

# EXAMINING THE POST WAVES OF DEMONITISATION ON INDIAN ECONOMY: A CONCEPTUAL REVIEW

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**Abstract:** Demonetisation is an act where the old unit of currency gets retired and replaced with a new currency unit. It can also be considered as withdrawal of a specific currency from the market. The aim of this study is to find out the reasons and post impacts of demonetisation. Data were collected from the secondary sources like various newspapers, journals and online database. The collected data was analysed and interpreted to draw conclusions keeping in mind the set objectives of the study. The paper discusses about the move of demonetisation taken by Central Government of India on 8th November, 2016 with respect to its reasons and through's light on the post effects of demonetisation on different sections and sectors in India. Demonetisation creates effect on different sectors in different manners resulting into boom for some sectors like E-Wallet businesses while resulting into temporary slowdown in other sectors like micro businesses, vegetable vendors or some small seasonal businesses, where most of the transactions are on cash basis. The demonetisation effects would be related to the extent to which the currency is not replaced within the economy. If the entire currency is replaced, there would not be any major effects on the economy.

**Keywords:** Demonetisation, Currency, Central Government, Economy.

## 1. INTRODUCTION

Demonetisation is an action where the time-honored unit of currency gets abandoned and substituted with a different currency unit. It can be considered as pulling out of a particular currency from the open market. In other verses, it is a practice by which a sequence of currency will not be a legal tender i.e. series of currency will not be tolerable as binding currency. It can be denoted as a weapon of government to eradicate the currency in very adverse circumstances. Further, demonetisation is the apparatus by which the government states to take away the money which is the existing permissible tender. The government being autonomous can give such judgement. The end result of this declaration results in that the currency notes which were in circulation will now cease to be accepted as valid tender and can only be substituted at the banks. This reduction, in the form of wiping out cash balances from the economy, reduce a number of dealings for a while, since there is no or not adequate of a medium of exchange remaining. This effect would be more

severe on individuals whose earnings are totally in the form of cash and also spend it in cash. To a lesser degree it will also have emotional impact on individuals who earn incomes in non-cash forms but need to withdraw the cash for day to day consumption purposes, since a number of sectors in the economy still work predominantly with cash. This is for the third time that the tool of demonetisation was used in India to tackle many problems. The only difference between the three time decisions is the quantum however. The former i.e., first and second demonetisation scrapped really high worth notes which formed a minor portion of notes in movement making it considerably easy to withdraw. But this time the 500/- and 1000/- currency notes represented 85% of physical money in circulation making it very tough and hard for the people to cope up with the decision.

According to the Reserve Bank of India's annual report for April 2015 to March 2016, the worth of the currency notes at the completion of March 2016 stood at 16.42 trillion Indian rupees. The five-hundred rupee and thousand rupee legal tender notes formed 86.4% of the value. By deploying one hit, the government detached 86.4% of the currency in circulation by value. From the volume perspective, the currency notes of these two denominations formed 24.4% of a total of 90.27 billion pieces. Further, RBI's statistics revealed that as of March 2016, 632,926 exchange notes were forged which are also termed as FICN-Fake Indian Currency Note. The interesting thing was that the proportion Notes in circulation i.e., the 1,000 rupee and 500 rupee notes were the maximum. Hence the insufficiency of cash because of demonetisation headed to chaos and most people holding old banknotes encountered difficulties exchanging them due to long-standing lines outside banks and ATMs throughout India.

With the ban of Rs.500 and Rs.1000 currency and insertion of fresh notes, India is coping with demonetisation. The measure isn't new, however, several other countries had already tried it but the results were quite complex. Here is the mention of eight nations that tried demonetisation in the past before India. Table 1 shows the countries which previously banned the notes and their effects on economy.

**Table No. 1 List of countries where demonetisation had been carried out earlier**

Serial No.	Country	Year	Effect on Economy Successful/unsuccessful	Reason for failure
1.	Ghana	1982	Drove economy towards weakness unsuccessful	People support for black market and investment in physical assets.
2.	Nigeria	1984	Distortion of economy unsuccessful	Debt-ridden and inflation did not take change well
3.	Myanmar	1987	Unsuccessful	Led to mass protest resulting in killing of many people.
4.	Soviet Union	1991	Unsuccessful	People did not take change positively due to poor harvest.

