

# DEMONETISATION AND ITS IMPACT ON INDIAN ECONOMY

DR. RANJANA SAHU

G.S. College of Commerce and Economics, Nagpur

*ranjanatsahu@rediffmail.com*

**Abstract:** One announcement by the government of India on 8<sup>th</sup> of October, 2016 to withdraw 500 and 1,000 rupee notes from circulation and making it an illegal tender to repudiate the value of 86% currency with the primary aim of chasing black money, curbing corruption, stopping the funding of terrorism and to tackle the problem of counterfeit currency has affected the Indian economy to a great extent. This paper attempts to gauge the impact of demonetization on overall economy when nearly half the economy runs entirely on the basis of currency transactions. This paper gives a clear picture of changing scenario from swapping of currency to swiping of cards, switching over to click from brick and mortar bank and also attempts to analyze whether demonetization was successful in achieving its objectives. This paper throws light on challenges and opportunities post demonetization in India. This paper gives a critical analysis of role of financial system in the success of demonetization in India.

**Key words:** Demonetisation, black money, digitization, Indian economy, cashless, cash crunch, currency.

## Introduction:

*“When you have eliminated the impossible whatever remains, however improbable, must be the truth.”*

### *Sherlock Holmes*

One announcement by government of India on 8<sup>th</sup> of October, 2016 to withdraw 500 and 1,000 rupee notes from circulation and making it an illegal tender to repudiate the value of 86% currency with the primary aim of chasing black money, one of the major problems acknowledged by everyone has affected every Indian of all age, caste, class, religion, region, profession, business, self employed though degrees may differ. India is a cash based economy with 1.3 billion of population (May 2016), it will take time to switch over to a cashless or less cash economy.

A Credit Suisse Global Survey shows that India alone accounts for nearly 250 million of the world’s poorest people. Long waits in the queues at banks are the collective sufferings, sufferings of farmers, jobless migrant labourers and daily wage earners can’t be estimated. The adverse impact is not an end, just a beginning on the hope “we’ll overcome one day” and that “every dark cloud has a silver lining.” The differential impact of demonetization on rich and poor also limits its impact on benefits.

## Review of literature:

Samal, Kishore C, (1992) in his paper, “Chasing Black Money in India” gives a history of the various measures taken by the Government of India to mop up black money since 1946 such as demonetization, voluntary disclosure schemes and bearer bonds. Journal of Indian School of Political Economy, April-June 1992

Tripathi Ashish K (2016) in the paper, “Demonetisation challenges for Rural India” points out that demonetisation is good but our financial system should be ready to change. Also it would be too early to come to any conclusion regarding its success or failure of this demonetization in Indian Economy.

**Research Methodology:** Descriptive design has been used in this research which is based on secondary data. Secondary data has been taken from various government and non-government publications on demonetisation and from articles related to it published electronically or otherwise.

**Objectives of the study:** The following are the objectives of this study:

- To study the overall impact of demonetization in Indian Economy.
- To suggest measures to improve the condition post demonetization in India.

**Hypothesis of the study:** Hypotheses for this research are as under:

- The differential impact of demonetization on rich and poor limits its impact on benefits?
- Transition to cashless economy from cash based economy is difficult?

**Meaning of Demonetization:** Demonetization in a booming economy is like a huge gamble, with a limited impact on black money (unaccounted money), corruption, terrorist activities, cash hoarders and counterfeit currency. Demonetization is the act of stripping a currency unit of its status as legal tender. When any Government withdraws the legal tender rights of any denomination of currency, it is known as demonetization.

In terms of value, the annual report of Reserve Bank of India (RBI) of 31 March 2016 stated that total bank notes in circulation valued to 16.42 lakh crore of 500 and 1000 banknotes.

**History of demonetisation in India:** Demonetisation of Indian currency notes of higher denominations and voluntary disclosure schemes by Government of India to mop up black money which is generated due to undisclosed monetary deals and transactions for evading taxes is not for the first time in India.

