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Demonetization and Its Impact

RITU RANI
M.COM, UGC-NET
HANSRAJ COLLEGE, UNIVERSITY OF DELHI

ABSTRACT

Demonetization can be said as a "Surgical Strike" on black money. It can also be said as 'Swachha Bharat Initiative' in the terms of making India free from the garbage of black money. Black money sows the seeds of corruption and money laundering in many sectors. It leads many social, unethical and economic struggles, helps in funding of terrorism, affects real estate and funds illegal activities in the country. To demolish black money and flush out fake currency, the step of 'Demonetization' was taken by the government of India thrice. The last demonetization was announced by the Prime Minister Sh. Narendra Modi at 8:17PM on Nov8, 2016. Currency notes of Rs.500 and Rs.1000 denominations were ceased to be legal tender from midnight that day. It was an attack on black money holders. The present study is made out of available literature on post demonetization. It portrayed the positive and negative effects of demonetization. It encompassed the recent decision of the central government on Demonetization and its gradual effect on Indian economy.

Key Words: Demonetization, Surgical Strike, Black Money, Fake Currency

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

INTRODUCTION

Whenever there is a change in national currency, it is termed as Demonetization. On Nov8, 2016 the Prime Minister Sh. Narendra Modi announced the demonetization of all Rs.500 and Rs.1000 bank notes of the Mahatma Gandhi series. In place of these demonetized currency notes, new notes of Rs.500 and Rs.2000 were declared to be issued. It was stipulated in the announcement that the old demonetized currency notes could be deposited with banks or exchanged with new currency notes over the counter at all banks. People had been given time till Dec 30, 2016. There were limits on currency exchange and cash withdrawals. With demonetization, approx. 86% of the Indian currency was made worthless. RBI data showed that as of March 2016, about 632,936 currency notes were counter feet also known as FICN (Fake Indian Currency Notes). Proportion of Rs.500 and Rs.1000 notes were highest in NIC (Notes In Circulation). Eliminating these FICNs was also a target of the demonetization. Cash in circulation was substantially squeezed. The Specified Bank Notes (Cessation of Liabilities) Ordinance, 2016 was issued on Dec 28, 2016 which ended the liability of the government for demonetized bank notes. It declared imposition of fines on people found carrying out transactions with old currency notes after Nov8, 2016 or holding more than 10 of them after Dec 30, 2016.

Rumours became rife. People devised new ways for saving their hard earned money! Some tried to invest their dying currency in gold. Some contacted their near and dear ones in this miserable hour. People could get only Rs 4000/ of old denomination exchanged with the new one. Big queues before the banks and ATMs became the order of the day.

Instead of getting shorter, these queues were getting longer with every passing day. The last date for the whole process was 30th of December. The persons could deposit the old cash worth Rs 2.5 lac till the said date.

The main objective of this move was to curb the black money, corruption and fake money menace. All the people but those who were indulged in malpractices welcomed the move. The whole opposition shook hand against this move under one pretence or the other. They called this decision a draconian law and wanted the govt to roll it back. Tirades were made to target the decision. Govt also carried out counter attacks.

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

The new currency which replaced the old one was in the denomination of 500/- and 2000/-. Though the people faced a lot of inconvenience owing to shortage of funds, they did not criticize the govt for the move. Rather they lauded the Modi govt for this historic move. Prime Minister also addressed the people many times telling the people that it was a *mahayajna* *(□□□□□□ज्ञ)* and they must offer their own *ahuti (□□□□□)* in it.

He further said he was aware of the hardships they were suffering from but he sought only 50 days for setting the things right. He jibed at the chief political leaders who had stashed big amount of money and therefore, joined hands to force govt to rollback its decision. The most interesting thing regarding the demonetization was that people had devised various unique methods for transforming their black money in to white one. Some of these methods were as follows –

- Depositing money in the accounts of their poor relatives and friends.
- Enticing the people with some percentage of money for exchange.
- Asking their employees to stand in the long queues in front of Banks and ATMs for getting money exchanged.
- Hiring labors for some Rupees ranging from Rs 500/- to 700/- for becoming the part of long queues in front of banks/ ATMs.
- Converting black money in to gold.
- Paying a few months salaries in advance.
- Paying back loans forcibly.
- Using their influence / links with bank employees and so on.