5.	Australia	1996	Moderate effect	As the purpose was only to replace paper with plastic.
6.	North Korea	2010	Weak unsuccessful	People left with no food and shelter
7.	Zimbabwe	2015	Weak unsuccessful	Face value one hundred trillion dollars dropped to \$0.5 dollar.
8.	India	2016	Loss of GDP by 2% Increase in unemployment Loss of Lives	Less time given to people Cash based economy Non availability of banks in most of the rural areas.

From the table 1 it becomes evident that the demonetisation experiments done in the above mentioned countries has mostly failed. The experiments were seen as with a mix of wonder and worry. In the past, countries such as Myanmar, Ghana, North Korea and Zimbabwe tried their luck with demonetisation, but it brought forth troublesome results. Looking at the Indian side so far, Modi's move has left masses scrambling for cash, trouncing consumption and in this manner threatening GDP growth in India. The conversion is already drawing criticism, with quite a lot of economists questioning the government's implementation of the policy and raising apprehensions regarding the absence of infrastructure for a cashfree future in an almost completely cash-dependent nation.

However after the India's move of demonetisation to counter black money and different other issues, it seems like demonetisation is spreading around the world. Three countries in three continents like Australia, Pakistan and Venezuela have also decided to demonetize their currencies in the soon period.

### 1.1 Countries that have proposed to demonetize their currency in the coming years

#### Australia

On 14 Dec. 2016, Australia's financial services and revenue minister Kelly O'Dwyer said that the country is looking over a move to ban its \$100 notes, the uppermost denomination existing, as well as possibly limiting cash transactions over a certain limit. Australia, much like India, wants to hold down on the secretive economy.

According to UBS analysts "Removing large denomination notes in Australia would be good for the economy and good for the banks".

#### Pakistan

On 19, Dec. 2016, a resolution was passed in the Pakistan's senate to phase out its Rs. 5,000 notes in an endeavor to curb black money from the economy. It may be noted that in value expressions, Rs. 5,000 bills account for approximately 30% of the currency in rotation in the country.

Pakistan's government plans to employ this decision over the subsequent three to five years, as against the India's hastened tactic of demonetisation. Osman Saifulla Khan, the senator who positioned forward the motion, spell out that the government wasn't in any approach following India's ideology, stating that he

remained the last person to be impressed by Modi, according to the Dawn newspaper. Similar to India, Pakistan is on a process to combat tax dodging and the hoarding of illegitimate wealth.

### **Venezuela**

On 11, Dec. 2016, Venezuela— of whom inflation rate is predictable to hit 475% -declared that it has demonetised its most worthy note, the 100-bolivar bill. The government headed by Nicolás Maduro provided citizens a 72-hour gap in advance of retreating the currency, which weighed for 77% of the state's cash in revolution. The government held that old notes will be substituted, at some point, by means of new ones in denominations in the middle of 500 and 20,000 bolivars.

The South American country considers that cross-border mafia has been obtaining Venezuelan bolivars and vending them for huge returns in Colombia. Still, the government was impelled to offer citizens a stretched extension for the usage of the 100 bolivar bill when a severe shortage of currency steered to intense protests and looting.

### **2. Objectives of the Study**

1. To identify the reasons that force the government to withdraw nations high denomination currency notes.
2. To investigate the impact of demonetisation on the economy as a whole.

### **3. Research Methodology**

The facts were composed from secondary basis of information. This research also took the support of Secondary data like many newspapers, journals, online database, facts released by Reserve Bank of India (RBI), Exchange, Central statistics office India and different bank websites. The collected data was analysed and interpreted to pull out the conclusions keeping in mind the framed objectives of the study.

### **4. Reasons of Demonetisation**

After reviewing a lot of literature we came across the following main reasons which prompted the nations to demonetize their valuable existing currencies.

According to The Reserve Bank of India, the most important reason for the demonetisation of 500 and 1000 rupees note was the rise of fake currencies of the same notes, and also the higher occurrence of black money in the economy. "The fake notes are being used for illegal activities by anti-nationalists like terrorists and India being a nation of a cash-based economy, the circulation of fake currency continues to be a threat.

