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## **Impact of Demonetisation on Indian Economy**

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### **ABSTRACT**

The government of India announced the demonetization of ₹500 and ₹1000 bank notes of Mahatma Gandhi series on November 8, 2016. Prime Minister Narendra Modi announced this move in his speech. Demonetization refers to the act of taking off and retiring a current form of currency and is often followed by replacing it with a new one. This was done so as to reduce the corruption, to beat terrorism and to get rid of the menace of black money. Stimulating India towards a cashless economy was another important objective. It has been observed that this whole episode had mixed outcomes for different sectors of the Indian economy. By this paper, the impact of demonetization 2016 on the different sectors of the economy is described.

**KEYWORDS** Demonetization, Corruption, Shadow economy, Cashless economy.

### **INTRODUCTION**

It would not be hyperbole that demonetisation announced by Mr. Modi on November 8<sup>th</sup>, 2016 might have been one of the largest self-levied macroeconomic shocks on a country. The government enforced a major change in the economic environment by demonetising the high value currency notes of ₹500 and ₹1000 denomination. These ceased to be legal tender from the midnight of 8<sup>th</sup> of November 2016. People have been given 50 days up to December 30, 2016 to deposit the demonetized currency notes in bank accounts or exchange them for new notes at banks and post offices, when only half of Indian adults had bank accounts. The reasons offered for demonetisation were multi-fold: to combat corruption, to target terrorism, to brush off the menace of shadow economy and to persuade India towards a cashless economy. The demonetization, by removing 86 per cent of the currency in circulation, resulted in a very severe contraction in money supply in the economy.

Compounding the arduous challenge required to replace such a large amount of cash was the fact that a significant proportion of the new notes had yet to be printed at the time of the announcement, causing weeks-long cash shortages, which in turn led to significant, government-mandated restrictions on cash withdrawals. In spite of these challenges, public reactions to demonetisation were initially broadly positive. Gradually, however, the public mood began to change.

Though people had time until the end of the year to deposit the notes in bank accounts, doing so in large quantities could have exposed them to high taxes and fines. So, they resorted to gas pumps, banks, foreign-exchange counters, ATMs, to jewellery shops, and to creditors to repay loans and several deaths were linked to the inconveniences caused due to the rush to exchange cash. There was a spike in donations in the form of the demonetized notes in temples in the form of defunct notes. People started making multiple transactions at different bank branches and also sending hired people, employees and followers in groups to exchange large amounts of banned currency at banks. The Indian Railways authorities found that a large number of people started booking tickets particularly in classes 1A and 2A for the longest distance possible, to get rid of unaccounted cash. People used the demonetised 500 and 1,000 notes to pay large amounts of outstanding and advance taxes.

### **OBJECTIVES OF THE STUDY**

1. To study the impact of demonetization on different sectors of the Indian economy.
2. To study the benefits and problems associated with the demonetization drive 2016.

### **RESEARCH METHODOLOGY**

This study is descriptive in nature. Here, we have explained the probable impact of demonetization on various sectors of the economy. For this secondary data has been collected through different articles, research papers and reports published about demonetization. Hence this study highlights opportunities and challenges faced by different sectors due to demonetization move.

### **IMPACT OF DEMONETIZATION**

This move brought the Indian economy to a halt. The aftermath was much severe for the sectors which still work predominantly with cash whereas it affected to a lesser extent the sectors which transact mostly in non-cash forms. It caused an abrupt collapse of the India's commercial ecosystem. Trade across all facets of the economy was disrupted. It led to a situation where lack of currency jams consumption, investment, production, employment etc.

Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓

**Agriculture:** As farmers generally deal in cash therefore they found difficulty buying seeds and fertilizers and also wholeselling crops and perishable products. The demonetization led to unavailability of cash to pay for food products leading to a reduction in demand which resulted in downfall in the prices of crops as a consequence of which the farmers across the country dumped their output in grief. The fishing industry which depends on cash sales of freshly caught fish also fainted.