REASONS OF DEMONETISATION

- To curb black money.
- To control inflation rates as demands of people holding black money were rising day by day.
- To move from cash to cashless economy.
- To lower the cash in circulation which was the main cause of corruption?
- To eliminate money laundering.
- To diminish fake currency so that terror funding and other illegal activities come to an end.

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

LITERATURE REVIEW

Nithin and Sharmila (2016) studied demonetization and its impact on Indian Economy. They opined that demonetization has short term negative impact on different sectors of the economy and such impacts are solved when the new currency notes are widely circulated in the economy. They also argued that the government should clear all the problems created due to demonetization and help the economy to work smoothly.

Nikita Gajjar (2016) deliberated a study on Black Money in India: Present Status and Future Challenges and Demonetization. She described the framework, policy options and strategies that Indian Government should adapt to tackle with this issue and the future challenges to be faced by the Government.

Vijay and Shiva (2016) examined demonetization and its complete financial inclusion. They felt that the rewards of demonetization are much encouraging and the demonetization is in the long-term interest of the country. They expressed that it had given temporary pain but it taught financial lessons. It influenced banking industries to do considerably investment on digitalization of banking services.

Manpreet Kaur (2017) conducted a study on demonetization and impact on Cashless Payment System. He said that the cashless system in the economy has many fruitful benefits less time-consuming, less cost; paper less transaction etc. and he expected that the future transaction system in all the sectors is cashless transaction system.

Lokesh Uke (2017) researched on demonetization and its effects in India. He studied positive and negative impact of demonization in India. The study was based on secondary data available in newspaper, magazines etc. The main purpose of demonetization is to eradicate the black money and diminish the corruption. He expressed that Government of India has become success to some extent. Demonetization had negative impact for a short duration on Indian financial markets. But he said that the real impact will be shown in future.

Sweta Singhal (2017) carried out research on Demonetization and E Banking in India. It was a case study to check the awareness level of people of rural areas in India about e-banking facilities and how much it has increased after demonetization. A sample size of 100 was used with ANNOVA test to show that rural people differ much with urban people in their awareness level as well as usage level of e-banking. It was found that urban male youth have

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

higher awareness and usage of e-banking. She felt that the study shall also helpful for banks to improve their e-banking facilities.

OBJECTIVES OF THE STUDY

1. To study the influence of demonetization on Indian economy.
2. To find out positive and negative results of post demonetization on Indian economy.

METHODOLOGY OF THE STUDY

The study is based on Secondary Sources of data. It includes available published literatures such as books, journals, newspapers and relevant government websites. The study tries to look at the extent of demonetization influence on Indian economy.

DEMONIZATION AND INDIAN ECONOMY

The Indian Economy which was billed as the "fastest growing major economy" in the world and the "only bright spot" among Emerging Markets seems to have slowed down even before the latest "shock therapy" of "demonetization". Indeed, the recently released growth figures from the CSO or the Central Statistical Office considered to be the official department that releases projected, and actual growth figures (apart from the RBI or the Reserve Bank of India and the Finance Ministry) hints at a slowdown in the Indian economy even during the quarter before demonetization happened.

While this is indeed cause for concern with projected growth figures revised downwards from 7.6 % to 7.1% for the financial year ending March 2017, what is cause for greater worry and even alarm is the view among some economists including the former Prime Minister Dr. Manmohan Singh (who is a reputed economist in his own right) that the current and ongoing attempt to flush out black money would shave a good 2% of the GDP or the Gross Domestic Product.

Indeed, some think tanks and research institutes such as Ambit Research have given even more dire assessments with their projections of growth figures tending to be in the less than 3% range. Of course, the consensus view among many economists is that while there would be indeed a noticeable slowdown in the economy for a "quarter or two", most of them seem to

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

agree that growth would indeed bounce back and the Indian economy would regain its momentum as well as turnaround with a renewed sense of vigour due to higher tax revenues.

Having said that, one must keep in mind the fact that as per the recent estimates by some economists, **nearly 90% of the total cash in circulation has come back into the banking system** and hence, the stated purpose of the Demonetization exercise which was to "extinguish" black money and enable the RBI to lower its liabilities thereby providing the government with a huge dividend seems to have been belied. Of course, there are some who now argue that the Indian Banking System is now "flush with cash" and this has enabled the government to "nudge" the RBI to cut rates as well as to allow banks to pass on the benefit of ample liquidity to consumers by lowering lending rates.