**Black Money:** A latest study had estimated India's black market economy at over Rs 30 lakh crore or around 20 % of overall GDP. Interestingly the estimate is even higher than the GDP of nations like Argentina and Thailand. So after the decision of demonetisation black money hoarders are left only with just two choices – either channelize this cash through banks, stating it to be their income or burn the secreted file.



**Terrorism & Counterfeit Currency:** Terrorism is a worrisome thing. The main point lies here is about by what means these radicals acquire their money. Adversaries from across the boundary are running their acts expending fake currency notes. This has been there happening on for years. Such cases turn out to be the reason for demonetisation.

**Polling/Election:** We are well aware about the fact that black money is used by political parties. With demonetisation it becomes a very tough task to use trucks of money for the upcoming elections. For example, in UP election in India which were held in January neither of the parties were able to purchase the vote of poor people which resulted in drastic change in the elections.

**Unorganised Trading:**

- Prices upturn in Real estate segments is mostly for the reason of the inclusion of black money, but on the other hand subsequently taking this decision the values of property will certainly come down to their genuine value.
- Unorganised dealing in share market will also be eliminated after this decision and this will gain positive result in the economic condition of the country.
- The problem of inflation will get curbed as a result of demonetisation because with this decision the government will be able to get more and more money in its pocket in the form of taxes and unrevealed income.

**To promote cashless economy:** It is not conceivable to make a state a cash-less economy by customary means. It is by demonetisation that people are compelled to deposit their cash in banks and at the same time it also becomes very tough for the people to get their money back in cash terms, which ultimately forces the people to make use of cashless sources to make payments like e-Payment and use of plastic currency. Cashless economy also guides the economy towards transparency.

**To combat corruption:** By demonetisation a lesser amount of cash remains available in the economy which eventually condenses the probabilities of corruption. It is an old saying that where there is no cash there is no corruption.

**To strengthen the banking system:** By demonetisation the banking system of the country gets reinforced, as banks are flooded with enormous amount of currency. This will also result in further economic development in the country as the money will be channelised properly through banks.

**5. Impact of Demonetisation on varied Sections and Sectors**

The announcement of demonetisation was in continuation of a sequence of measures engaged by the Government of India in last two years for eliminating bribery, black money, forged currency and terror finance. The judgement was steered by the goal of securing its huge potential medium-term interests by way

of condensing corruption, better digitisation of the economy, enlarged flow of financial savings and greater formalisation of the economy. All of these were aimed at giving greater GDP growth and tax proceeds that could be used by the Government for inclusive and durable economic development, besides contributing to overall improvement in business environment. But the decision yielded complex results. From one side it has created some positive impacts but on the other side it has also generated some negative impacts in the short run.

Demonetisation by taking out 86 per cent of the money in circulation, has led to a very severe reduction in cash supply in the economy. This reduction, by pulling out cash hoardings in the economy, reduced a numeral amount of dealings for a while, as there was certainly not sufficient of a medium of exchange accessible. It is so, because Rs500 and Rs1000 notes amounted to 86% of the aggregate currency in movement in India, particularly in the vast rural zones. One economist associated the pain to what people might experience if 86% of their blood was removed from their bodies. This effect was found to be extra severe on persons who make earnings in cash and expend it in cash. To a slighter degree it also affected individuals who receive earnings in non-cash forms but then again require to withdraw in cash for consumption purposes. The effects were allied to the level to which the currency was not substituted within the economy. If whole the notes had been replaced, there would not had been any severe effects on the economy. Demonetisation caused impact on diverse sectors in different manners ensuring boom for some segments like e-wallet businesses and somewhere causing short-term slowdown in micro businesses like vegetable hawkers or some minor seasonal businesses, where utmost of the dealings are on cash basis. Various sectors have been chosen for the research which revealed the following most important impacts of demonetisation.

***Cash on delivery facility momentarily stopped by online retail suppliers:*** Popular online retail stores in India like Flipkart, Amazon, Snapdeal and other online retailers provisionally suspended providing cash on delivery facilities. According to a research firm namely Redseer Management, nearly 70% of the online orders are still paid in cash. When such a step was taken, it halted the volume of business since cash on delivery is the popular method of payment for shoppers in India. Further Flipkart Ltd, Snapdeal and Shopclues have put a restraint on the maximum value of cash-on delivery transactions. There existed a lot of orders which stood in the chain to be delivered and for which method of payment was cash on delivery.

