

Impact of Demonetization & Digitization On Parallel Economy

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Introduction:

When a currency note of a particular denomination ceases to be a legal tender, it is termed as demonetization. Legal tender refers to money which can be legally used to make payments of debts or other obligations. A creditor is obliged by law to receive such money in payment of due debt to him. The term demonetization is not new to the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the 10,000 rupee note in 1938 and again in 1954. It was demonetized first in 1946 and then in 1978. Since not many people had access to such notes at the time, this did not have a big impact on the country.

Demonetization was a landmark in the history of the Indian economy. It was an experience which created fear in the minds of the people who indulge in illegal activities like tax evasion or money laundering of any kind. The latest round of demonetization has undoubtedly affected the common public and bankers. It has had many short term effects which are visible. The long term effects are yet to be experienced and felt.

Objectives:

- ✚ To understand the impact of black money on Indian Economy
- ✚ To know the Impact of Demonetization & Digitization on Indian Economy

Effects of Black Money on Economy

Black money is a socioeconomic evil. The existence of rapidly growing black money in our economy has grave and disastrous consequences. The major effects of black money are discussed below

1. Dual Economy: The increase in the amount of black money in India over a period of time lead to the perpetual growth of economic dualism which consists of **Parallel economy** (black money economy) operating side by side with the **Official or Reported** economy on the

country. The black economy represents not less than one fifth of the aggregate economic transactions. There is also interaction between the reported and unreported activities such that it is difficult to identify black money from the white money economy. Such a **Parallel Economy** will ruin the entire economic development of the country.

2. Under-estimation: A large underground economy and growth of black income lead to under-estimation of the true size and incorrect picture of the economy by the officially compiled national income data. Since unreported economy is apparently excluded from the official records of the Gross National Product, the estimates of savings and consumption of nations to the national income and measurement of other macroeconomic variables would be biased and misleading for accurate policy making and planning considerations.

3. Loss of Revenue to the Government: Black money is largely attributed to tax evasion. Its direct impact is the loss of the Government revenue. Since the Government fails to get sufficient tax revenue due to large-scale tax evasion, it is forced to resort to high taxation and deficit financing which again carry their ill-economic effects.

4. Undermining the Equity: When the Government resorts to progressive direct taxation to maintain equity in the distribution of the tax burden, the tax evasion and growth of black money affect the very concept of social justice by not allowing the desirable reduction in inequalities of incomes. Again, when underground activities like smuggling etc. could not be taxed, the Government will impose higher taxes on officially sanctioned activities.

5. Widening the Gap between the Rich and the Poor: Growth of the black economy causes regressive distribution of income in the society. When the black money grows faster, rich becomes richer and the poor become poorer. By way of concentration of income and wealth in few hands, the black money widens the gap between the rich and the poor.

6. Lavish Consumption Spending: Black money is disposed off by lavish spending on travels and tours, entertainment, ostentatious articles, financing of extravagant elections etc. This has also lead to many social evils and deteriorated the values of life of the common people.

7. Distortion of Production Pattern: The black money has altered the choice coefficients in the market in favor of luxuries, which lead to the diversification of productive resources from essential goods to the non-essential goods.

8. Distribution of Scarce Resources: Black money holders are always in a position to put their prior claim over the scarce goods in the market due to their readiness and ability to pay more, thereby depriving the honest and poor people from their legitimate share. This obviously reduces the net economic welfare of the Indian society at large.

9. Deteriorate the General Moral Standards of the Society: Black money is largely responsible for the deterioration of general moral standards of the society. Black income generation implies a deviation from the accepted norms in society and from the point of view of the society is unethical. Socially, we can say that the structure and ethos of a society undergoes a massive change. Social values of honesty, hard work, thrift and simplicity get eroded. Even the political institutions and organizations lose their credibility as they also gradually become a part of the entire system of black income generation.

10. Average Effect on Production: As a consequence, the consumption pattern is tilted in favor of the rich and elite, at the cost of encouraging production of articles of mass consumption. A rise in overall consumption leaves fewer resources for investment in priority areas, having an adverse effect on production.