Government of India demonetized currency in 1946 and 1978, the number of active users of e-banking services in India were very less in 1946 and 1978 making it difficult for the people. This is the third time when government demonetized high value notes. In 1946, hundred rupee currency notes were demonetized, a time limit was provided for the exchange of old currency on the basis of declaration and was not allowed if the source of income was not satisfactory. But it did not produce impressive results.

It was again announced by the government of India, on 16<sup>th</sup> January, 1978 to demonetise all the currency notes of denomination of Rs. 1,000 and above. Currency notes of Rs. 5,000 and Rs. 10,000 were in circulation in the economy. The high denomination notes were already out of circulation a week before the demonetization, exchanging old notes at a discount and sent to gulf countries were also reported as secrecy could not be maintained. It was also stated that frequent demonetization of currency notes will not serve any of the purpose as people will convert their black money in high denomination notes convert them into smaller denomination notes.

**Present Demonetisation in India (2016):**

“This move was needed to address the issue of corruption in the country, other issues in terms of counterfeit money is important but secondary. A possible 2.5 lakh crore windfall for the government, a lower rate of interest regime for a prolonged period, better tax compliance, recapitalization of battered state-run banks are among the benefits to be delivered by demonetization of currency in India this time.”

**KV Kamath, Chairman of New Development Bank of BRICS countries.**

People dumped banknotes at discounts of 40% to middlemen and then instead of discounts, premia were offered in the form of interest rate between 6 % to 8 % to the persons who deposited old cash with one year locking period.

Stories of some bank officials indulged in illegal practices for personal gain, as on one side there is shortage of new currency, long waiting serpentine queues and on the other side there are instances of seizure of new notes in large volumes with some, is also a truth.

**Process of demonetization:** 2,010 crore pieces of smaller denomination, 170 crore pieces of Rs. 500 and Rs. 2,000 denominations notes were printed during one month 10 November to 10 December this year in the process of demonetisation. Reserve Bank of India released Rs. 4.6 lakh crore and Rs. 12.4 lakh crore were returned to banks by December 10, 2016.

**Cost benefit analysis:** Cost benefit analysis is must, right from cost of paper, printing of new currency notes, making it available to banks and ATMs through Chest, recalibration required due to little variation in size of notes, payment to all the technicians, cost of logistics to make the availability in remote areas in quick span of time, interest factor concerned, loss of working hours, loss of productivity and to tragic deaths.

**Demonetisation and its impact in Indian Economy:** This time demon in demonetization seem to have larger impact as compared to earlier moves of the Government of India in 1946 and 1978 as Rs. 500 denomination notes were held by common man not having a single penny of unaccounted money or black money in other words.

i) **Impact on parallel economy:** Wiping of Black money, corruption and counterfeit money are the main objectives of demonetization. Temporarily these objectives may be said to be achieved to a little extent as it affected the circulation of large volume of counterfeit currency, funding of smuggling, terrorism etc.

ii) **Effect on demand:** There is a gradual decline in the demand of consumer goods, real estate, property and automobiles. Many marriages happen in India on Akshay Tritiya and in winters which open the doors for earnings of florist, caterers, tentwala and many more alike purchases which were affected due to lack of cash.

iii) **Effect on prices:** Decline in demand also resulted in fall in prices of consumer goods, perishable items where use of cards and acceptability of cheques are not possible. In cash based economy even the real estate sector may witness fall in prices in the short term.

