

Impact of Demonetization on Indian Economy

Abstract

The buzzing topic demonetization is a double edged weapon used by the Modi's Government to wipe out the counterfeit currency, scrap tax evasion, curtail black money and terrorist funding activities, and to promote a cashless e-economy. The initiative declared as a master stroke for the Indian economy and received gigantic support by several bankers and from some international economists, though it was criticized by members of the opposition parties. The subject has involved widespread debate and needs to be understood in a holistic manner. There are various advantages and disadvantages of the demonetization drive. This paper has made an attempt to discuss the pros and cons of demonetization and its impact on the Indian Economy.

Keywords: Demonetization, Black Money, Digitalization, Corruption.

Introduction

Demonetization is the process of stripping a currency unit of its status as legal tender and involves withdrawal of a particular form of currency from circulation. With this move, the government of any nation either introduces new notes or coins of the same denomination or completely replaces the old denominations with the new one. According to Wanchoo committee (set up in 1970s), the Demonetization is a measure to unearth and counter the spread of black money. On the night of November 8, 2016, the Prime Minister came with a shocking decision of Demonetization of Rs. 500 and 1000 notes making thousands queue up in front of banks and ATMs during the last few months. The Modi's decision was a post dated cheque as this was today's pain for tomorrow's gain.

According to The Reserve Bank of India, the foremost motive for the demonetization was to stop the augmentation of fake currencies of the same notes, and also to curb the higher occurrence of black money in the economy. The fake notes are being used for felonious activities by anti-nationalists like terrorists and India being a realm of a cash-based economy, the elevation of counterfeit and black money continues to be a threat. Before, demonetization, the Government had taken several initiatives to combat black money like Income Declaration Scheme 2016, Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015, the Income Declaration Scheme (IDS) in the Budget for 2016-17, the August 2016 amendment of the Benami Transactions (Prohibition) Act of 1988, and Joint Declaration of Automatic Exchange of Information (AEOI) between India and Switzerland to address black money etc. The aforesaid list also includes a scheme named 'Taxation and Investment Regime for Pradhan Mantri Garib Kalyan Yojana, 2016' (PMGKY) providing an opportunity to pay taxes with heavy penalty on black money deposited, and come clean. Finally, Prime Minister took "a bold, even visionary, step" with demonetization in an endeavor to eliminate black money generated out of money laundering and terrorist funding activities, and to promote a cashless e-economy

But the Government has created a cushion for the innocent people to get exactly the equal amount in lower denominations for higher value cash. In addition, there was a warning that of all the cash deposited during the November 9, 2016 to December 30, 2016, above a threshold of Rs 2.5 lakh in any account would be matched with the income tax returns filed. For more transparent results, the Government also introduced the Taxation Laws (Second Amendment) Bill, 2016 in the Lok Sabha on November 28, 2016. The demonetized currency was to the tune of Rs.14.2 trillion, which was about 85% of the total value of currency in circulation. The Government had either considered this amount for paying relevant tax or larger proportion of this unaccounted currency was extinguished (HDFC Bank Investment Advisory Group, 2016).

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The Demonetization has been considered as powerful instrument for unearthing the black money in Indian economy. In 1946 and 1978, then Government had also taken this decision and restricted the circulation of Rs. 1000, 5000 and 10000 notes in India (Palanisamy, 2017). Modi Government has followed the phrase "History repeats itself" and opted Demonetization third time in India. The initiative declared as a master stroke for the Indian economy and received gigantic support by several bankers and from some international economists, though it was criticized by members of the opposition parties. Hence, proceedings in throughout the winter session in the parliament were disturbed and opposition even demanded the Prime Ministers' explanation.

The plan of the paper is as follows. Firstly, the objectives of the study are given. After that, the existing literature has been reviewed. Then, research design is presented. Later on the pros and cons of demonetization in India and subsequently, the impact of demonetization on Indian economy have been discussed. Finally, the conclusion for the study is given.

Objectives of the Study

The main objective of this paper is to study pros and cons & respective impact of Demonetization on 8th Nov. 2016 by the present government on Indian economy.

Review of Literature

(Kumudha & Lakshmi, 2016) discussed the aftermath of Demonetization on retail and online shopping and further explained how it has affected rural consumer and promoted digital payment. (Rani, 2016) has also discussed the impact of Demonetization on retail outlets. (Ramdurg & Basavaraj, 2016) addressed the history of demonetization in India and around the world. The Demonetization has been expressed as a tool for redefining Indian economy. It has been concluded that long-term benefits of Demonetization will overrides the shorter challenges. The immediate impact of Demonetization on different sectors in India has been discussed by (Mali, 2016) and (Kaur, 2016). The one study is conducted by (Veerakumar, 2017) for assessing the impact of Demonetization on public. (Kanchan, 2016) explained the concept of Demonetization and its brief history in India. The decision is fruitful or carries any negative impact for the economy is also discussed. (Lahiri, 2016) presented the implication of Demonetization with respect to cash shortage and black money. (Deepika, et.al, 2017) elucidated the positive and negative impact of demonetization for the Indian economy. A comparative study for Demonetization in India and other countries has been conducted by (Palanisamy, 2017).

