

# DEMONETIZATION: IMPACT ON INDIAN ECONOMY

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**Abstract:** Indian economy is a growing economy. For the overall growth of country in all sectors there is the need of well regulated and corruption free environment in India. For that to curb the black money, corruption and fake money menace P M Narendra Modi has announced “demonetization” on 8th November 2016. It refers to an economic policy where a certain currency unit ceases to be recognized or used as a form of legal tender. With that the old currency of 500 and 1000 is ceased to be legal tender and it is replaced by new currency of 500 and 2000. People faced short term difficulties for couple of months but after that we have seen lot of positive impacts on Indian economy as well as on Indian society. This paper is an attempt to study the concept of demonetization and how it works in economy. The purpose of this study is to show the various challenges faced by people in economy during demonetization period. Through the study we will show the overall impact on growth of Indian economy.

**Key Words:** Demonetization, Banking, legal tender, Corruption, Black money, FICN, NIC.

## 1. INTRODUCTION:

Demonetization is the process of withdrawal of a particular form of currency from circulation the old units should be retired and replaced by new currency. There is one important thing exist in economics, which is remonetization, in which forms of payment is restored as legal tender. There are so many reasons why governments demonetized their nation’s currency. Some reasons are like resisting inflation, remove corruption and demotivate cash system in the country. It involves either introducing new notes or coins of the same denomination or completely replacing the old denominations with the new denomination. The government’s main motive of note ban is to remove fake currency, resist tax evasion, destroy the black money and terrorist financing activities and to motivate the country towards cashless economy.

In India demonetization had happened thrice. The 1st was on 12th January 1946 (Saturday), 2nd was on 16th January 1978 (Monday) and the 3rd was on 8th November 2016 (Tuesday). RBI data showed that as on March 2016, there was 632,926 counterfeit—known as an FICN (Fake Indian Currency Note). The circulation of 1,000 rupee and 500 rupee notes were the highest, to decrease the effect of these FICNs was also main cause of the demonetization. Due to this nearly 90% of currency value of Rs (500 and 1000) was withdrawn without replacing bulk of it. Due to this (withdrawal of Rs 500 and Rs 1000) notes, there was large gap in the currency composition because after Rs 100; Rs 2000 note was the only means of exchange. Absence of intermediate denominations between Rs 500 and 2000 was reduced the utility of Rs 2000. Effectively, this made Rs 2000 less useful as a transaction currency though it could not be a store value denomination.

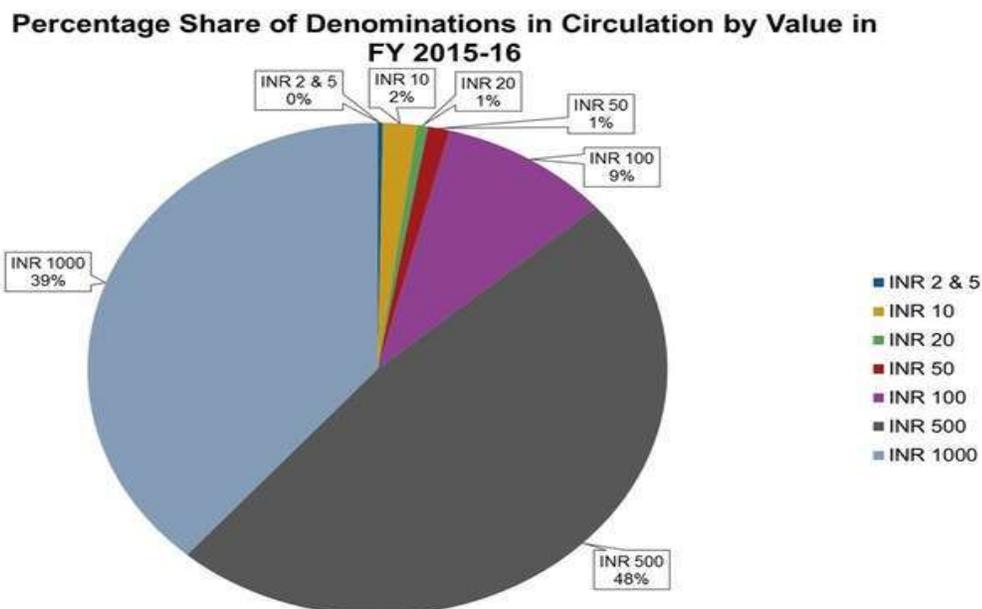


FIGURE 1

## 1. OBJECTIVES:

Demonetization is a great move of P M Modi. The main objectives of our study are:

- 1) To study the basic concept of demonetization.
- 2) To show the circulation of 500 and 1000 FICN.

- 3) To point out the challenges faced by people.
- 4) To show the effect of demonetization on black money and corruption.
- 5) To show the overall impact on economy.
- 6) To estimate the consequences for future of note ban decision.
- 7) Suggestions regarding how to increase Indian economic growth after demonetization.

**2. RESEARCH METHODOLOGY:**

This study is based on secondary data collected from various books, magazines, journals, government reports and analysis, publications by relevant websites which focuses on various aspects on demonetization and research based on various situations about demonetizations time, expert’s opinions, and use of internet for information search.