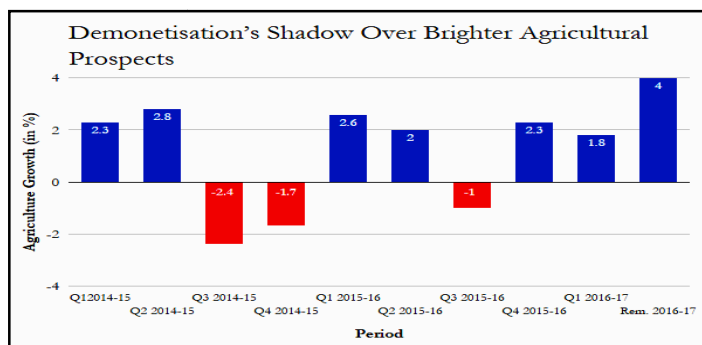
iv) **Effect on economic activities:** There are certain economic activities where the number and frequency of cash transactions are comparatively high as retail outlets, ticket counters, small traders, agriculture, small and medium enterprises, households, etc. Their routine functioning and profit will be adversely affected.

v) **Effect on banks:** Although liquidity of banks will increase as deposits will increase in the short term which may result in more lending and reduction in rates.

vi) **Impact on payments:** Alternative modes of payment as online payment using E-wallets, apps, e-banking, usage of plastic money will increase for which development of infrastructure and systems is needed.

vii) **Impact on agriculture:** Agriculture is the backbone of Indian economy. Economic activity in rural markets has slowed down, many tragic deaths, mandi arrivals of agri commodities also crashed, rural artisans, MGNREGA workers, agricultural labourers suffered a lot as banks run out of cash, it become harder for them to

collect their meager wages. Delayed sowing of Rabi crops could affect the harvest and ripple effects may be visible, macro-economic trend of growth trajectory may be derailed. Drought affected regions are coping with the problems of less rain, less crop and to worsen the effect also facing the problem of less cash. Many farmers with debt burden are committing suicide and due to demonetization deposits in their accounts increase through Jan Dhan Accounts should also be inspected.



**Source: Data released by Deloitte, International Consulting firm**

Thus it is clear from the above graph, that in comparison to the last year, quarterly agriculture growth went down. The demonetization of Rs 500 and Rs 1,000 notes will hurt agriculture, informal sector workers—about 482 million people who earn cash incomes—and disrupt India's consumption patterns for at least the next quarter.

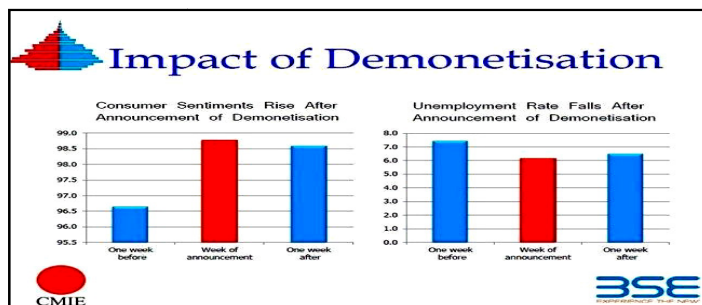
**viii) Impact on productivity:** The loss of working days of every person due to visit to banks or ATMs with long waiting period, the time involved in journey to banks, ATMs in many urban areas should also be considered.

**ix) Impact on industrial growth:** Selling of products and services has become tough in these tough times, thereby registering decline in profit figures this quarter. Many companies are slashing their production and laying off the employees, and threatening jobs of many. FMCG companies are postponing their new product launches as consumers face the currency note shortage in the wake of the government's demonetization drive. Every industry be it big or small, cash based or online players is affected by the demonetization. The used car market is 1.2 times the new car market according to a recent report by vehicle pricing guide Indian Blue Book.

**x) Impact on black money:** Demonetization targets only a small portion of the black economy as the untaxed money is in circulation, doubling the untaxed income, in gold, real estate and overseas assets, the remaining unaccounted money held in cash is only to be converted.

**xi) Impact on digital transactions:** Digital transactions are increasing and also promoted these days. The government of India, through the schemes of Lucky Grahak Yojana, Digi-Dhan Vyapari Yojana unveiled by Niti Ayog and run by NPCI for 100 days will launch on 25<sup>th</sup> December offer Rs.50 lakh to Rs. 1 crore to merchants and consumers for digital transactions till April, 2017. Government is trying to achieve digital inclusion, shifting India to cash-less or less-cash economy.