However, the flip side of this has been that banks have cut their deposit rates as well which is natural considering that any cuts to lending rates have to be accompanied by cuts to deposit rates. This has resulted in a situation where banks with enough deposits seem to be encouraging spending more than saving and this can indeed create demand in the system since more money with consumers means more spending thereby leading to an uptick in sales of goods and services and which has the "multiplier effect" of resulting in more growth.

On the other hand, **with more taxes being collected due to higher deposits in banks that can be taxable as well as increased compliance due to greater scrutiny and oversight by the IT (Income Tax) Department**, the government too might be tempted to announce lower rates for taxes and other aspects of what are known as fiscal measures. In this context, it is worth remembering that fiscal stimulus which is by lowering taxes and providing more incentives to consumers as well as producers by boosting supply can be complemented and supplemented by the monetary stimulus which is by boosting demand for goods and services by lowering lending rates thereby putting more money in the hands of consumers.

Moreover, **there are also reports of farming sector taking a hit due to lack of cash as well as sales of automobiles and other capital goods falling even though inventories are building up**. Thus, it remains to be seen as to how the growth figures for the next quarter and the overall financial year turn out to be. Given that mainstream economists tend to debate and argue both sides with equal passion and vigour, it is the case that as the cliché goes, the "proof of the pudding is in the eating" and hence, the actual growth figures have to be watched.

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

Of course, there are other indicators to keep track of as well in the form of various Indices such as the PMI or the Purchasing Managers Index which tracks industrial activity as well as the rates of investment and the credit pickup as well as the Inflation figures. Having said that, one must also note that given the lack of communication about some of the economic indicators from the government is indeed worrying given that Demonetization has been billed as the "Biggest Monetary Experiment" in recent times in the entire world.

The point here is that any such "disruption" must be both communicated and implemented well and given some of the concerns expressed in this regard by many commentators, one must indeed look for "straws in the wind" to make sense of the economic impact of Demonetization on the country.

DEMONETIZATION: POSITIVE IMPACTS ON INDIAN ECONOMY CLAIMED

Economic Survey after careful review of Demonetization which was announced one and a half year back, has found that the cash-to-GDP ratio has stabilized. It suggests a return to equilibrium:

- The Economic Survey says that India's GDP is set to grow at 7 to 7.5 percent in 2018-19. This is an increase from its prediction of 6.75 percent growth this fiscal year.
- The Economic Survey has cited exports and imports data to claim that the demonetization effect was now over. It claims that re-acceleration of export growth to 13.6 percent in the third quarter of Financial Year 2018 and deceleration of import growth to 13.1 percent is in line with global trends. This suggests that the demonetization and GST effects are receding. Services export and private remittances are also rebounding.
- According to the statistics released in the Survey, the Demonetization had led to Rs 2.8 lakh crores less cash (Equivalent to 1.8% of GDP) and Rs 3.8 lakh crores less high denomination notes (Equivalent to 2.5% of GDP) in the Indian economy.
- The Economic Survey has also clarified that income tax collections have touched new high with demonetization and introduction of GST, "From about 2 percent of GDP between 2013-14 and 2015-16, they are likely to raise to 2.3 percent of GDP in 2017-18, a historic high."

MERITS-DEMONETIZATION FAVOURED INDIA'S ECONOMIC GROWTH

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

- Demonetization policy of the Government has been termed as the greatest financial reform that aimed to curb the black money, corruption and counterfeit currency notes.
- All the people who are not involved in malpractices welcomed the demonetization as the right move.
- Demonetization was done to help India to become corruption-free as it will be difficult now to keep the unaccounted cash.
- Demonetization will help the government to track the black money and the unaccounted cash will now flow no more and the amount collected by means of tax can be better utilized for the public welfare and development schemes.
- One of the biggest achievements of demonetization has been seen in the drastic curb of terrorist activities as it has stopped the funding the terrorism which used to get a boost due to inflow of unaccounted cash and fake currency in large volume.
- Money laundering will eventually come to halt as the activity can easily be tracked and the money can be seized by the authorities.
- Demonetization aimed to stop the running of parallel economy due to circulation of fake currency as the banning of Rs.500 and Rs. 1000 notes will eliminate their circulation.
- The unaccounted cash could be deposited in the Pradhan Mantri Garib Kalyan Yojana after paying 50% tax. The money will remain deposited for 4 years with the bank without incurring any interest. However, after 4 years the amount will be returned. This amount can be utilized for social welfare schemes and making the life of low income groups better.
- The Public Sector Banks which were reeling under deposit crunch and were running short of funds have suddenly swelled with lot of money which can be used for future finances and loans after keeping a certain amount of reserve as per RBI guidelines.
- The people who opened the Jan Dhan accounts will now use their accounts and become familiar with banking activity. The money deposited in these accounts can be used for the developmental activity of the country.
- The tax collected due to launch of demonetization policy will be put to developmental activities in the country.

