



Finance Management

Elixir Fin. Mgmt. 102 (2017) 44405-44407

Elixir
ISSN: 2229-712X

Bang of demonetisation of Indian currency on Nepal-India trade

Shailendra Siwakoti

Faculty of Management, Tribhuvan University, M.M.A.M.Campus, Biratnagar, Nepal.

ARTICLE INFO

Article history:

Received: 21 November 2016;

Received in revised form:

6 January 2017;

Accepted: 16 January 2017;

Keywords

Demonetization,

Economy,

Government,

Kinship,

Movement.

ABSTRACT

This paper deliberated to impact of domestic trade and Nepal-India trade by demonetization of Indian currency by Indian government. The Indian government is claiming that the action is a surgical strike against black money. The demonetization of the large bills has received mixed reactions. A large section of industry and the public reacted to the decision with overwhelming support, stating that the government should have taken such action a long time ago. Their point is that deflation is the most prominent and quick bang that is going to be seen in the Indian economy. On the other hand, this move is not only going to affect the Indian economy but also the Nepali economy, which is very closely linked to India.

© 2017 Elixir All rights reserved.

Introduction

As close neighbors, India and Nepal share a unique relationship of friendship and cooperation characterized by open borders and deep-rooted people-to-people contacts of kinship and culture. There has been a long tradition of free movement of people across the borders [Andersen, Torben, M., 1994]. Nepal has an area of 147,181 sq. kms. and a population of 29 million. It shares a border of over 1850 kms in the east, south and west with five Indian States – Sikkim, West Bengal, Bihar, Uttar Pradesh and Uttarakhand – and in the north with the Tibet Autonomous Region of the People's Republic of China. The India-Nepal Treaty of Peace and Friendship of 1950 forms the bedrock of the special relations that exist between India and Nepal. Under the provisions of this Treaty [Berg, Andrew, and Catherine Pattillo, 1998] the Nepalese citizens have enjoyed unparalleled advantages in India, availing facilities and opportunities at par with Indian citizens. Nearly ten million Nepali citizens live and work in India. The trade between Nepal and India is more than 90% and transaction in Indian currency so highly impact for the demonetization Indian currency by Indian government. There is no official estimate of how much Indian currency is in circulation in Nepal, but the fact that it is freely acceptable and convertible in Nepal – in some places outnumbering the Nepali currency – indicates that its volume is quite huge. The Central Bank said it has around twenty million Indian currencies with it, and has asked the government to work out an easy way out for their exchange through diplomatic channels. In addition, a large number of commercial banks, some in official collaboration with Indian banks, and the State Bank of India also have their sizable presence and transaction [Blackburn Keith, and Martin Sola, 1993]. Unofficial ballpark figure suggests there is at least 1,000 million Indian rupees in Rs 500 and Rs 1,000 denomination in circulation in Nepal. This is just a representative case of how every ordinary Nepali is being affected without knowing the way out. Far west Nepal, adjoining stretch of Uttar Pradesh and Uttarakhand, has more Indian currency in circulation than the Nepali notes as more

people go for work and studies in India than in Nepal from this region. Besides these, large number of pensioners from India Army – about three million – live in Nepal, and business people and traders in major border towns – Birgunj, Bhairahawa, Biratnagar and Nepalgunj as well as Indians doing business in Nepal – deal with their partners and suppliers on the other side on a routine basis. Ranin Dahal, general secretary of Federation of Nepalese Chamber of Commerce and Industries (East) said there are thousands of Indian labours working here, without any bank account in India, and they are the worst sufferers. Rs 500 and Rs 1,000 currency notes were earlier 'banned' in Nepal, but Prime Minister Narendra Modi lifted the ban during his first visit to Nepal in July 2014, with Nepalese coming from India allowed to carry Rs 25,000 each time. That also legitimized the use of those currency in trade and business in big volume. Apart from the casinos where Indians frequent, private hospitals with official or unofficial arrangements for their patients being referred to Delhi, Gorkha pensioners, students in Indian schools and universities and traders are among the most affected. And so far, none of them knows how to have their 'savings' or hidden money being exchanged. Indian government came out with a surprise announcement that 500- and 1,000-rupee banknotes would cease to be legal tender. The move has not only shaken India but also many South Asian economies that are tied to the Indian economy. The Indian government is claiming that the action is a surgical strike against black money. The demonetization of the large bills has received mixed reactions. A large section of industry and the public reacted to the decision with overwhelming support, stating that the government should have taken such action a long time ago. However, some sections, including political leaders, are saying that it is a draconian scheme causing hardships to the people. Experts are saying that though the move is a smart step in the effort to eradicate black money, terrorist funding and arms smuggling, there was little preparation, and hence, it will create some problems in the Indian economy in the near future.

