

Impact of Demonetization in India on MSME

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Demonetization in India: A Review

On November 8th 2016, around 8:30 Prime Minister Narendra Modi announced the de-monetization of Indian currency notes of Rs. 500/- and 1000/- while the rest of denomination of notes remain legal tender and will not be affected by this decision.

De-monetization is process in which high denominated notes are taken away from the market in an attempt to counterfeit. But this time this attempt was taken to deal with black money. Since independence, it has been done twice in India till date. The government in January 1946, in order to deal with counter forgery, had withdrawn the notes of Rs.1000 and Rs.10000. However, these notes again reintroduced Rs.1000, Rs.5000 and Rs.10000 in 1954. Again these notes were de-monetized in 1978, when Janta Party government came into the power.

The reason behind this decision is to keep a check on corrupt and black money hoarders. Black money or Unaccounted money which is frequently used in any form of corruption or illicit deals, usually takes the form of high-value notes, which in this case are the Rs 500 and Rs 1,000 bills. In his speech, Modi specifically pointed out that these large-value notes were being used to finance corruption and fund terrorism. "The Financial Action Task Force, a global body that looks at the criminal use of the international financial system, notes that high-value bills are used in money laundering schemes, racketeering, and drug and people trafficking". In India, the Rs 500 and Rs 1,000 notes also constitute a huge percentage

ABSTRACT

Demonetization of Indian currency notes of Rs. 500/- and 1000 is considered as boldest move taken by PM Narendra Modi. The decision was announced on the evening of November 8th 2016. The reason behind this decision is to keep a check on corrupt and black money hoarders. It is expected that this move of government will be helpful in reducing inflation which will be a great relief for general public of India. Though the decision is sudden and quick hence it will definitely have major impact on economy. Almost all sectors of economy get affected by demonetization. The small and medium business sector in India has a heavy influence on the economy. It provides employment to millions of people every year and contributes a good 8% to country's GDP. A large part of our population rely on this sector for employment hence the importance of MSME in India cannot be overlooked. Keeping all these factors in mind the present paper is an attempt to measure the impact of demonetization on MSME. The study will be descriptive in nature. Data collected for the purpose of this study is based on secondary sources as researcher has reviewed more than 50 articles and research paper for the purpose of collecting data for the same.

KEYWORDS: MSME, Parallel economy, De-monetization, Inflation, corruption, Black Money, GDP, Balance of trade

of the money spent by governments, political parties and candidates during general elections. "A Centre for Media Studies report showed that nearly Rs 30,000 crore was spent during the 2014 general election, while official spending only accounted for Rs 7,000-Rs 8,000 crore".

It is expected that this move of government will be helpful in reducing inflation which will be a great relief for general public of India. Though the decision is sudden and quick for general public, hence we cannot ignore the problems associated with the implementation of this decision. Modi's decision to decommission Rs 500 and Rs 1,000 notes should ideally not hurt most individuals in the long-term, although it will have a significant negative impact on the working class and small and rural businesses in the short-term.

A Review of Economist's Opinions on Demonetization

Every aspect has two facets so demonetization is. Leading economists has mixed opinion on it, some advocating it by saying that it will be beneficial for economy. In the discussions on demonetization, there is a consistent reference to the resultant increase in credit creation in the economy. Like Finance Minister Arun Jaitley says, "Bank deposits will increase and they will have more capacity to support the economy."

Arvind Virmani: Leading economist; Former India's representative at IMF; Former Chief Economic Adviser, GOI advocating demonetization by saying that "This is a useful

method for flushing out black money, However, he agreed that it would have a negative impact on the small businesses: as when such a large proportion of currency is being demonetized, the immediate effect is a collapse of retail trade in goods and services.

Surjit Bhalla: Chairman, Oxus Investments, a Delhi-based economic research/advisory firm; Former Professor at Delhi School of Economics; Previously worked at the World Bank Calls it a “bold step” on PM’s part: Bhalla wrote in The Indian Express that, “There should be no question that this BJP policy is bold and courageous. The trading community has long been identified as the BJP’s core constituency and Prime Minister Narendra Modi has gone against this powerful support group. So let us give Modi a considerable amount of credit for taking a bold step for the country — genuinely in the name of the nation.”

Amartya Sen: Leading economist; Noble Laureate; recipient of the Bharat Ratna Calls the move authoritarian: In an interview with The Indian Express, Professor Sen said, “Only an authoritarian government can calmly cause such misery to the people — with millions of innocent people being deprived of their money and being subjected to suffering, inconvenience and indignity in trying to get their own money back.” he told The Indian Express that the move is a failure — the intended targets know how to avoid the trap: he added that “It is hard to see how. This will be as much of a failure as the government’s earlier promise of bringing black money stacked away abroad back to India (and giving all Indians a sudden gift — what an empty promise!). The people who are best equipped to avoid the intended trap of demonetization are precisely the ones who are seasoned dealers in black money — not the common people and small traders who are undergoing one more misery in addition to all the deprivations and indignities from which they suffer.”

Dr. Manmohan Singh, Former Prime Minister; eminent economist; former RBI governor, Speaking at the Rajya Sabha, Dr. Singh has called demonetization an “organised loot”, a “legalised plunder” and a “monumental mismanagement”. He even said that the National income would fall by 2 per cent, which in his mind was “an underestimate”. He asked the government that “I would like to know from the Prime Minister the names of any countries he may think where people have deposited their money in banks but are not allowed to withdraw their money. This alone, I think, is enough to condemn what has been done in the name of greater good of the people of the country.”