**3. OVERALL IMPACT OF DEMONETIZATION**

The demonetization has reduced consumption activity in economy of India. But has increased the money in banks. At the time of demonetization the consumption had reduced and the market become slowdown, but the increase in the deposition in the bank would be better for economy in future. According to reserve bank of India, deposits crossed 5 trillion rupees from 10th November to 18th November. ( Due to this many banks like SBI, ICICI, HDFC, PNB reduced their deposits).According to Pranabsen (India’s First Chief Statistician) said that, the targeted economic growth rates about 7.5% presented by Indian government for upcoming financial year is over optimistic. By this it seems the decision about ban on currency note has adversely affected the industrial sector. It affected the IT sector which is 45% of the India’s Gross Domestic Product, and approximately 80% of India’s employment depends upon IT sector. Before note ban there was 17.9 Lakh crore cash in the economy which is now 16.3 Lakh crore in the economy. Till august 2017 the number of point of sale (pos) has been doubled and reached to 29 lakh. So, pos transactions has been increased 89% that is 26.54 crore.

**Positive impacts:**

- A large part of black money is removed from the economy. This money can be spent by Indian government for the development of country.
- With increased transparency, trust on Indian Economy is increased. Thereby foreign investments poured in.
- Due to the fears of government moves, everyone is now ready to pay the taxes. Hence more revenue for Indian government.
- Demonetization encouraged cashless transactions which is a boost to economy.
- Due to more money in the banks, loans will be available to more people. Due to increased loans banks will be benefitted by the high interest.
- The extremists had threatened the people in remote areas like Jammu and Kashmir and Chhattisgarh not to go and deposit the money in the banks. But people queued up in the banks and deposit their money. This show positivity among people against demonetization. 3 % of total money deposited in the banking since demonetization began was in Jammu and Kashmir banks.

**Negative Impacts**

Dharmakirti Joshi, chief economist at Crisil Ltd, had said that the local unit of S&P Global Ratings is downgrading his growth forecasts for India from 7 % for the year through March 2018. However, he said, the trajectory will be upwards .GDP growth was earlier estimated as 7.8%. Post-demonetization, estimates are lowered to 7.1%.

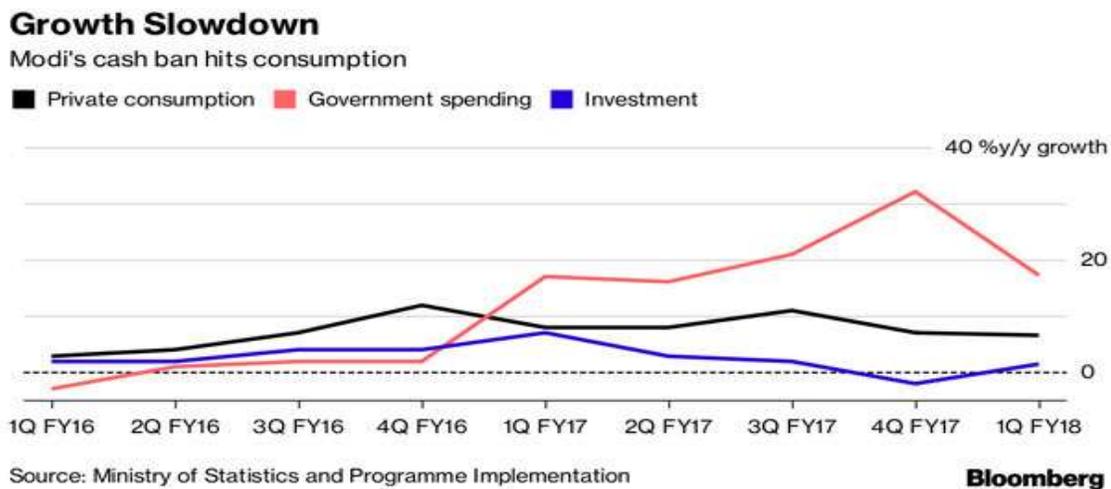


FIGURE 2

- Because of demonetization agriculture sector and SME’s and unorganized are badly affected by demonetization. It takes a lot of time for them to recover from the losses.
- There is no guarantee that demonetization move will definitely turn India into a cashless economy.
- Consumer demand was reduced by demonetization; hence retail inflation fell to 3.17% – a multi-year low. With this, growth of economy will slow down.
- There is fall in the prices of real estate.

**4. WHY DEMONETIZATION INTRODUCED**

1. To remove black money: In the economy during 2015-2016 circulation of black money was very wide which was estimated Rs 5lakh crore at that time. This fake currency in circulation was not counted within the overall currency figure of 16.6 lakh cores. This was directly affecting the security of India.
2. To remove corruption: Ban on Rs 500 and 1000 notes made these notes just a useless paper and this lower the cash circulation in the country which is directly related to corruption in our country.
3. To abolish fake currency and evasive funds: which have been used by terror funding groups to fund terrorism. According to one estimate the naxalite funding is about Rs 50000 to Rs 60000crores is in the form of cash.It has been very difficult for them to deposit their funding is designed for cash economy.
4. Supports Jan Dhan yojna: Over the last 2 years, while the number of Jan Dhan accounts has recorded a lower growth, only 1% remained in total deposit base of banking system.Demonetization gave a higher push to cash deposits in these accounts.
5. To improve transmission of money in banks and decrease lending rates.
6. To support small business in India : big industries in India have access to foreign funds and are able to draw money at international rates.it is very difficult for small industries that are paying very high rate of Interest .but demonetization increases deposits and reduce loan interest which will very helpful for these industries.