Though number of studies are available for discussing the impact of Demonetization on different parameters, but this study incorporates the impact of Demonetization on Indian economy by showing recent data within respective sector and also presents its positive and negative aspects.

Research Design

This study is conceptual in nature. The secondary sources of data are used for this study. The data is collected from different books, journals; articles, periodicals, research papers and RBI's & MCA's official website.

Pros and Cons of Demonetization

As every coin has two facets in the same way, the decision of demonetization has several positive as well as negative aspects. The benefits to the Indian economy from demonetization are:

1. The extinguishing of unaccounted currency in a large proportion has created ample funds in the Government's account without borrowing from the market and can be utilized for investment in large infrastructure.
2. The people in India received this positive teaching from demonetization to utilize banking channels for keeping their spare funds and also use formal channels for spending.
3. This exercise has reduced the quantum of cash transaction in real estate sector in urban as well as in rural area.
4. The move will positively improve fiscal management of the Government and will reduce borrowings.
5. The demonetization has forced people to deposit money in their Jan Dhan Account. Prior to this, these account holders were reluctant in increasing their respective balance.
6. The fake currency circulation has come to standstill and positively contributed in controlling illegal activities like terrorism and money laundering etc.

Besides above positive side, the Demonetization has also negative aspects, which are discussed as below:

1. The most affected section of the measure of demonetization was mango people. The restriction was imposed on the daily withdrawal limit on the cash counter of banks as well as on Automatic Teller Machines (ATMs). The problems of the public got multiplied with the introduction of a higher denomination note i.e. Rs. 2000. As there was shortage of small currency notes and coins and to get a change of such big note at the local shops was a tricky task.
2. The demonetization has pushed Indians to opt for cashless transactions. But only sections of the people are accustomed to this practice but majority of Indians have no knowledge about this cashless mode of transaction especially in rural area.
3. The insufficient new currency in ATMs also created problem for the public standing in long queues as only 40 percent of these machines have been calibrated to the new currency. The available cash in ATMs got exhausted within hours and causing further inconvenience to the people.
4. Many instances of illicit activities can be quoted for banking and post-office personals during the demonetization period. These officials were found

illegally exchanging old currency for the new currency just for a commission amount.

- The black money hoarders had used Jan Dhan Accounts for converting their black money into white.

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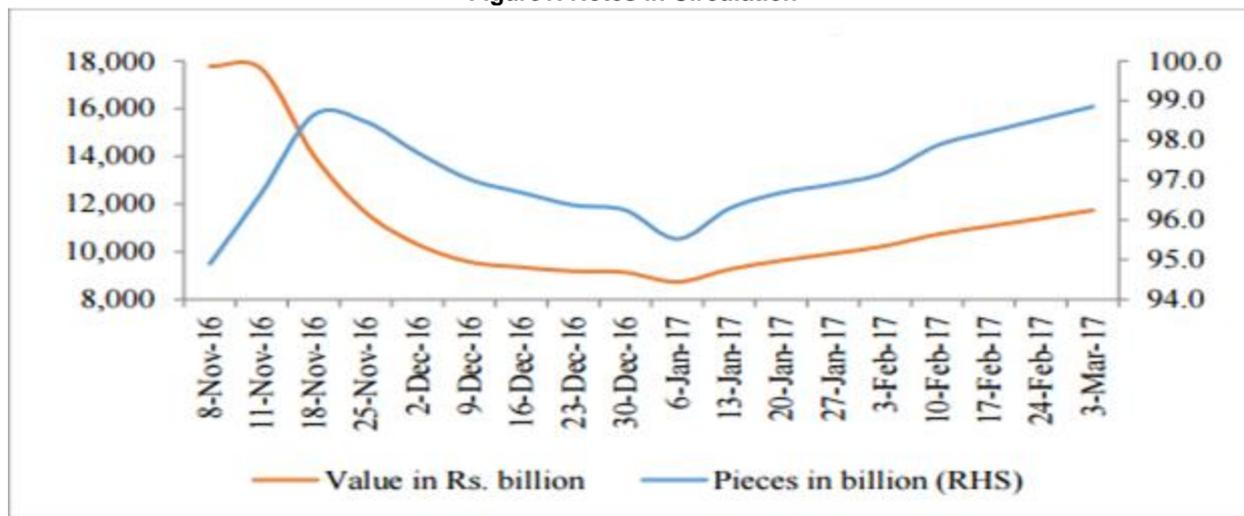
The decision of Demonetization has affected poor class, middle class and upper-class people in India. The impact of this initiative can be seen in all most all the sectors in economy. All though the impact of Demonetization is for short term but it may show the way to form a stronger economy in long term. The

prime aspects on which this initiative has its immediate footprint are discussed below:

Notes in Circulation

The notes in circulation has been progressed at a fast pace. There was a net increase in currency in circulation by about 2,600 billion between end December 2016 and early March 2017. Due to the introduction of new currency, deposits with banks also declined moderately throughout aforesaid period. The currency in circulation in terms of number of pieces and value during demonetization and remonetisation is presented in Figure 1:

Figure1: Notes in Circulation



Source: (RBI, 2017)

Black Money

The prime objective of demonetization was to abolish black money. But this initiative has not entirely eradicated this as it has three components i.e. black wealth, black income and black currency. Black wealth is generated with accumulation of black income over a several years and black income can be earned without black currency in the form of gold and diamond. So, the demonetization has only targeted black currency. Further, the reissuing of the currency notes in the denomination of Rs. 500 and Rs. 2000 is a debatable issue as high denomination currency is always used to hoard black money.

Economic Activities

The different sections of economy had faced short-term disturbance due to shortage of cash. The sectors like agriculture, small traders, services sector, professionals like doctor, carpenter, utility service providers, etc. and retail outlets. The real estate sector was one of the most affected sector as sellers and buyers preferred to do cash transaction for a significant amount to escape from capital gain tax and stamp duty. The Table 1 presents the growth in consumer durable segment during Demonetization phase:

Table 1: Growth in Consumer Durable Segments

(in per cent)

Category	Volume Growth		Value Growth	
	October 2016	November 2016	October 2016	November 2016
Microwave	90.6	-53.0	90.7	-51.5
Refrigerator	74.0	-41.2	73.4	-40.3
Air Conditioner	1.8	-34.0	4.0	-33.8
Washing Machine	116.7	-31.7	113.1	-34.4
Flat Panel TV	94.7	-30.4	99.4	-26.6

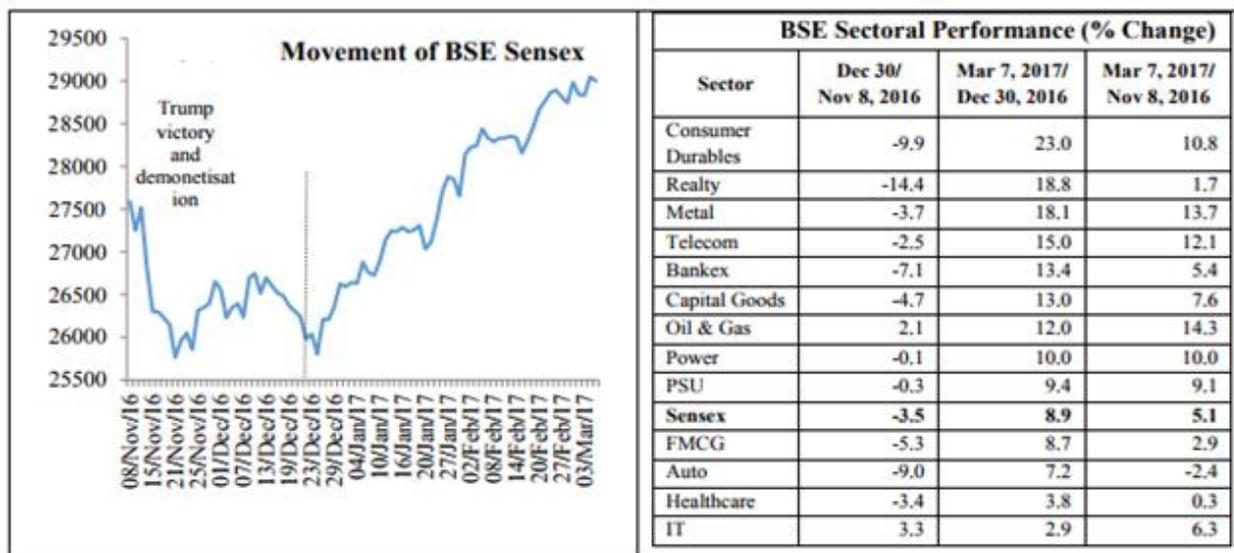
Source: (RBI, 2017)

