

# A STUDY OF DEMONETISATION AND THEIR IMPACT ON INDIAN ECONOMY

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## ABSTRACT

On 8th November, 2016 our Prime Minister Shri Narendra Modi, announced demonetisation decision. Of this cash, 87% is in the form of Rs. 500 and Rs. 1,000 notes or roughly Rs. 14 lakh crore (\$190 billion). Indian Demonetisation has impacted the economy remarkably and lots of repercussions were recorded, few sectors of the economy are hoping to get positive impact whereas few fear to get hard hit. A significant portion of the household cash on hand is generated by economic transactions that are not reported to tax authorities or generated through corruption. Sudden announcement of demonetisation has resulted in to insecurity and fear among peoples. There were huge crowds outside ATMs across the country as people lined up to withdraw currency of smaller denomination. Media- news channels and newspapers were projecting suffering of people as well as benefits of demonetisation. This research article therefore, is an attempt to find out ground reality and how demonetisation had impacted the different sectors of Indian Economy.

**KEYWORDS:** Demonetization, Cashless transaction, Digital economy, Indian Economy

## INTRODUCTION

Demonetisation means withdrawing the legal tender rights of any denomination of currency. Units of money have deprived the status of legal tender. Demonetisation is an act of taking away the legal tender rights of any currency. The units of currency will not be considered as valid currency. Demonetisation is the process of ceasing a unit of money of its status as legal tender.

### Impact on People

Demonetization has affected the short term consumption needs of the people basically belonging to the lower and middle class families for whom cash is the primary mode of payment for their day to day activities. Along with this, the direct impact of demonetization drive is seen on those who live in remote areas of country, having no bank accounts and no identification proofs.

### Impact on Economy

The immediate effect of demonetization of economy would probably be short-lived. However, the long term effect will drive the Indian economy to new areas of growth in the coming times with its impact not just only on black money, terrorism and corruption but also in improving tax compliance, better fiscal balance and lowering inflation. Though the contraction in GDP by 0.5% cannot be ruled out due to fall in economic

activity, growth in demand will start gaining momentum once the economy moves out of the transition stage of demonetization to remonetisation.

### Impact on Businesses

Demonetization drive has impacted the Indian businesses directly or indirectly in terms of impact on demand but the impact of demonetization is majorly seen on small businesses as these are highly driven by cash transactions. The labour-intensive sectors mainly agriculture and construction sector have been impacted since a major portion of transactions involve cash for the purchase of raw materials and payment to daily wage labourers.

MSMEs sector has been impacted significantly as the sector is majorly driven by the contractual and daily wage work force and most of the mobile work force doesn't have their bank accounts at the place of their working.

### Summary of Withdrawal and Deposit Balance sheet in the wake of demonetization

<b>Total deposits</b>	Rs.13,00,000 Crore
<b>Demonetized money</b>	Rs. 5,92,613 Crore
<b>Deficit</b>	(-) Rs.7,07,387 crore

**Source:** PHD Research Bureau, compiled from RBI

Production process not only in the informal sector but also in the formal sector has been impacted directly or indirectly. Cash driven segments such as fruits and vegetable markets, horticulture and floriculture, agricultural and food processing, construction activities, among others have been impacted. Nonpayment of wages to the workers of cash driven sectors has adversely impacted the employment situation in the informal sector. Also, the formal sector is impacted as demand in the economy has been decelerated significantly.

### Impact of demonetization on Businesses

Since businesses are the backbone of the economy, we focus on secondary data survey to analyze the impact of demonetization on the business firms and to assess the impact on various sectors of the economy.

The sectors which are majorly impacted by demonetization includes retail sector followed by agriculture sector, real estate, construction, media & entertainment, gems & jewellery, tourism & hospitality, labour intensive sectors and automobiles sector.

- 1. Retail** – The impact of demonetization is majorly seen on the retail sector since 88% respondents said that cash crunch is leading to low consumer demand of their products ultimately causing fall in their sales since Indian retail segment generates a lot of cash transactions. The impact is comparatively higher on the small traders and the unorganized retailing segment.
- 2. Agriculture** – Majority of the respondents (81%) respondents unanimously responded that agriculture is impacted majorly since sale, transport, marketing and distribution of ready produce to wholesale centres or mandis, is dominantly cash-dependent. Further, it has been reported by the respondents that disruptions, breaks in the supply chains, increased wastage of perishables have severely impacted the sector. The marginal farmers who sell their products on day to day basis to the mandis and directly to the consumers have been impacted.
- 3. Real Estate** – Majority of the respondents (77%) reported that demonetization has finished their businesses as cash is always a major component of their transaction. Like the other sectors, small real estate developers are severely impacted because of very high involvement of cash as a component of payment in real estate deals.

