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Is worst of recession coming in India?

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Abstract

Business cycle is a part of the capitalist system. Liquidity crunch and bursting of housing and financial bubbles in the advanced countries (particularly USA) led to economic crisis in 2008. A slowdown in the US had influenced almost all economies. This was no longer confined to the western world. India along with others countries also felt the heat. After widespread contraction in economic activity and loss of exports and employment, consumption led Indian economy performed well in this recession. With the announcement of the demonetization and introduction of new notes, now the main concern is that economy may face more serious challenges in coming years than we have seen during the recent global downturn. The present paper has been made to highlight will the worst of recession is coming or cashless economy will achieve the objective of economic growth and financial inclusion.

Keywords: Recession, demonetization, growth, employment, cashless economy

Introduction

War and politics have been the focal point of the downfall of many dominant nations, but poor economic decisions have also led to countries falling. With the announcement of the demonetization and introduction of new notes, the main concern at present is that the economy may face more serious challenges in coming years than they have seen during the recent global downturn. The present paper has been made to highlight will the worst of recession is coming or cashless economy will achieve the objective of economic growth and financial inclusion.

Business cycle is a part of the capitalist system. Keynes defines in his Treatise of money: "a trade cycle is composed of periods of good trade characterised by rising prices and low unemployment percentages, altering with periods of bad trade characterised by falling prices and high unemployment percentages." A typical cycle is generally divided into four phases: 1. Expansion. 2. Recession 3. Depression 4. Recovery.

Before the Great Depression of the 1930s any downturn in economic activity was referred to as a depression. The term recession was developed in this period to differentiate periods like the 1930s from smaller economic declines that occurred in 1910 and 1913. A depression begins during a recession when GDP falls below the long-run trend and ends in the recovery when GDP rises above that trend. Joseph Schumpeter accepts Juglar's statement that "the cause of depression is prosperity". According to Prof. R.G. Hawtrey, "The trade cycle is a purely monetary phenomenon, 'Prosperity cannot continue limitlessly. Albert Aftalion Arthur C. Pigou and John M. Clark placed expectations as the central cause of fluctuations. The stock market crash of 1929 and failure of banks led to the Great Depression. Keynes predicted that the concentration of wealth would drain the purchasing power of the middle and lower classes, those most likely to consistently support demand for goods and services. Such an economy would become dangerously dependent on the luxury spending of the wealthy few and on unsustainably high levels of private investment.

The origin of economic crisis in 2008 can be traced back to mid-2007 with the huge size of this sub-prime housing loan market. Wall Street financial engineers had packaged these loans to really complicated financial instruments called Collateralized Debt Obligations (CDOs). The economic crisis 2008 was different from the Great Depression of 1929-33. Economies then were less integrated than they are today. Our economy has felt the impact of the crisis, not only in our stock market but also through its liquidity and wealth effects, on our real economy also. There was loss of confidence in the sustainability of our domestic fundamentals such as GDP growth, credit expansion,

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interest rates and inflation differentials and exchange rate expectations. Admitting of this, the demonetisation was announced in order to curb terrorist financing and counterfeit currency and to eradicate the black economy.

Over the past several decades, the Indian economy is facing a growing challenge with respect to black money generation and accumulation. Almost every sector in our country generates and uses black money for its survival in the market. It includes real estate, financial market, bullion & jewellery market, external trade, mining, telecom, non-profit organisations and so on. Black Money in India is generated through activities which are not legally recognized, such as crime and corruption; and activities which are legally recognized but not accounted for leading to an evasion of tax.

Black Money in India

Black money is a big menace for the Indian economy. It leads to less tax for the government, uncontrollable inflation, mass poverty, impact on growth by moving investments on gold, stones and jewellery, corruption, inflated real estate, transfer of funds abroad, encourages anti-social activities, increase in inequalities of income, wasteful consumption, decrease in working efficiency of people and so on. A number of administrative and legislative policies have been formulated by the government to counter the problem of black money. Government of India has introduced commissions under Kaldor, Wanchoo, Rangnekar, Chopra, and Gupta for estimating black economy. Searches, seizures, surveys, and scrutiny of income tax returns are being done. Introducing the scheme of Special Bearer Bonds, demonetizing high denomination currency notes, stringent raids and scheme of voluntary disclosures are some of the schemes introduced by the govt. to curb black money. Amendments have also been made to the Finance Act 2004 to intensify efforts. India has tried to combat tax evasion by permanent account number (PAN) for all major financial deals. Prevention of Money Laundering Act enacted in the year 2005 is a core measure to curb the problem of money laundering. Further, the legislature introduced the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act in the year 2015 to tackle this problem.