Impacts of demonetization on Parallel & Main economy

Demonetization is going to leave its impact for short and long term on parallel and main economy as summarized below.

Parallel Economy:

1. Parallel economy is mainly based on cash transaction that's why has hit hard by recent demonetization.

2. Some money of parallel economy is going to come in formal economy and will work as a boost for main economy.
3. Finance of terror and other unsocial organization have destroyed overnight because of sudden invalidation of cash.
4. It will be hard time further for parallel economy to sustain with limited cash availability.

Main Economy:

1. However main economy has also affected by lack of cash and it will result in deflation.
2. Money coming from informal economy to formal economy will increase liquidity for banks which further decrease interest rate and help for banks to handle their NPA.
3. Reduced interest rate will boost investment.
4. Land prices will fall and people will be able to afford houses.

Effects of digital payment on Indian economy

The impact of Digital Transaction on Economic Growth in India is as following:

- 1. Taxation:** with lesser availability of hard cash at homes and more in banks, there is lesser scope of hiding income and evading taxation, thus increasing the number of tax payers in the whole country.
- 2. Transparency and accountability:** it becomes a lot easier to track the flow of money with every transaction being recorded with the buyer, seller as well as regulatory bodies, making the system much more transparent and compliant. In the long term it leads to better business and investment prospects for the economy as a whole. More currency in bank will mean more circulation of money in the economy, leading to greater liquidity.
- 3. Reduced red tapism and bureaucracy:** with cashless transactions through electronic means the wire transfers are tracked and people are accountable which in turn reduces corruption and improves service time.
- 4. Consumption:** According to the Bank, India's growth in the first half of FY 2017 was underpinned by robust private and public consumption, which offset slowing fixed investment, subdued industrial activity and lethargic exports.
- 5. Banking:** The medium-term may be liquidity expansion in the banking system, helping to lower

lending rates and lift economic activity," the World Bank noted.

Impact of Demonetization on Cashless Transactions

Cashless transactions account for only 10% of all transactions on daily basis. The government in order to divert some of the blame for the poor implementation of this demonetization exercise announced mid-way that making India a cashless or less cash economy was one of the important objectives of this demonetization drive. Towards this end, the Finance ministry, RBI and NITI Aayog announced a host of incentives to boost cashless transactions. This was also done to ease some of the problems that have resulted due to acute shortage of cash in the economy.

1. The use of mobile wallets and cashless transactions, as a whole, has **increased by about 300% since the launch of demonetization exercise**. However we need to remember that this 300% increase is against a **very low base of digital transactions** and most of this increase has been noticed in the urban areas where people have ready access to PoS machines, internet banking, and mobile wallets.

2. Cashless transactions are still rarely used in rural areas and in the informal sector like road side vendors, small shops, buying seeds, wage payments etc.

Conclusion:

Demonetization has been praised as well as criticized on various grounds. There has been a lot of opposition regarding the implementation of this policy. In the short run, there have been problems related to liquidity crunch, unemployment, loss of growth momentum, and a temporary halt to major economic activities. All this is evident from the data provided by the RBI. The long term effects of Demonetization are yet to be ascertained. It is expected that it can improve the Indian economy in the long run by increasing tax compliance, financial inclusion, consequently improving the state of the economy. It can boost the GDP by increasing the availability of funds for lending and also by reducing transaction costs if the economy moves to digital modes of payments. On priority, it is up to the government to address the capacity building amongst

the lesser-endowed participants, such as the small-scale manufacturers and traders. Ways have to be found for lowering the overall compliance cost, and necessary changes may have to be made for the good of the masses. GST will become good and simple, only when the entire country works as a whole towards making it successful.

Demonetization was a one-time event and after two years, it can be said, its effect has been transitory. It alone is not sufficient to counter black money and corruption in the country; rather other measures are more crucial like bringing the offshore tax evaders to book whose names figure in the Panama papers, raid on benami properties, making donations to political parties open to public scrutiny and making it mandatory for all donations above Rs. 2000 to political parties and religious places to be through digital means only.

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