4. **Construction** – Construction sector is severely impacted as majority of the respondents (74%) responded that demonetization has led to lower collections in the form of customer advances as projects in early stages of construction are mostly dependent on these advances for construction progress and debt servicing. The demonetization drive has majorly impacted the fate of the unskilled workforce in the construction sector as the sector absorbs maximum of the unskilled workforce after the agriculture sector.
5. **Media and Entertainment** – Due to slump in consumer spending in the wake of the demonetization drive, 68% respondents said that media and entertainment industry is impacted majorly as viewership has dropped to a very low number. The drop in demand is comparatively higher from the lower middle class.
6. **Gems & Jewellery** – Majority of the respondents (65%) reported that the impact of demonetization on Gems & Jewellery sector is quite high since cash payment is the significant mode of payment for purchasing jewellery by the substantial portion of the customers. The sector is impacted because people are not able to fulfill their daily needs.
7. **Tourism and hospitality and wellness** – According to the survey, 61% respondents responded that tourism sector is highly affected since people consume a major part of their undeclared income on luxuries. Hence, with the inability of customers / tourists to spend due to lack of available currency, the tourism industry is suffering the most wherein the unorganized inventory of hotels is mostly impacted.
8. **Labour intensive sectors (Leather, mining, textiles)** - Labour-intensive sector requires huge amount of money to be paid in cash to the daily wage labourers, majority of the respondents (56%) reported that they have been impacted by demonetization drive. Restriction of withdrawals from bank is impacting the weekly payment to contractual workers in textile, mining and leather industries.
9. **Automobiles** – Automobiles sector is impacted majorly by demonetization as reported by 52% respondents. The major decline is seen in the demand of two wheelers than luxury cars/four wheelers since cash is the primary mode of transaction in the purchase of two wheeler vehicles. Another segment of automobile industry which is facing effects of demonetization is the used car industry wherein numerous car dealers have reported sudden decrease in sales.

## REVIEW OF LITERATURE

According to Sasyak pattnaik (29 November 2016), in his research paper of “exploring the effects of demonetisation in India”, has elaborated the various effects, that the act of 2016 has made in the economy of the country. Properly explaining the facts regarding demonetisation and its relating history, Sasyak Pattnaik had described the impact of the same in the country.

According to Veerakumar, K. (2017) posits that the announcement of demonetization of 500 and 1000 currency notes by the government is a big shock to the citizen of India. The highest currency notes are withdrawn from the economy to counter the problem of tax evasion, counterfeit currency and financing of terror activities. It is shown that huge money is being deposited into the bank accounts which are more than specified limits and are subject to penalties and taxes. Usage of e-wallets, debit and credit card has been increased tremendously and this will create better cashless infrastructure.

According to Ayush Yousuf Shah (March 2017), a research scholar at MPISSR Ujjain, Mp, has also studied demonetisation and his research of “ Impact of demonetisation on rural India”, has focused on the impact of the act on common people, agricultural sector, farmers and on the economy of India. Analysing the data from the secondary source, he has explained the impact on agriculture and the economy of the country and its effects after the act.

According to Abhani Dhara K. (2017) posits that this Demonetisation is proving to be more successful than the previous two. The era is changing. People are using online banking as a mode of payment. Bank employees are giving their best to make the demonetisation a successful one. Their support matters a lot. Though the demonetisation move has failed to grab total black money in the economy, this has at least created fear in the minds of people holding black money. He concluded that demonetisation was a compulsory step to tackle the problem of black money, terrorism and corruption etc.

According to Shukla, Bal Govind and Gupta, Hariom (2018) in their paper entitled “An Exploratory Study Of Business Students Perspectives On Demonetization In India: With Special Reference To Allahabad City”. They used primary data for their study and concluded that the people actively support any initiative taken by the governments which are basically targeted to eradicate corruption, black money, and any other threats like terrorism and naxalism in the country.

## OBJECTIVES OF THE STUDY

1. To understand meaning and reasons of demonetisation.
2. To study the sector-wise impact of demonetisation.
3. To study the positive and negative impacts of demonetisation.
4. To study of demonetisation and their impact on indian economy

## RESEARCH METHODOLOGY

This study is of descriptive nature and tells about the meaning and reasons of demonetisation along with the sector-wise impact of demonetisation and positive and negative impacts of demonetisation on Indian economy. Hence makes use of secondary data. The entire study is based only on observation and documentary analysis. Furthermore, the required & relevant secondary data are collected from various Research Papers, Journals, & Publications, websites and many others. Books have also been referred for theoretical information on the topic as required.