**xii) Impact on daily wage workers:** Daily wage workers are being laid off or retrenched as a result of low production and have nowhere to go as they have left their villages long back and with no work, no money it becomes all the more difficult to live in cities.



**Source: CMIE, BSE**

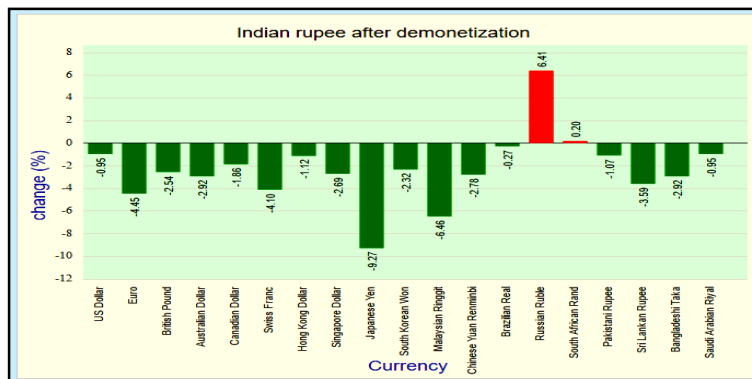
Thus, it is clear from the above graph, the overall consumer sentiment rose over 210 bps to 98.75 from 96.65, while the unemployment rate fell by nearly 150 bps to 6.10 per cent during the week demonetisation was

announced. Disrupted consumption is the main problem and it is going to take time for demand to pick up so that investment picks up.

**xiii) Impact on inflation:** Post demonetization the Wholesale Inflation (WPI) eased to 3.15% in November compared with 3.39% in October due to fall in demand as a result of cash crunch. Consumer inflation touched to two-year low of 3.63% in November compared with 4.2% in October. In the WPI basket, food articles inflation dropped to 1.54% from 4.34%. (data released by Ministry of Commerce and Industry on 14<sup>th</sup> Dec, 2016)

**xiv) Impact on GDP and stock market:** Post demonetization, India's GDP growth may be down by 1% to 1.25% in the quarter ended December 2016. India's economic growth is estimated to slow to 7.1 percent in the current fiscal year ending March 31 compared to 7.6 percent last year, the first indicator of the impact of the demonetisation drive. (data released by the Indian Central Statistics Office). Stock markets are like mirror of economy. Small cap and midcap stocks may see a bull run. IT related software and hardware companies have become investors' first choice when country is moving towards less-cash economy. Stocks of State-run companies on the hope that Government would increase the spending on infrastructure as roads, power, rural housing and farming will show an upward move amidst the worries of economic slowdown.

**xv) Impact on Indian Currency:** Rupee has become stronger than currency of 143 countries or economies which includes Euro, Australian Dollar, Swiss Franc, Singapore Dollar, Japanese Yen, British Pound, Canadian Dollar and Hong Kong Dollar. Out of currencies of 161 countries it has become weaker than 17 currencies after demonetization which includes Russian Ruble and South African Rand



Source: <http://statisticstimes.com/economy/indian-rupee-after-demonetization.php>

As it is clear from the above graph, Rupee has become stronger by 0.95% against US Dollar (\$) from 66.40 to 65.78 INR per unit US Dollar. Indian rupee (INR) became stronger than currencies of other South Asian nations Pakistani Rupee, Sri Lankan Rupee, Bangladeshi Taka.

**Role of financial system:**

Indian financial system played a very important role in the success of demonetization. Formal sector encountered no difficulty in exchanging old cash into deposits but due to lack of liquidity it was troublesome to get new cash in exchange making the overall impact inconvenient for the general public.