Their point is that deflation is the most prominent and quick impact that is going to be seen in the Indian economy. However, this move is not only going to affect the Indian economy but also the Nepali economy, which is very closely linked to India.

Nepal's central bank halts transactions with Rs 500, Rs 1000 Indian notes

HT Correspondent, Hindustan Times, Kathmandu | Updated: Nov 10, 2016 20:33 IST



Control of Black marketeering

The legal provision regarding Indian currency in Nepal is creating confusion among Nepali citizens. Trade in the country's border areas has almost stopped in the last few days. This is going to create some quick inflationary impact on Indian products in the Nepali market. However, the situation is not going to last long. Meanwhile, black marketeering has spread in the border areas of Nepal. Indian banknotes of Rs500 and Rs1,000 denominations are being exchanged at par with the Nepali rupee. The Nepal Rastra Bank (NRB) has reported that the formal banking system holds Rs500 and Rs1,000 Indian banknotes totaling INR33.6 million. However, this total does not include the cash in the possession of the general public, businesspeople and Indian tourists in Nepal. Apart from that, the NRB has issued a directive to all banks, financial institutions and money transfer companies to immediately halt transactions of Indian currency of these denominations. This move has created total chaos among Indian currency holders, and is, indeed, promoting black marketeering in Nepal. Nepali citizens returning from India and those holding demonetized Indian currency notes have become victims of black marketeering. They are compelled to exchange them with black marketers who accept them at par with the Nepali rupee or for an even lower rate. Moreover, the demonetization of the large bills can also have a draconian impact on the rural economies of Nepal, mostly in the mid- and far-western regions where many people work in India to feed their families. They hold more Indian currency notes than Nepali currency notes because most of these villages do not have a bank. And business transactions are mostly conducted in Indian currency.

Publicity campaign

Residents in these regions could face a huge problem. Even if they get to a bank somehow, it will not do any good because banks have stopped accepting these notes. Many people here may not even understand what it means when Rs500 and Rs1,000 notes have been cancelled. Thus, if these areas are not taken seriously, and something is not done in time about the banknotes in their possession, their savings are going to turn into ordinary paper. Moreover, asymmetric information could lead to villagers being cheated by black marketers spreading rumors that paper currency of other denominations too has been cancelled. Thus, the concerned bodies should launch a massive publicity campaign, particularly in rural areas that lack access to information,

about the procedure for exchanging the demonetized Indian bank notes. Specifically, NRB should direct financial institutions to collect legally earned Rs500 and Rs1,000 Indian banknotes from Nepalese and talk to its Indian counterpart, the Reserve Bank of India, to take these currency notes back from Nepal. Otherwise, The aim of this paper impact of demonetization of Indian currency on trade of Nepal and discourage black money will promote black marketeering in Nepal and spread panic among the Nepali people but direct impact of domestic trade to adjacent part of northern India and tarai region of Nepal.

Methodology

The study uses a logic and direct survey model that considers how various macroeconomic data and political events affect the probability of a crisis. It is based on data from 21 developed economies and 16 emerging market economies, with an emphasis on variables that are consistent with the literature on speculative attacks and currency crises. On an average, trading activity measured by traded capitals, share volume and number of trades, has significantly negative effect on price volatility after eliminating the effect of the persistence in volatility. However, certain features of the Asian crisis were decidedly different from the earlier ones.