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

- Demonetization has driven the country towards a cashless society. Lakhs of the people even in remote rural areas have started resorting to use the cashless transactions. The move has promoted banking activities. Now even the small transactions have started going through banking channels and the small savings have turned into a huge national asset.
- The high rising price pattern and inflationary trends which the Indian economy was facing are taking a down turn making the living possible within low income group reach.

DEMERITS-BLOW TO ECONOMIC GROWTH AND INCONVENIENCE ALL AROUND

The very next day of announcing the demonetization, the BSE Sensex and NIFTY 50 stock indices fell over 6%. The severe cash shortages brought detrimental impact on the economy. People trying to exchange their bank notes had to stand in lengthy queues causing many deaths due to inconvenience and rush.

- The sudden announcement has made adverse impact on business and economy. Instead of a growing economy India has become a standstill and no growth economy. It is feared that a fall of 2-3% in the GDP growth will be recorded coming year.
- India is an agriculture based economy. Due to the cash crunch, the farmers especially small and marginal who largely depend on cash to buy seeds, fertilizers and to pay for sowing, borrowing water for irrigation and for other related agriculture equipments remained worst affected and could not complete the crop related activity.
- Since small branches of the banks were also not supplied with adequate cash within time of sowing season of the crop, farmers could not get their crop loans disbursed. This added to the woes of the farmers leading to a weak agriculture production the coming year.
- Real Estate sector came to a standstill and is still gasping for buyers of the constructed and half constructed inventory without buyers. This has resulted in poor cash flow leading to a poor demand.
- Demonetization has made the situation become chaotic. Tempers are running high among the masses as there is a delay in the circulation of new currency.

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

- Due to the inability to pay cash to poor daily wage workers, the small employers have stopped their business activity.
- The poor planning on the part of the government has also added to the woes of the common people with low incomes. The Rs.2000 currency note does not find many takers as it is difficult to get the balance back when you are buying daily needs like vegetables, milk, and bread or paying for petty expenses like bus fare. While rs.100 currency notes were not available in sufficient number, Rs.500 note arrived in the market very late.
- Demonetization is the 2 way sword in regard to incurring the public expenditure. On the one hand huge cost is to be incurred on printing the new currency and on the other hand managing the lakhs of crores of old currency volume has also become a big expenditure incurring item.
- Many Economists are of the view that Rs.2000 currency note will be much easier to hide and can be used to store black money in shorter space.
- Entire opposition has stood against demonetization and has called this decision a draconian law.

DEMONIZATION: SUCCESS POINTS

India has marched on the path of digital transactions at a much faster pace. Key points describing success of demonetization are:

1. **Rate of Inflation goes down:** Prices of commonly consumed commodities like Pulses, fruits, vegetables had gone down substantially post demonetization. Accordingly it brought down the rate of inflation during the months that followed demonetization.
2. **India moves to cashless economy:** One of the key effects of Demonetization 2016 has been that more people have made digital payments part of their lives moving towards a cashless economy. The details of growth of such digital transactions since January 2016 to August 2017 reflect that NEFT transactions that involved Rs. 7086 bn increased to Rs.12500 bn; Debit cards transactions increased from Rs.2328 bn to Rs. 2700 bn; credit cards from Rs. 214 bn to Rs.366bn and the IMPS transaction which was not used by the people, got a share of Rs.651 bn.