**5. CIRCULATION OF RS 500 AND 1000 NOTES:**

Demonetization acts as a liquidity shock that disturbs economic activities. Liquidity crisis was there due to demonetization for a short term. So we can define liquidity shock as people are not able to get sufficient volume of popular denomination especially Rs 500. This currency unit is the favorable denomination in daily life. Higher the time required to resupply Rs 500 notes, higher will be the duration of the liquidity crunch. approximately 16000 million of Rs 500 notes were in circulation as on March 2016.Some proportion of this were filled by the new Rs 2000 notes. On 28<sup>th</sup> October 2016 total Rs 17.77 trillion (US\$280 billion) bank notes were in circulation and nearly 86% of this is in the form of Rs 500 and 1000 banknotes, and this the total cash in circulation has come back into the banking system by the end of 31 march 2017.

**6. CHALLENGES FACED BY PEOPLE DURING THAT PERIOD:**

The daily wage earners, labourers, smalltraders, householdsetc. Who reside out of the formal economy uses cash frequently. Cash stringency compelled firms to reduce labour cost and thus reduces income to these working class people because they had to leave their duty, work by standing in the queue outside the banks for exchange Rs 4000 at once.

People were waiting in the queue of A.T.M but in spite of waiting for so many hours and even some sleep in the outside of A.T.M they could not get cash because of less supply by the government in the A.T.M. and many people who were getting Rs 2000 notes not able to get the change is big worry for a common man during that period. People are frustrated by paying hospital bills, grocerybills, transportation charges etc. and even some ill and old age people losing their lives due to standing in queues for long hours. People faced so many problems in booking banquet halls, payingrents, purchasing gifts and other due payments.

**7. EFFECT ON BLACK MONEY AND CORRUPTION:**

Only a small portion of black money is actually stored in the form of cash. Usually, black money is kept in the form of physical assets like gold, bullion, land, buildingsetc. Hence the impact on black money due by demonetization based upon the amount of black money kept in the form of cash and it will be smaller than expected. But besides all that, demonetization had a big effect.

A study in 2015 showed that at any given point of time, Rs 400 crore worth of fake notes are in circulation( The Indian statistical institute, Kolkata ).The National crime records bureau (NCRB) revealed that various enforcement agencies seized 1.78.022 pieces of Rs 1000 and 2,99,524 pieces of Rs notes in 2015. To that extent, it will address the problem of terror financing and fake currency. Around 12 Lakh crore of the Rs 15.44 lakh crore demonetized currency is with banks now and it is believed that an estimated 1.5 lakh to 2 lakh crore may be identified as black income from which ,about Rs 1.2 lakh crores may be collected as taxes at 50% to 85% tax rate.

**8. TO ESTIMATE THE CONSEQUENCES FOR FUTURE OF NOTE BAN DECISION:**

In the view of Fitch Rating it was observed that the positive effects of demonetization of Rs 500 and 1,000 notes will not be of long term. It may support banks' credit profile. The demonetization drive has the potential to raise government revenue and encourage bank lending. The demonetization step will increase government revenue to so many amounts which may help to increase economic activity from unorganized to the organized sector. The Chairman of the Godrej group also said that it would help to fight with black money and it will also reduce corruption. He further said there is a fair amount of cash has come into the economy and more is being coming regularly basis, and this is good sign for the economy.

**9. SUGGESTIONS:**

- Government should take the initiative to increase the general knowledge of public about digitalization.
- To bring new programs and applications to promote cash less transaction.
- There should be increase in the number of POS.
- Govt. should take strict action against the person who indulges in corruption and malpractices.
- Besides the increasing number of bank branches in rural areas there should be increase in saving habits of these people govt. should started various plans to increase their knowledge.

**10. CONCLUSION:**

India is a growing economy in which several initiatives have been taken by the government from time to time for the progress of Indian economy. Demonetization is also one of such step. Indian economy is going towards significant growth by adopting the demonetization strategy

and it will create a huge positive impact on the entire economy in a long run. Due to demonetization there is increase in deposit base of banks and government has details of all the depositors so it is more difficult to evade taxes. With that transparency trust on Indian economy is increased so that foreign investment poured in India. The positive impact that India is moving towards cashless economy. In December 2016, approximate 100 crore transactions were in cashless that is 87.7% in September 2017. From November 2016 to September 2017 there is 31% increase in digital transaction and after note ban there is 9% reduction of cash in the economy. In order to study the overall impact of demonetization on growth we have to study the other initiatives taken by government to root out black money such as Digital India, Benami Property Act, GST etc. Because. It can't be properly analyzed in isolation.

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