Informal sector of the Indian financial system played a role when people faced emergent use of cash and cash were not available, when people faced difficulty in the use of cheques, and other negotiable instruments for payment due to lack of trust on the part of issuer/drawer which also affected many business.

India is witnessing a financial reform. Financial inclusion through PM Jan Dhan Yojana, huge deposits and limited withdrawal will definitely bring about a rise in capital formation as savings get deposited in banks which also includes household savings of all Indian women not essentially black money which they keep intentionally to be used at times of bad fortune.

Formal financial services showed no excellency, be it cash exchange, withdrawal, filling up of forms, people waiting in long queues in banks and ATMs both in urban areas due to cash crunch. Limited reach of brick and mortar banks in rural areas at times when financial inclusion is one of the prime objectives of the government is also a major concern.

Seizure of large volumes of new currency has also put functioning of banks and regulator (RBI) in radar, regulator's role in the light of frauds by Axis Bank official and many other is also making the efforts by government to chase black money go in vain.

**Challenges:**

The biggest challenge of demonetisation which would lead to digitization and increased use of e-banking facilities, is to provide for Cyber Security to protect the data and the people. India's digital infrastructure should be developed for smooth transition to cashless economy. Use of plastic money has increased, debit cards are

there but limited number of places to swipe them is causing pain, limiting its use in rural areas. The real impact would be seen depending on whether the people stick to the use of new financial services.

Honest individuals should not be troubled and harassed in any way in this drive to unearth black money, as many individuals have deposited their life time savings. Purchases of gold and high value goods leave more grounds for investigation and more work for the Income tax department this year which indeed is a big challenge .

When people got money especially in Rs. 2000 denomination after along waiting in queue, there is another problem of getting change for which no one had. The working of banks when news of corrupt bank officials come is also questionable on which the success of this decision depends. It also raises question on the operation and performance of Co-operative banks, most important part of formal sector of Indian financial system.

**Opportunities:**

Demonetization proved to be good in terms of enabling India to move towards a cashless economy and to transform India through digitization. It may be seen as a radical reform with short term pain and long term gain. Despite some inconvenience, sufferings and problems, it will show positive impact in the long run.

It is very difficult to provide for brick and mortar bank within the reach of every villager, and so with the unique advantage of smart phones making cash transfer very easy, it will be easier to solve this problem provided villager change their cheap handphones and government should provide for cheaper smart phones which will prove to be small price to promote a cashless culture in rural India. It also requires a significant investment in training users and on security from cyber frauds and crimes.

There were many who used debit cards, mobile wallets and electronic cash transfer for the first time with a little difficulty but then instances of being helped by techno savvy generation were also common. India is moving to digital banking, many new products, services and systems have popped up wherein there is no need of e-wallet, only mobile number is required to pay an amount upto Rs. 1 lakh per day as declared by Yes bank.

There will be an impact on interest rate which should decline by as much as 100 basis points over a period of six months and inflation will go down, which will drive the economy to a new height.

**Conclusion:**

**“When you change it is progress, when we all change it’s a revolution.”**

This is a time for financial revolution, this move of demonetization will boost digital transactions. Demonetization can be seen as building a bridge to digital nation. Strong infrastructure is the foundation of making a digi-India. The government, through a number of regulatory interventions and path breaking reforms, has significantly eliminated bottlenecks to propel the financial sector to a new growth trajectory. The sector has a number of forward and backward industry linkages, so it will result in the development of nation. Demonetization will lower gaps between haves and have nots, create increased job opportunities and will contribute to economic growth in the long run. This is also true that in this difficult time, only online players with deep pockets will survive. By the time everything gets back to normal, it would have done irreversible damage. The other way of looking things is to stay organized. But most importantly it should not result in survival of the richest and sufferings to the poor.

**“Recall the face of the poorest and weakest man you have seen, and ask yourself if this step you contemplate is going to be any use to him,” Mahatma Gandhi.**

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