Stock Market

The equity market resembles the picture of both domestic and global factors, hence, the impact of Demonetization alone can be judged from the movement in indices of cash sensitive sectors such as FMCG, consumer durables, auto and realty vis-a-vis the overall index. After demonetization, BSE SENSEX was down by 1,689 points and NIFTY by over 541

points. At the close of the intraday trading as on 15 November 2016, the BSE SENSEX index was low down by over 565 points and the NIFTY 50 index was under 8100 on intraday (Manohar Chowdhry & Associates, 2017). The Figure 2 with respective table shows the performance of BSE Sensex during Demonetization phase:

Figure 2: Performance of BSE Sensex



Source: Bloomberg

Digital Payment

The demonetization has positively affected the e-commerce business like Amazon, Flipkart, Myntra etc. The e-wallets like Paytm, Ola Money and other online payment mode have also shown an increasing trend in number of transactions. The Demonetization has created surge in digital marketing, which was earlier in the nascent stage. The government has also encouraged the use of plastic money and online transaction through e-wallets, online banking and mobile banking by doing its promotion in social media at a large scale. The different new modes for cashless transaction

advertised at government level are (i) Unified Payments Interface (UPI) which enables a person to transfer funds to any other person registered on UPI through mobile phone connected to internet; (ii) (Aadhaar Enabled Payment Systems (AEPS) wherein funds can be transferred using Aadhaar numbers seeding with bank accounts; and (iii) Unstructured Supplementary Service Data (USSD) wherein funds can be transferred from mobile phones without requiring access to internet connection by dialing *99# (Palanisamy, 2017). The growth in different electronic modes of payment during Demonetization is presented in Table 2:

Table 2: Growth in Selected Electronic Modes of Payment (y-o-y growth in per cent)

Category		Oct-2016	Nov-2016	Dec-2016	Jan-2017	Feb-2017
National Electronic Funds Transfer (NEFT)	Volume	16.2	23.3	39.0	38.0	34.5
	Value	37.6	38.3	40.8	60.2	49.5
Cheque Truncation System (CTS)	Volume	-1.1	23.0	58.4	52.7	20.2
	Value	2.9	8.6	13.0	19.3	0.8
Immediate Payment Service (IMPS)	Volume	116.7	89.6	157.2	177.7	150.4
	Value	150.7	135.9	186.6	196.7	184.2
National Automated Clearing House (NACH)	Volume	53.0	30.8	58.3	19.8	-0.9
	Value	89.8	76.3	116.7	22.8	54.2

Source: RBI Bulletins and Press Releases on Electronic Payment Systems-Representative Data

Elections

The opposition parties had tried very hard to push the people against the present government's decision but with little success. The election results in Uttar Pradesh, Utrakhand and Maharashtra and recently in Delhi MCD poll are lively witness of the success of Modi Government's demonetization decision.

Inflation

There was marginal reduction in prices for a short-term period because of reduction in consumer demand. The prices in real estate only were significantly affected due to high cash based transactions. The overall price level was lowered due to moderation from the demand side. But, on the whole, inflation excluding food and fuel during November 2016 - January 2017 was not impacted due to Demonetization (RBI, 2017). This impact is depicted in the Table 3:

Table 3: Consumer Price Index (CPI) Inflation in Selected Groups

(Y-o-y in percent)

Category	Nov-15	Dec-15	Jan-16	Oct-16	Nov-16	Dec-16	Jan-17
Fuel & Light	5.3	5.4	5.3	2.9	2.8	3.8	3.4
Clothing & Footwear	5.8	5.7	5.7	5.2	5.0	5.0	4.7
Housing	5.0	5.1	5.2	5.1	5.0	5.0	5.0
Miscellaneous*	3.8	4.0	3.9	4.7	4.8	4.7	5.1
CPI-excluding Food-Fuel	4.7	4.9	4.7	4.9	4.9	4.9	5.1