In most of the Asian economies, macroeconomic performance measured in terms of growth and inflation was generally strong, and monetary and fiscal policies were considered to be fairly consistent with maintaining exchange rates. Consequently, the Asian crisis was widely unanticipated. It appeared to be rooted in financial sector fragilities, stemming, in part, from weaknesses in governance in the corporate, financial, and government sectors. Given the rapid movement of international capital, the weaknesses exposed in those countries made them increasingly vulnerable to changes in market sentiment, a deteriorating external situation, and contagion. The authorities in several of the east Asian countries allowed the exchange rates to continue to float rather than readjust the pegs to rates that the markets deemed defensible and that were consistent with medium-term fundamentals. Their decision to keep floating opened the door to continued market depreciation. As the economic climate worsened amid political uncertainty, capital flight continued. Capital flight, coupled with currency depreciation, weakened the corporate and financial sectors. Inflation rose sharply in Nepal.

Results and Discussions

The Nepal Rastra Bank and other financial institutions have already stopped exchange of Indian currency. "Most people are still holding Indian rupees, which they brought from India after Dusshera and Diwali," Murarka said. The industry leader said the Nepal Rastra Bank might allow exchange limit of Rs 25,000 per Nepalese citizen. Though there are reports that Indian businessmen are sending their black money to Nepal and exchanging it for half the value, experts say exchange of Indian rupee once allowed will only be in the Nepalese rupee, which is not in transaction outside the Himalayan country and defies the purpose of money laundering.

According to India's Ministry of External Affairs (MEA), around 600,000 Indians are working or domiciled in Nepal whereas six million Nepalese are working in India.

In recent years, trade between the countries has increased substantially.

"Exports from Nepal to India increased from Rs 230 crore in 1995-96 to Rs 3,713.5 crore (\$605 million) in 2013-14 and India's exports to Nepal increased from Rs 1,525 crore in 1995-96 to Rs 29,545.6 crore (\$4.81 billion) in 2013-14," says the MEA website. There are media reports that people from bordering Nepal, which shares 1,850 km with five Indian states – Sikkim, West Bengal, Bihar, Uttar Pradesh and Uttarakhand – are flocking to India to exchange their Indian currency. Business is mostly affected in the Madesh area, which has 21 districts. The Madeshis mostly trade in Indian currency due to its closeness to Bihar and Uttar Pradesh. The NRB issued the directive after the announcement of the Indian Prime Minister Narendra Modi in his televised address to the nation on Tuesday evening about the demonetization of Rs 500 and 1000 currency notes with effect from midnight. The Indian Prime Minister also shared that the new notes of high-security Rs 500 and Rs 2000 will be soon introduced to the market. NRB, the central bank of the country, has also made a decision to write to the central bank of India -the Reserve Bank of India - for the management of the Indian Currency notes of Rs 500 and 1000 denomination in Nepal. The notes of IC Rs 500 and Rs 1000 denomination that will no longer be legal tender in India is bound to directly impact currency market in Nepal, the economic experts argue. Millions of Nepalese in India and those residing and working in various bordering places between Nepal and India stretching across 1,800 kilometers are also likely to be affected from this move of the Indian government taken up to tackle black money and fake currency [The Kathmandu Post. Nov. 2016]. The latest move of the Indian government has also posed a challenge in the management of Indian money worth billions possessed by the Nepalese [Brown, William Adams, Jr., 1940]. The provision put in place for the Indian public holding notes of Rs 500 and Rs 1000, who can deposit the same in their bank and post office accounts from November 10 to December 30 showing their passports or permanent account number (PAN), has further made it difficult for this section of Nepalese working in India but not bearing any passport or PAN. As far as the reserve of these notes in the banking system of Nepal is concerned, that the NRB and the government should work in tandem to resolve the issue through the diplomatic measure [The Indian Express Online Media Pvt Ltd]. Experts said the Indian government's decision would hit Nepalese pilgrims, traders, students and people going to the neighboring country for treatment. Millions of Nepalese citizens also live in India and those residing and working in areas along the 1,800-km border are also likely to be affected by the move, they said. The Indian government has allowed people to deposit old notes in their bank and post office accounts after showing identity documents such as passports or permanent account number (PAN) but experts said many Nepalese working in India do not possess such documents.