## Reasons of Demonetisation

### Black money

Demonetisation was a bold and revolutionary action taken by the government of India to curb black money and one that will have the deep impact on the parallel economy in the country. Pockets and persons with black money can be identified with this move. A few businesses like property dealers, jewellers, foreign currency dealers, private money lenders generally hold huge amounts of unaccounted money in form of currency notes.

Such unaccounted money had created a parallel economy in the country. Such illegal money has reached the bank accounts through direct or indirect channels.

### To hit the fake currency rackets

Fake Currency Notes have been wasted by the demonetisation. Withdrawing highest currency notes out of the economy will have a serious impact on the fake currency syndicates, thus putting an end to the terror funding in Jammu and Kashmir, Naxalite hit states and North-eastern states. The fake currency with racketeers have been left in vain, and new currency notes with high security; making a counterfeit impossible. Demonetisation was a surgical attack on a fake currency circulating in the economy. Demonetization has converted those fake currency notes into a mere piece of papers.

### Online transactions

Demonetization's motto was to encourage the cashless/digital economy. More and more cash-less or less-cash transactions will lead to more disclosure of income which will increase the direct tax collections. With a reduction in cash transactions, alternative forms of payment will more in demand. Electronic mode of payment like online transaction, payment through applications, E-wallets E-banking, usage of debit and credit cards etc. will surely see the substantial increase in demand

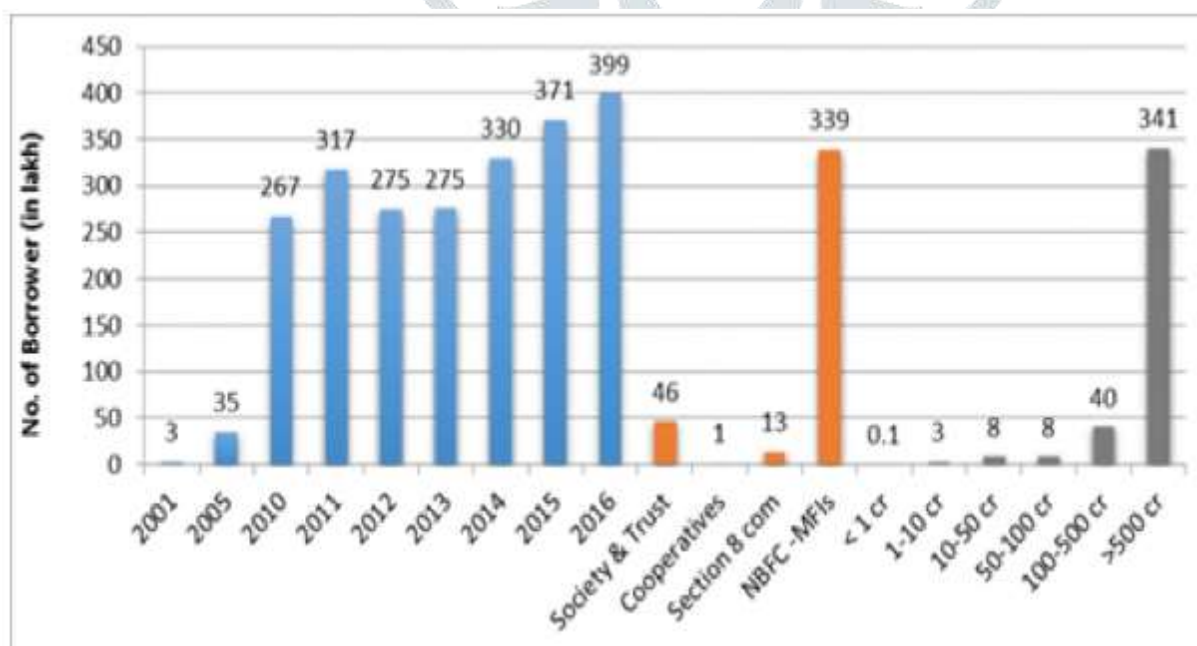
### To hit Maoists

This step actually made money with Maoists worthless. As reported Maoists had hoarded over Rs.7000 cores with them at Baster in Chhattisgarh. All such currency is now nothing but pieces of papers

### Rise in GDP

Though demonetisation has negatively impacted sectors such as real estate and property, construction, and household consumption in general, it is believed that long-term benefits for GDP growth will outweigh the short-term transitional impact. We are now heading towards a 9% GDP growth by FY2018-19.