***Slowdown in disbursement rate of Microfinance Institutes:*** Micro finance institutions (MFIs) are vital institutions which deliver financial help to micro businesses. The same MFIs have saw their distribution rate lessening after the government's decision of currency demonetisation. The MFIs had also acknowledged that the move had also resulted in a delay in collection of instalments from the clients which ultimately impact on unavailability of cash and thus hampers cash disbursement.

**Effect on small and microbusinesses:** Indian Micro Small and Medium Enterprises (MSME) sector contributes considerable share in India's GDP. In Small and Micro businesses transactions usually take place on cash basis especially micro businesses. They face lot of difficulties due to the decision as most of the people running the business are not that educated and tech savvy. So such move obstructs micro businesses in a ruthless way bringing about slowdown in micro and small sector.

**E-wallet firms gain upright business:** A digital wallet is an application in smart phone or any electronic device which permits a person to make transactions like payment of bills, online bookings and shopping electronically. In the periods of demonetisation wallet businesses are the major beneficiaries of the decision. Further such wallets get boost in trade as no other means are left to pay due to non-availability of cash. Paytm, PayU India, MobiKwik, and Freecharge are the examples of wallet in India.

**Automobile sector:** Restriction on cash dealings and provisional cash crisis hurt buying, particularly in the case of two wheelers where the percentage of cash dealings stood high. Further due to momentary liquidity crunch the seasonal slowdown was seen in the demand of passenger vehicles and commercial vehicles during the initial months of the decision in response of the laxity in the economy on account of demonetisation.

**Impact on GDP:** The GDP creation gets crushed by this measure, with decrease in the consumption. As per the government's recent development estimates, the speed of growth was obstructed by decelerating growth in the manufacturing and mining sectors and also construction sector. All this resulted in the overall downfall of GDP by 2%.

**Impact on Agriculture Sector:** Agricultural growth in India was already slight for the reason that it was continuously hit by droughts. It was expected to grow at 4% in 2016 as per CRISIL report, but unfortunately owing to demonetisation this prediction proved incorrect because farmers ran out of money to get seeds, fertilizer, tools, and wage payment to labor force etc. Further due to cash deficiency day-to-day supply transport system suffered as well, which brought around 25 to 50 % decline in sales.

**Impact of Demonetisation on Business sector:** Small as well as big businesses both in urban as well as rural areas feel the impact as these are generally run via cash transactions and big businesses also require to pay to their labourers in cash. Companies using cash transaction will here and now have to depend on finance from alternative sources. It also increased labour turnover owing to lack of Production. For example,

#### **Textile industry:-**

The industry also remains among worst sufferers. Maximum of the businesses report nearly 60 % drop in deals after demonetisation. But after some time this sector slightly recovers as the cash is channeled in the form of new currencies in the economy.

#### **Real Estate:-**

Demonetisation crashed the real estate business and it bring about 50% drop down in the business.

**FMCG Products:-**

Consumer expenditures are also impacted by the decision of demonetisation. The demand for only those products persist which are needed for day-to-day consumption due to less or no cash in the pockets of the consumers. Further the per diem sells of these sellers drop down by 20 to 30 %.

**Impact on Service Sector:** Service sector was smashed very stiff by demonetisation after November 2016. Most horrible Collapse in just about three years existed. The services segment slid into contraction territory for the first time since June 2015 and jagged to the piercing drop in yield for almost three years. The only sector which experienced boom in trading on other hand is the banking sector. This remained the lone sector which was profited by that pronouncement in numerous facets.

**Impact on parallel economy:** The removal of the currency and replacement of the same with new notes is anticipated to get rid of black money from the state as they will be obstructed and in the meantime the holders will not be in a position to deposit the same in the banks. Further for the time being the decision halts the movement of huge size of counterfeit currency and also stops the funding of anti-social elements for smuggling, terrorism, undercover activities.

**Effect on Money Supply:** With older currency being scuffled, until the new notes get widely disseminated in the economy, the currency supply come to be condensed in the short run. Further, the limit put on withdrawal of money e.g. a limit of Rs.2000 per day per card was set by the Govt. of India and subsequently the limit was increased also lead to the decrease of money supply in the economy . However step by step as the new currency gets disseminated in the market, the disparity gets adjusted.