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

3. **Stock Market gets bullish:** After demonetization stock market in India got bullish. While BSE index which was 27, 459 on November 7, 2016 rose to 33680.92 on November 6, 2017, the NSE rose from 8497 to 10,443.
4. **Banks lending increases for small businesses:** Banks' finance to small business was going down in pre-demonetization period. There was a negative growth even in short period of months. As on November 25, 2016, a negative growth of -7.71% was recorded in Banks' lending to small business. It went to -8.16% as on December 23, 2016. However, as on September 29, 2017 the Reserve Bank of India has reported a positive growth of 1.65% in lending to small business by the Banks.
5. **Automobile sales picked up:** Sale of 2 wheelers and 4 wheelers was showing a negative growth in 2016. In 2017 it went up substantially and recovered from the impact of negative growth to high positive growth as reflected in the report.
6. **More people use Mobile wallets than cash:** Instead of using cash, more people have started using Mobile wallets for making payments for their regular needs. Even less educated people have learned and switched over to mobile transactions. The volume of transactions which was Rs.22.14 bn in January 2016, had gone up to Rs. 83.53bn in January 2017.

FAILURES OF DEMONETIZATION

1. **Economic Growth slows down:** Post demonetization growth of Indian Economy slowed down from 9.1% to 5.7% in less than one year.
2. **Realty sector bears the brunt:** The triple decisions of demonetization, RERA and GST resulted in a deceleration of new property launches. The supply of new housing units in the top-6 cities in India during the first three quarters of 2017 was down by around 60 per cent, compared with the corresponding period of 2016.

   With respect to property sales, the secondary market was obviously highly susceptible to demonetization as compared to the primary market. Property transactions in the secondary sales and luxury housing segments tended to have significant cash components, and such sales have been hampered significantly due to demonetization.

However, the shadow of Demonetization now appears to be fading in reality sector. The prevailing attractive home loan rates, flexible payment plans and other attractive offers by developers, coupled with restricted new supply addition, has led to a steady decline in the

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

unsold inventory. As of Q3 2017, only 6,38,500 units remained unsold in the top-6 cities, registering a 9 per cent decline from Q4 2016 levels. The demand for affordable and mid-segment housing has been on a rise.

Initiatives such as interest waivers on home loans, the government's push for affordable housing through Pradhan Mantri Awas Yojana (PMAY) and the 'Housing for all by 2022' mission have come to the forefront over the past one year. Various policy initiatives, amendments and reforms were all aimed at making the real estate sector more transparent, organized and fundamentally stronger. Demonetization played a significant role in this process. In the long term, the real estate sector is likely to regain a faster growth trajectory and is estimated to contribute around 13 per cent to India's gross domestic product by 2028. This optimistic forecast is very much attainable because the various reforms now redefining the realty landscape in India will not only incrementally boost consumer sentiment but also improve investment inflows from foreign and domestic institutional investors.

The Finance Minister Arun Jaitley on November 7, 2017 came out with a spirited defense of demonetization announcement on November 8, 2016 calling it a "watershed moment for the Indian economy". According to him the demonetization has not only changed the agenda but also made corruption difficult. Thus, in his opinion, it was not only a "morally and ethically correct" step but also "politically correct".

CONCLUSION

Demonetization is a tool used by central government to fight against corruption and black money. In the same path, it influenced and brought changes in all the corner of the economy. Banks are major institutions affected by demonetization. Banned denominations were ploughed back and allowed the citizens to exchange with the banks. While exchanging, it disturbed temporarily and influenced its regular operations. Though it affected badly to major extent of bank operations, it helped the economy to find growth and development of the country through financial institutions like Banks.

The Demonetization undertaken by the government is a large shock to the economy. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency in circulation is extinguished. While it has been argued that the cash that would be extinguished would be

ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

"black money" and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy, this argument is based on impressions rather than on facts. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility.

Demonetization has both its positive and negative impacts. It has different effects for different sections of people. For economists it is a failure while for the government it is the success. It was promised to withdraw all black money from economy but couldn't happen completely. Definitely it had major impact in curbing black money to a large extent. RBI is taking all required steps to overcome the cash shock. The effect of demonetization move along with policies like Digital India, Benami Act, and Cap on Cash transactions will spur GDP growth in coming years. Generation of black money itself should be attacked. As stated by Dr. Raghuram Rajan former RBI Governor, "I would focus more on tracking data and better tax administration to get at where money is not being declared." Thus demonetization alone can't fight parallel economy and eliminate black money. Several other supporting measures are also required.

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ISSN: 0971-1260
Vol-22-Issue-4-October-December-2019

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