Growth in Microfinance Industry, Impact of Currency Ban



## IMPACT OF DEMONETISATION ON INDIAN ECONOMY

Demonetisation impacted to every area in Indian Economy. Daily routine of people has changed a lot due to not exchange. Many people's face difficulties due to sudden decline in the money supply. Even this decision lowered the GDP of the country and sever impact on cash based sectors like MSME, and downfall in stock market as well. Major impact of demonetisation on various fields is as follows:

**Effect on GDP:** The sudden decline in money supply and simultaneous increase in bank deposits was adversely impacted consumption demand in the economy in the short term. This, coupled with the adverse impact on real estate and informal sectors may lead to lowering of GDP growth (based on facts, 2016)

**Effect on Bank:** As directed by the Government, the 500 and 1000 Rupee notes, which at that time cease to be legal tender were to be deposited or exchanged in banks (subject to certain limits). This would automatically lead to more amounts being deposited in Savings and Current Accounts of commercial banks. This, in turn, would enhance the liquidity position of the banks, which would be later utilized further for lending purposes. (based on facts, 2016)

**Effect on Parallel Economy:** The currency of the aforementioned denominations constitutes around 86% of the total value of the currency in circulation. It was expected to remove black money from the economy as they would be blocked considering the holders would not be in a position to deposit the same in the banks, temporarily halt the circulation of large volumes of counterfeit currency and curb the funding for anti-social elements like smuggling, terrorism, espionage, etc. (based on facts, 2016)

### FINDINGS OF THE PAPER

As per the facts 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 has accomplished, but that is just one side of it. A good part of black money is eliminated from the economy and this money can be used for development of economy. With increased transparency, trust on Indian Economy is increased. Thereby foreign investments poured in.

Demonetization move encouraged cashless transactions, which is a boost to Economy GDP growth was earlier estimated as 7.8%. Post-demonetization, estimates are lowered to 7.1%. Agriculture sector, small and medium scale businesses and informal sectors are the worst hit by demonetization Even though demonetization move created adverse short-term policy impact the real impact of demonetization must be assessed in the medium/long term, at this point of juncture we cannot precisely conclude whether demonetization is a failure or a success.

### SUGGESTION

- 1) There is a need of setting up of digital literacy booths outside banks majorly in rural regions for spreading digital literacy across all sections of the nation.
- 2) Government should print more and smaller denominations such as Rs. 50, 100 and Rs. 500 notes so that there should be sufficient circulation of money in the market.
- 3) Government needs to ensure that the sufficient quantity of money is being transported to the banks and ATMs in both rural and urban areas on time.
- 4) Facility of mobile ATMs in the Government, public sector and private corporate sector offices having more than 25 employees in their establishments.

- 5) Cash driven sectors such as construction sector and Small and Micro Units (SMEs) should be facilitated by expanded cash limits for the payment of salaries of their daily wage and contractual workers.
- 6) Cash driven sectors such as construction sector and Small and Micro Units (SMEs) should be facilitated by expanded cash limits to withdraw from the banking sector for the payment of salaries of their daily wage and contractual workers.
- 7) Incentivize RTGS (Real Time Gross Settlement) and NEFT (National Electronic Funds Transfer) under the ambit of digital transfers so that more and more people adopt the available facility and are less dependent on cash transactions.
- 8) Enhance in the limits of Removal of service tax charged while making payments through credit card, debit card, charge card or any other payment card up to Rs. 2,000 in a single transaction is a good start for the transformation from cash transactions to the digital transfers, however, the limit needs to be revised to Rs. 10,000.
- 9) Increase in daily cash withdrawal limits from ATMS: Daily cash withdrawal limit from ATMs should also be increased to Rs. 10,000 so that people are not coming in queue again and again.

## CONCLUSION

The present study based on descriptive analysis examined the impact of Demonetisation on Indian Economy. The analysis revealed that different segments of the economy were influenced differently with the demonetisation move. Further, various sectors viz auto & auto ancillary Consumption, banking sector, hospitality and tourism, oil & gas and real estate sector were also affected differently. Negative impact of demonetisation was observed in case of hospitality and tourism and real estate sector. Neutral impact was observed in case of Oil and Gas and auto & auto ancillary sector. Whereas, in case of banking sector, marginally positive impact was observed due to the demonetisation.

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