**Influence on Demand:** The overall demand generally gets affected severely. The demand in following areas like consumer goods, real estate and property, gold and luxury goods, workshops are affected harshly. Altogether these cited segments are expected to face definite restraint in demand from the consumer side, due to the substantial volume of cash transactions involved in these sectors.

**Effect on Prices:** Price level is let down due to control from demand side. Consumer goods prices fall with immediate effect in absence of proper system of cashless facility. Further real estate and property are mostly projected to reduce due to demonetisation, particularly for trades of properties where main portion of the deal is cash centered.

**Impact on numerous economic entities:** With cash dealings lowering in the short run, until the fresh notes are spread widely into circulation, certain sections of the society like small traders, vegetable hawkers, shopkeepers, cobblers, households, retail outlets, carpenters, etc, experience short term disorders in enabling of their dealings. The rate, occurrence and volumes of the commercial businesses involved with these



demand cash on more recurrent basis. Thus, due to demonetisation they face the most significant impression until the normalcy of the economy.

**Impact on Banks:** As instructed by the System, the certain currency notes become priceless or cease to be legitimate and are required to be deposited in banks to make them valuable. This will spontaneously bring rise in the flow of money towards Savings and Current Account of commercial banks and ultimately the liquidity position of the banks will get enhanced, which can then be used by banks for lending purposes.

**Effect on Online Dealings and alternative modes of payment:** Unusual methods of payment saw a rush in demand when cash dealings faced decline. Digital methods, e-wallets and applications, online e-banking, usage of debit and credit cards, etc. experienced a positive and significant upsurge in demand. This also made the people habitual of using cashless methods and thus drive economy towards cashless and digital economy.

**Loss of lives:** Due to long lines to withdraw cash from banks and ATMs numerous people were reported to have had heart attacks while standing therein for a long period. Demonetisation claimed the lives of more than 100 people. Life headed to stand still and considerable sadness gave rise to when people find themselves powerless to use their own hard-earned money. The grief it has triggered to millions of Indians is unjustified.

## 6. Conclusion

Demonetisation is an exercise by means of which a series of notes will stop to be a legal tender i.e. currency in circulation will not be acceptable as functional currency. It is the mechanism by means of which the government states to pull out the money which is presently circulating in the economy as legal tender. The current study was carried out to find out the pattern of demonetisation in different countries as well as to find out the possible reasons of taking such decision and its outcomes. The study was carried out by reviewing a lots of literature available on demonetization. It revealed that demonetisation is having both the positive (in the long run) as well as negative impacts on the economy. With cash dealings facing a decline, substitute methods of payment experience a bulge in demand. Digital transactions method, e-wallets and applications, e-banking, application of plastic money etc. grasped a considerable upsurge in demand. This eventually led to strengthening of cashless systems in the country and the infrastructure required also gets maintained and well organized. Further it lowers the corruption practices and will discourage the black money holders for a long period. For the time being the decision halts the movement of huge size of counterfeit currency and also stops the funding of anti-social elements for smuggling, terrorism, undercover activities. From the other side, the decision of demonetisation affected some sections adversely. It directly affects the individuals who receive earnings in non-cash forms but then again require to withdraw in cash for consumption purposes e.g., vegetable hawkers or some minor seasonal businesses who make earnings in cash and expend it in cash. Talking about the sectors in the economy, the sectors to be undesirably affected

are those where demand is commonly funded in money terms, specifically those not within the organised vending. For instance, transport services, kirana, fruits and vegetables and all other perishables, would face compression in demand which is assisted by purchasing power. In conclusion it can be stated that if demonetisation is backed by a proper planning and due care has been taken to set up the infrastructure facilities to support cashless system then it will lead to a legitimate and corruption free economy but if the decision is sudden i.e., without any proper planning it could lead to a severe pain for the individuals living in the economy and will ultimately have adverse income and employment consequences for the economy.

### 7. Limitations and Future Research:

The study was conducted to get the conceptual outline of demonetisation and to find out the reasons which force the nations to deploy the weapon of demonetisation. Although all the efforts were made to make this research objective but yet some limitations were there to limit the scope of this study. The limitation of this study is that it relied only on secondary sources of data for research enquiry and is conceptual in nature. Future studies could take empirical studies into consideration.

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