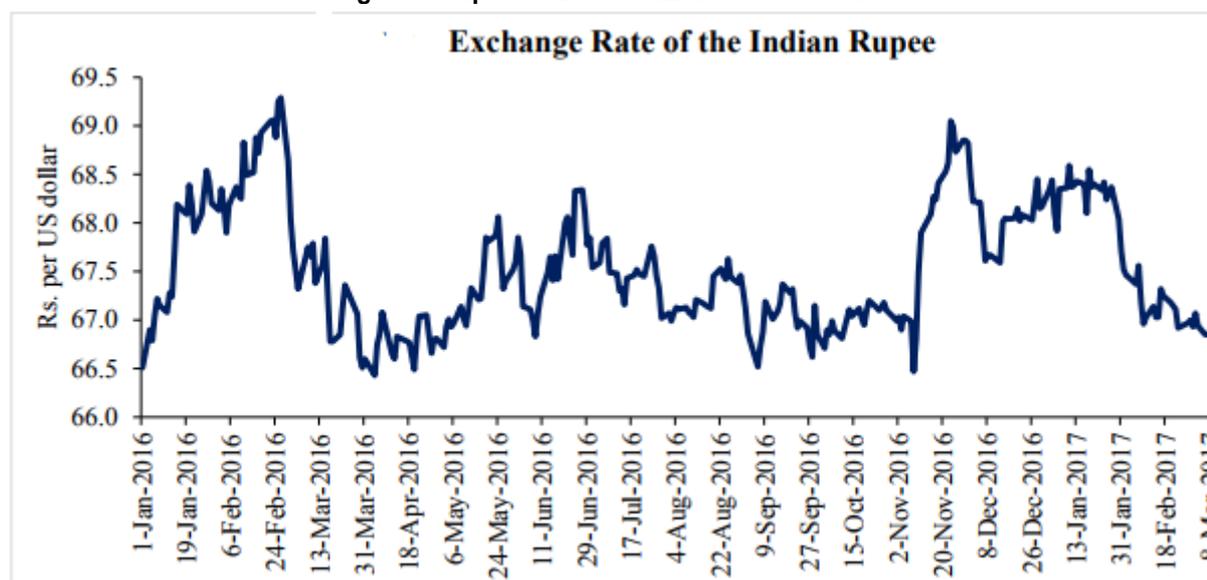
* Includes household goods & Services; health; transport & communication; recreation & amusement; education; and personal care and effects.

Source: (RBI, 2017)

Exchange Rate of Indian Rupee

The volatility can be observed in the foreign exchange market in post Demonetization period, which reflects the both global as well as domestic developments. However, The Indian rupee, which depreciated by 2.6 per cent during November 8, 2016

to November 30, 2016 against the US dollar again took an upward swing and appreciated in the first week of December 2016 (RBI, 2017). The impact of Demonetization on the forex market appeared to have been momentary and presented in the Figure 3:

Figure 3: Impact of Demonetization on Forex Market

Source: Bloomberg

GDP

Initially just after demonetization, it was assumed that due to low cash availability, there will be a negative impact on consumer demand and ultimately GDP will be negatively affected. But coming to the festive session in March, this presumption was

not proved true and no such downfall was observed in GDP. The estimated Gross Value Added (GVA) for 2016-17 by Central Statistics Office (CSO) is given in the following Table 4:

Table 4: Estimated Gross Value Added (GVA) for 2016-17

Period		May 31, 2016	Aug 31, 2016	Nov 30, 2016	Jan 6, 2017	Jan 31, 2017	Feb 28, 2017
2015-16	Q1	7.2	7.2	7.2	7.2	-	7.8
	Q2	7.3	7.3	7.3	7.3	-	8.4
	Q3	6.9	6.9	6.9	6.9	-	7.0
	Q4	7.4	7.4	7.4	7.4	-	8.2
	Annual	7.2	7.2	7.2	7.2	7.8	7.8
2016-17	Q1	-	7.3	7.3	-	-	6.9
	Q2	-	-	7.1	-	-	6.7
	Q3	-	-	-	-	-	6.6
	Q4	-	-	-	-	-	6.5*
	Annual	-	-	-	7.0	7.0	6.7

*Implicit, derived from annual number, given data for first three quarters; -: Not available.

Source: (RBI, 2017)

The projected growth estimates based on key drives after demonetization are given in Table 5:

**Table 5: Projected GVA Growth
(Y-o-y in percent)**

Period	2017-18
Q1	7.1
Q2	7.5
Q3	7.7
Q4	7.5
Financial Year	7.4

Source: (RBI, 2017)

Conclusion

Demonetization decision was a historical step by the Modi Government and it should be praised and supported by all. The move has resulted in the collection and extinguishing of black money. But there is an immense need to ensure that black money and counterfeit currency do not rematerialize in another form in due course of time. It will require stringent measures and monitoring on a continuous basis. Though, no considerable results are achieved in short-term but this decision will definitely fetch results in the long term for the overall development of the economy. This move can lead to improved tax compliance, better fiscal balance, lower inflation, lower corruption, complete elimination of fake currency. The digital transactions got a green signal from different sections of the economy and accordingly no stone should be unturned in making e-banking foolproof as the security issues in electronic transactions can prove disastrous than the limitations of the paper currency.

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