Effects of demonetization

In addition to it, demonetization has been announced as a step towards curbing black money. It is argued that this move by the government is likely to have long term benefits for the economy. This move is likely to lead to better tax compliance, raise the Tax to GDP ratio and improved tax collection. This could lead to lower borrowing and better fiscal management. The extinguishing of the major proportion of unaccounted currency would reduce the liabilities of the government and would add to its finances. With a large part of the cash moving through the banking channels, the banking sector is likely to be flush with funds in the near term. Demonetization would likely to reduce real estate prices. Also with lower cash transactions in the near term, inflation may see a downturn in the near term. Also with higher tax to GDP ratio, the government may also get enough headroom to reduce the income tax rates, which can lead to higher disposable income with people and can improve consumption demand in the near future. Fake Indian Currency Notes network will be dismantled by the

demonetisation measures, thus affecting the funding of terror networks in the country.

As a result of demonetization, many financial transactions that were not reported as an economic activity would now be added to the GDP, therefore it will only add to the GDP, not reduce the GDP. With nearly five state elections in 2017, demonetization has also curbed the undeclared funds of political parties. By this move many new accounts have been opened. Bank branches have been growing, ATMs, debit cards, and card-swiping machines have increased, Online transactions have grown. PayU India (E-Commerce portal), Paytm 'Ola Money' registered increase in their e-wallet. Consumers who are otherwise using cash mode of payments, have started switching over to e-payments.

On the other side, due to demonetization, India risks its position of being the fastest growing largest economy. Reduced consumption, income, investment etc. may reduce India's GDP growth as the demonetization has affected only the stock of cash but activities also.

We are the fourth-largest user of cash in the world. Factors like dependence on agriculture, existence of a large informal sector, and insufficient banking contribute to the large cash economy in India. Cash circulation has slowed down significantly in the economy after demonetization came into effect. Consequently, business across sectors has declined as consumers are prioritizing spending on necessities. Farmers also faced difficulties in buying inputs and selling outputs. Traders, Retailers, Small and Medium industries all were damaged. The question arises whether it will worsen the recession or bring the country out of it. The supply chain was disrupted and has affected production. Transport industry is at a standstill. Rickshaw pullers, vendors, domestic servants and daily laborers - not only the wage earners but middle class all are adversely affected. It has affected supply as well as demand. The currency ban has reduced the money supply drastically, thereby resulting in a GDP contraction, low employment opportunities and low consumption in the economy. A possibility of increase in inflation will worsen the balance of trade. This could result in pressures on the rupee towards depreciation.

Deposit in the short term may rise, but in the long term, its effect will come down. People are depositing the money into banks just to convert the old notes into new notes. It will be converted into active liquidity by the savers when full-fledged new currency supply will take place. So, banks are going to have short-term deposit. Only a small portion of black money is actually stored in the form of cash. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. People have found ways of recycling this. People in order to turn black money into white money are largely buying gold and jewellery. One can buy Bit coins easily and can convert back to money anytime. Businessmen gave advance salary to their servants and workers. The accounts of Jan Dhan Yojana is being used in large amount. Terrorists again can counterfeit the new currency notes. It is assumed that black money will again be generated and the purpose of introducing new currency will be defeated. Rather, this will lead to inflation and worsen the balance of trade. The collapse of confidence has affected not just domestic investors but also their foreign counterparts.

As most of people are illiterate, poor, engaged in small transactions and having less banking habits. For them cash is the most convenient and easy form of medium of

exchange, free from hassles. The small trader is not able to sell goods. Even the large trader is not able to sell produce. So circulation of income is slowing down, leading to a decrease in demand. Money in circulation is like the blood flow of the body, which keeps everything going. A decline in money supply will directly impact growth in the economy.

Recent month has seen millions of poor and middle class people, with no cash to buy food and medicines, stand in long queues to access their own money from the banks and ATMs. There is mismatch between people's preferences for cash and the availability of cash. The people who will suffer the most are those in the unorganized sector, as they don't have credit or debit cards or card readers. They are the ones who need more currency in circulation. Government itself acknowledged that its decision to pull high-value bank notes has caused pain in large parts of the economy as it lowered its growth forecast. In the survey, the government lowered its growth forecast for the 2016-17 to 7.1 percent, down from 7.6 percent in the previous year. The International Monetary Fund has also forecasted 6.6 percent growth rate for Indian economy in the current fiscal year against China's projected rate of 6.7 percent. "Growth slowed as demonetisation reduced demand, and increased uncertainty," said the survey. 'Hardship and inconvenience'

Conclusion

Due to demonetization, an economy that was supposed to have healthy macroeconomic parameters is going to see a sharp deterioration in these parameters which would aggravate the recessionary conditions and the irreversibility. While not entirely addressing the black economy. Cash crunch will have a dampening impact on inflation. This will reduce our consumption-based economic growth and even deepen instability in currency and asset markets. A better solution would have been simplify and reduce taxes; cut regulations, eliminate loopholes and widen the tax base. There is hope and a greater scope for fast transition to cashless economy.

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