 and Rs 10000 were removed from the system in India. Similarly, on 16th June, in 1978, the then Prime Minister of India Morarji Desai announced the currency ban taking Rs 1000, Rs 5000 and Rs 10,000 out of circulation. However, in the recent context, it is the banning of the Rs 500 and Rs 1000 denomination currency notes as a legal tender through an accouchement by Prime Minister of GOI on 8th November 2016. The government's stated objective behind the Demonetisation policy are as follows; first, it is an attempt to make India corruption free. Secondly, it is done to curb black money, third to control escalating price rise, fourth to stop funds flow to illegal activities, fifth to make people accountable for every rupee they possess and pay income tax return. Finally, it is an attempt to make a cashless society and create a Digital India. However, the element of 'suddenness' in the Demonetisation was criticized by many experts and political parties as lack of preparedness behind the entire exercise, which was further reinforced by the delays in the Demonetisation. Furthermore, many prominent experts denounced this step as a big mistake which would ruin the economy, growth and employment, especially in the informal sector which form over 90% of the economy.

Important among them included the Nobel laureate and eminent economist Amartya Sen who said, "The Demonetisation of currency is a despotic act as the government broke the promise of compensation that comes with a promissory note." Similarly, Chief economist of the World Bank Kaushik Basu expressed, "Demonetisation was ostensibly implemented to combat corruption, terrorism financing and inflation." Many other experts, academicians and researchers supported this step which included the

economist and former Indian representative to the IMF Arvind Virmani according to him, “Demonetisation is a useful method of flushing out black money.” Mr. Arun Kumar (Retired professor of economics, JNU, New Delhi and author of Black economy in India) opined, “Demonetisation is a remedy for curbing black economy, but questions are asked about its effectiveness and its economic cost.” Similar views were expressed by Mr. Kenneth Rogoff, author and professor of economics at Howard University, who opined, “Demonetisation is the bold and audacious move for a country with endemic corruption.” Major relief for the government came from the noted industrialists who supported this step.

It can be understood that the decision regarding Demonetisation was a very difficult one and Prime Minister himself acknowledged the same when he appealed people to be prepared for the hardship during next 50 days. However, the findings of majority of the reports and studies published after the Demonetisation presented a very grim situation of and a dismal ground reality. According to many of the reports the economy received a heavy jolt and the agriculture and informal sector was virtually destroyed. However, none of these reports have any comprehensive support from ground reality as almost all of them are based on secondary information, media reports and sometimes on speculations based on stereotypical approaches toward the issues. In light of this important gap, this study consulted people in target area and collected first hand information from them regarding the real impact of Demonetisation in their lives to achieve its objective which included;

- ❖ Finding out the factors behind the sudden launch of Demonetisation of high value currency notes by Government.
- ❖ Finding out the extent of reducing level of Inflation after launching of Demonetisation of high value currency notes.
- ❖ Finding out the level of consequences of Demonetisation on production and employment.
- ❖ And, to study on how far the Demonetisation increases the Digital Payment Mode to make more transparency.

Findings of the comprehensive literature review and analysis of secondary data from various sources, especially after the Demonetisation, suggest that economy has gone through sever jolt in terms of growth rate, employment loss, especially in informal sector, cash crunch for input of rabi crop along with the hardship experienced by

common person. However, analysis of the secondary data revealed that in many sectors the earlier trends were reinforced after the Demonetisation. For example sales of automobile and collection of direct taxes were down before the announcement. Although, growth rate has gone down, employment; especially in informal sector has drastically reduced, the core sectors of economy including agriculture suffered a temporary jolt, however, evidences suggested that it brought down stone pelting in Kashmir, terrorism and naxal activities for some times and gave central government appropriate time to respond to these issues with comprehensive strategies. Many experts worried about the fact that negative impacts of Demonetisation may outrun the benefits. Findings of the field survey suggested that majority of the people were in support of this step of government. However, it was found that rural areas reflected higher percentage of support for Demonetisation than the urban areas, especially in context of governments claim that it was an effective measure against corruption, black money and terrorism. The decision, according to major findings of the survey, was suddenly taken in order to startle the corrupt people and black money hoarders. Though majority of the respondents across rural and urban areas thought that it was an effective step towards curbing the black money and corruption, however, findings support this view that addressing the issue of black money would take longer time. People in both rural and urban areas had gone through some sort of discomfort due to Demonetisation and shortage of money during the time of need was a major form of suffering, apart from the fact that farmers/producers could not sell their produces during shortage of cash in the market.

Survey further reflected that re-monetization with introduction of the new notes has helped recover the economy in desired timeframe. Majority of the people felt that introduction of Rs.2000 note was logical and they did not find significant problem in using Rs.2000 note in the market. It was revealed in the survey people still have very low level of awareness regarding online payment modes and related application. Though government campaign had brought some difference in this regard, however, it would take long time to achieve the objectives of digitization in the country. Demonetisation had some impact on people's savings and expenditure, especially in context of their household's expenditure. It was found that there was significant impact on the individuals' employment status of respondents, however, this impact was felt more in urban areas than in rural areas. Furthermore, it was revealed that Demonetisation impacted the sale of produce due to sluggish market. It was expressed by the majority of the respondents that it would take at least a year or two to completely normalize the situation.