He also said that move will definitely be harmful for agriculture and other informal sectors he added “In my opinion, the way the scheme has been implemented will hurt agricultural growth in our country, will hurt small industry, will hurt all those people who are in the informal sectors of the economy. And my own feeling is that the national income, that is the GDP, can decline by about 2 percentage points as a result of what has been done....After all, 90 per cent of our people works in the informal sector, 55 per cent of our workers in agriculture are reeling in distress. The cooperative banking system, which serves large number of people in the rural areas, is non-functional and has been prevented from handling cash.... all these measures convince me that the way this scheme has been implemented is a monumental management failure.”

Kaushik Basu Leading economist; Senior Vice-President and Chief Economist at The World Bank, said that black money hoarders have already found loopholes: he added that “Anyone seeking to convert more than Rs 250,000 must explain why they hold so much cash, or failing that, must pay a penalty,” Basu wrote in The New York Times. This requirement, he wrote, has already spawned a “new black market to service people wishing to offload: Large amounts of illicit cash are broken into smaller blocks and deposited by teams of illegal couriers”.

Basu said “the move is hurting people who aren’t its intended targets as many individuals who have no illegal money could have build up cash reserves over time”.

Arun Shourie: Former economist at the World Bank; recipient of the Padma Bhushan and Union Minister declared this demonetization an unplanned move of government. He said that “This is not a strike on black money, and the reason for that is that those who hold this black money or who have black assets, they don’t hold them in cash. One percent of Indians own 53 percent of the total assets in India. 10 percent own 85 percent. Now these are the rich fellows, who would be having an even larger proportion of black money. They are not going to put money under the mattress! They are holding it abroad—and there also it’s not dollars in gunny bags, it’s property! Maybe jewellery, maybe other assets, maybe stock markets.”

Impact of the demonetization decision on economy

The de-monetization will have serious impact on overall economy. Some of the sectors will see positive and some will see negative. Parallel economy will be negatively affected by this move. The removal of these 500 and 1000 notes and replacement of the same with new 500 and 2000 Rupee Notes is expected to - remove black money from the economy as they will be blocked since the owners will not be in a position to deposit the same in the banks.

Consumer goods Prices are expected to fall only marginally due to moderation in demand as use of cards and cheques would compensate for some purchases. Real Estate and Property Prices sector are largely expected to fall, especially for sales of properties where major part of the transaction is cash based.

The GDP formation could be impacted by this measure, with reduction in the consumption demand. As former PM Manmohan singh said that GDP is expected to fall more than 2% because of this demonetization decision. This face is considered as transition phase to Indian economy or to Indian banking system, required strong infrastructural needs for fulfilling the demand of system.

This demonetization brings two major changes to the economy. 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. This would result in 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.

MSME is one segment of the economy which is credit constrained. Expansion in the potential credit in the economy could expand the credit available to this segment of the economy which is more employment intensive than the organized manufacturing. In other words, if the access to credit for this segment can be improved, it can generate many positive spin-offs. It is important to mention that credit is not the only constraint faced by the MSMEs. There are so many factors like cost, compliance with regulation, tax legislation and other legislation which would increase the cost of operation. In the absence of economies of scale, after incurring all these costs, some of the MSMEs might not be viable in the new environment.

It is, however, not correct to assume that expansion in credit will definitely materialize. In the last two years, the demand for credit in the economy has been sluggish at best. In comparison to a credit deposit ratio of 1.53 in 2011-12, the figures for 2014-15 were as low as 0.54. While there might be many factors that contributed to this outcome, what is of consequence is that the demonetization has been introduced in this environment where demand for credit is rather low. A compression in demand in the economy would further depress the sentiment driving investments. In other words, demand for credit would continue to be low and the potential credit will not be realized immediately.

The first consequence of expansion of credit would be a fall in the interest rates in the economy. If the demand for credit is not very sensitive to interest rates – then the lower interest rates would not bring in sufficient demand and banks would need to explore alternative ways of placing the additional deposits available with them. This could mean that banks take in more risky assets potentially opening up the economy to more volatility and risks. This could include real estate, consumer credit and consumer credit cards. The housing loan bubble of the US economy might be one such example of lending to more risky projects, thereby bringing in more volatility into the system.

Impact of Demonetization on MSME

1. According to a survey conducted by Dollar Business Bureau demonetisation will leave negative impact on small scale industries.....
2. Aimo conducted a detailed survey for knowing the impact of demonetisation on small scale industries in India. The finding reveals that manufacturing industry lost 30% jobs and 55% revenue.

3. According to the report of the Indian Express “unbanked villages, small businesses badly hits as currency crises continues
4. According to an article on “the cash demonetisation economy” November 2017 a cross section of economy is still smarting from the sharp blows of their exercise. The GDP is severely hit, the manufacturing sector significantly affected and small medium sector worst hit.....
5. The sudden act of demonetization will have negative impact especially on those sectors where cash transaction plays vital role and SME is one of them where most of the transactions in cash. Other sectors included in the list are agriculture, small traders, service sector, household, retail outlet.....
6. Tata steel said that demonetizing will also temporarily impact steel demand in rural India as the business there is mostly cash based.
7. Anil Bhardwaj, Secretary general of the federation of Indian Micro and Small and Medium Enterprises affected severely by demonetization which is quite a huge figure as approx 32% population is employed in MSME.

Conclusion

After reviewing the analysis of various leading economists, it can be concluded that though this demonetization decision bring the condition of social and economic unrest, the oppositions have their own share of criticism for government. There argument is that, India is the currency based economy where maximum transaction are done in cash form, even the farmers and daily wage earners are paid in Rs 500 and Rs 1000 denomination So it will quite difficult for them to comprehend the new mechanism.

As it was a major change in the economy thus it took so many efforts by the side of government to cope up with this change. As the phase is considered as the phase of economic and social transition hence if we are able to manage it properly it can be beneficial in Indian context as far as long run is concerned.

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