Conclusions

We identify a set of 'rules of thumb' that characterize economic, financial and structural conditions preceding the onset of banking and currency crises in 36 advanced economies over 1970–2010. We use the classification and regression tree methodology and its random forest extension, which permits the detection of key variables driving binary crisis outcomes, allows for interactions among key variables and determines critical tipping points.

We distinguish between basic country conditions, country structural characteristics and international developments. We find that crises are more varied than they are similar.

For banking crises, we find that low net interest rate spreads in the banking sector and a shallow, or inverted, yield curve is their most important forerunners in the short term. In the longer term, it is high house price inflation. For currency crises, high domestic short-term rates coupled with overvalued exchange rates are the most powerful short-term predictors. We find that both country structural characteristics and international developments are relevant banking-crisis predictors. Currency crises, however, seem to be driven more by country idiosyncratic, short-term developments. We find that some variables, such as the domestic credit gap, provide important unconditional signals, but it is difficult to use them as conditional signals and, more importantly, to find relevant threshold values. So government of Nepal should take seriously with respect to control of domestic deal.

References

1. Andersen, Torben, M.. 1994, "Shocks and the Viability of a Fixed Exchange Rate Commitment." CEPR Discussion Paper 969 (London: Centre for Economic Policy Research).
2. Berg, Andrew, and Catherine Pattillo, 1998, "Are Currency Crises Predictable? A Test." IMF Working Paper 98/154 (Washington: International Monetary Fund).
3. Berg, Andrew, Eduardo Borensztein, and Catherine Pattillo, 2004, "Assessing Early Warning Systems: How Have They Worked in Practice?" IMF Working Paper 04/52 (Washington: International Monetary Fund).
4. Blackburn Keith, and Martin Sola, 1993, "Speculative Currency Attacks and Balance of Payments Crises," *Journal of Economic Surveys*, Vol. 7, (June) , pp.119–44.
5. Bordo, Michael, and Anna J. Schwartz, 1996, "Why Clashes Between Internal and External Stability Goals End in Currency Crises, 1797-1994," *Open Economies Review*, Vol. 7 (Supplement), pp. 437–68.
6. Brown, William Adams, Jr., 1940, "The International Gold Standard Reinterpreted, 1914-1934" (New York: National Bureau of Economic Research).
7. Buiter, Willem, Giancarlo Corsetti, and Paolo Pesenti, 1995, "A Center Periphery Model of Monetary Coordination and Exchange Rate Crisis," NBER Working Paper 5140 (Cambridge, Massachusetts: National Bureau of Economic Research).
8. Calvo, Sara, and Carmen M. Reinhart, 1996, "Capital Flows to Latin America: Is there Evidence of Contagion Effects?" in *Capital Flows to Developing Economies*, ed. By Morris Goldstein (Washington: Institute for International Economics).
9. Dornbusch, Rudiger, Ilan Goldfajn, and Rodrigo O. Valdes, 1995, "Currency Crises and Collapses," *Brookings Papers on Economic Activity*: 2, 219–93.
10. Duttagupta, Rupa, Gilda Fernandez, and Cem Karacadag, 2004, "From Fixed to Float: Operational Aspects of Moving Towards Exchange Rate Flexibility," IMF Working Paper 04/126 (Washington: International Monetary Fund).
11. The Indian Express Online Media Pvt Ltd
12. Prasanna Kumar Baral/ Elixir Fin. Mgmt. 90 (2016) 37292-37299
13. The Kathmandu Post Nov. 2016.