**Manufacturing:** Temporary cash crunch affected purchases in Automobile: Two Wheelers, commercial vehicle and passenger vehicle segments as consumers postponed purchases due to temporary liquidity crunch and expectations of rate cuts. However, as most vehicles are financed through loans, the effect was temporary and demand was redeemed. There was a reduction in industrial output as all industries were hit by the cash crisis.

**Consumption-related sectors:** The headset was near-term negative as cash sales account for a significant nugget of sales for companies in these sectors especially those not within the organized retailing, kiriyana, fruits and vegetables and all other perishables.

**Real-estate:** With downfall in demand from agents who have earned unaccounted incomes and placed them within the real estate space – prices within this segment fell or transactions curtailed.

**Taxation System:** There were multiple channels through which taxes affected. At the point of transition to the new regime, people attempted to convert cash balances into commodities like gold or luxuries. On these transactions the governments had a spurt of taxes. In the subsequent period, the impact on indirect taxes was negative because of the compression in demand.

**Business:** Demonetization had a considerable impact on the informal sector, which employs more than 80% of India's workforce. Demonetisation caused serious disruptions to such businesses, many of which were already struggling due to the steady decline in credit flows. This reportedly led to a substantial drop in production capacity and significant loss of earnings, wages and employment.

**IT industry:** The IT industries prefer purchase and sales through banking system only. New-age payment mechanisms like PayTM, Instamojo Payment Gateway, PayUMoney and Mobikwik, online banking and e-commerce platforms saw an increased demand as people showed willingness to move away from cash. This particularly rewarded IT start-ups that work on online payments.

**GDP:** According to the government's growth estimates, the pace of growth was influenced by slowing growth in the manufacturing and mining sectors and also construction activity. This estimate was in line with the forecast of India's central bank, Reserve Bank of India.

### **PROS OF DEMONETIZATION**

1. It helped the government to track people who kept unaccounted money in cash on which no income tax has been paid. This money had no value after demonetization. So resulted in improved information about the cash economy.
2. Black money has inflated the price of major assets like real estate, gold etc. After demonetization, demand of these assets decreased resulting into decreased prices.
3. Good amount of tax was received which can be used by the government towards betterment of society.
4. An effective remedy to address the problem of corruption and the black economy. Hoarders would either have to come clean and pay punitive taxes or have to turn their cash to trash.
5. It reduced the extent of counterfeit money.
6. It was a move towards electronic currency and stimulating India to a cashless economy.

### **CONS OF DEMONETIZATION**

1. As everyone was in a rush to change their money, there arose a situation of chaos which lead to law and order problem.
2. Destruction of old currency and printing of new currency involve costs, these costs has to be born by the government, if the cost is higher than benefit, then there is no use of demonetization.
3. Major portion of black money is not kept in terms of liquid cash and is kept as real estate or gold resulting in a meager success of this move.

## **CONCLUSION**

In brief, Small farmers, sellers, merchants, daily wage laborer and traders were the ultimate sufferers not the money hoarders, because of lack of proper planning, intelligence and foresight on the part of government. This was a terrible setback for the international standing of the Indian economy. There was no “policy skeleton,” no cost-benefit analysis. However, the outlook is not all gloomy. Demonetisation is a continuation of a larger trend that demonstrates the increasing role of anti-corruption policies in the Indian public discourse. Demonetisation has changed the tone and pace at which corruption is spoken about in India.

As with most economic reforms, there are costs that are immediate, obvious, and asymmetrical while the gains are often hard to measure. In the case of demonetisation, Modi has staked his position as a leader capable of making bold decisions. While Modi may own the narrative now, much of the success depends on the next steps that his government introduces to tackle black money. There could have been recalibration of ATM machines. Enough 100 Rupee notes and other smaller denomination notes in the market should have been piled up before taking this step. Problem planning would have resulted in a better implementation of the whole drive and people would also have been spared of the whole plight.

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