

# A Research Paper on Demonetization: A Shock Therapy or Divine Blessing to Indian Economy



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## Abstract

The Indian Economy earlier known to be "Fastest growing Economy" got a shock on 8<sup>th</sup> November 2016, that use of all Rs.500 and Rs.1000 bank notes would be invalid past midnight announced by Prime Minister Narendra Modi. Most of the people were hailing it as "master stroke" move against black money, currency counterfeiting and terrorism, there were certain section of the people of society which were making hue and cry about the move that has brought unnecessary problem for them. It reduced the country's GDP and industrial production. The concern projected growth figures revised downwards from 7.6 % to 7.1% for the financial year ending March 2017. The study evaluates the pre and post demonetization impact on several sectors as well as on Indian economy.

**Keywords:** Demonetisation, India, GDP, Bank Notes, Government.

## Introduction

Prime Minister of India Mr.Narendra Modi announced the Demonetisation in an unprepared live telecast to address the nation at 20:15 IST on 8 November 2016. In the announcement, Modi declared exchange of all Rs.500 and Rs.1, 000 banknotes of the Mahatma Gandhi Series as unacceptable with effect from the midnight of the same day. The issue of new Rs.500 and Rs.2,000 currency in exchange of the old currency. After Modi's announcement, the Governor of the Reserve Bank of India, Mr.Urjit Patel, and Economic Affairs secretary, Mr.Shaktikanta Das explained the purpose to stop terrorism funded by counterfeit notes. While the supply of notes of all denominations had increased by 40 percent between 2011 and 2016, the Rs.500 and Rs.1,000 banknotes increased by 76 percent and 109 percent owing to counterfeit. They said that forged cash was used to fund terrorist activities against India and that the Demonetisation had a counter-terrorism purpose. Mr.Urjit Patel informed that the decision had been made about six months ago, and the printing of new banknotes of denomination Rs.500 and Rs.2, 000 had already started. However, only the top members of the government, security agencies and the central bank were aware of the move.

## History of Demonetisation

The Indian government had demonetised bank notes on two prior occasions—once in 1946 and then in 1978—and in both cases, the goal was to combat tax evasion by "black money" held outside the formal economic system. In 1946, the pre-independence government hoped Demonetisation would penalise Indian businesses that were concealing the fortunes amassed supplying the Allies in World War II. In 1978, the Janata Party coalition government demonetised banknotes of 1000, 5000 and 10,000 rupees, again in the hopes of curbing counterfeit money and black money.

## Government Ordinance of Demonetisation

The Specified Bank Notes (Cessation of Liabilities) Ordinance, 2016 was issued by the Government of India on 28 December 2016 ceasing the liability of the government for the banned bank notes, and also imposing a fine up to Rs.10,000 or five times the amount of the face value of the bank notes, whichever is higher, for people transacting with them after 8 November 2016; or holding more than ten of them after 30 December 2016. The ordinance also provided for the exchange of the bank notes after December 30 for non-resident citizens and others on a case by case basis. However, Petrol, CNG and gas stations, government hospitals, railway and airline booking counters, state-government recognised dairies

and ration stores, and crematoriums were allowed to accept the banned Rs.500 and Rs.1,000 bank notes until December 2, 2016.

#### **Facts and figures of Demonetisation of Bank Notes**

Up to 97% of the demonetised bank notes have been deposited into banks which have received a total of Rs.14.97 trillion (\$220 billion) as of December 30 out of the Rs.15.4 trillion that was demonetised. This is against the government's initial estimate that Rs.3 trillion would not return to the banking system. Of the Rs.15.4 trillion demonetised in the form of Rs.500 and Rs.1000 bank notes of the Mahatma Gandhi Series, Rs.9.2 trillion in the form of Rs.500 and Rs.2000 bank notes of the Mahatma Gandhi New Series has been recirculated as of 10 January 2017, two months after the Demonetisation. Currency demonetised on 8 Nov '16 Currency issued as of 18 Nov '16 Currency issued as of 28 Nov '16 Currency issued as of 7 Dec '16 Currency issued as of 21 Dec '16 Currency issued as of 10 Jan '17 Currency issued as of 24 Feb '17 Currency issued as of 28 Apr '17 .

#### **Relevance of the Study**

RBI data showed that as of March 2016, 632,926 currency notes were counterfeit—known as an FICN (Fake Indian Currency Note). As a proportion of NIC (Notes in Circulation), the 1,000 rupee and 500 rupee notes were the highest. Nullifying these FICNs was also part of the demonetization move.

So, there is a need of specific and in depth study relating to impact of Demonetization on Indian Economy.

#### **Objectives of the Study**

The following are the Objectives of the Study:

1. To make an evaluation of people's thought and opinion about Demonetisation in India.
2. To Study the impact of Demonetisation on several sectors.

#### **Review of Literature**

S Kumar Nithin, Sharmila (2016) in their article "Demonetisation and Its Impact on Indian Economy" have analysed the steps Government took of demonetising the currency as a tool to fight against black money and corruption in Indian Economy.

Rao Kavita, Mukherjee Sachidananda, Kumar Sudhanshu, Sengupta D. P., Tandon Suranjali, Nayudu Sri Hari, (2016) in the working paper "Demonetisation: Impact on the Economy" has evaluated the short run and medium-term impacts that such a shock is expected to have on the economy.

Manju G ,Kalamani C,(2016) in his article "The Impacts of Demonetisation on Indian Economy" have discussed biggest criticisms being that the implementation has been quite poor and has caused a lot of inconvenience to the common man sure certain tradeoffs had to be made between keeping the secrecy of the mission vs. consulting all stakeholders and creating a full proof implementation plan.

Banerjee Porinita, SayyedVasimraja,(2017) in their article "A Study on Impact of Demonetization on E-Commerce Industry" have analyzed the effect of demonetization on consumer's frequency of buying

product and consumer's mode of payment mode through online shopping post demonetization.

Bansal Jai, (2017) in his article "impact of demonetization on Indian economy" has explained Demonetization can be said as a "Surgical Strike" on Black Money, Terrorism, Fake Currency, Unorganized trading, Real Estate, Share market etc. ,positive and negative impact on several sectors.

#### **Research Gap**

There is no specific and in depth study relating to the pre and post Demonetization effect on Indian Economy. This enabled the Researcher to carry out the research in the specific area.

#### **Research Methodology**

The study focuses extensively on secondary data collected from various national and international news, published report, newspaper, publication from various websites which focused on various aspects of Demonetisation effect on Indian economy.

#### **Data Analysis and Interpretation**

#### **Evaluation of People's Thought and Opinion about Demonetisation**

##### **Positive Review**

The President of India Pranab Mukherjee said it a bold step.

Union Finance Minister Arun Jaitley said The series of reforms initiated by the Narendra Modi government like Demonetisation and the goods and services tax (GST) have put the Indian economy on a "far more stronger track",

Arundhati Bhattacharya (Chairperson of State Bank of India) and Chanda Kochhar (MD & CEO of ICICI Bank) appreciated saying it would help curb black money.

Former Chief Election Commissioner of India S. Y. Quraishi said "Demonetisation could lead to long term electoral reforms".

International Monetary Fund (IMF) issued a statement supporting Modi's efforts to fight corruption by the Demonetisation policy.

Chinese State Media Global Times said it as "fierce fight against black money and corruption."

##### **Negative Review**

The Indian Supreme Court while hearing one among a slew of cases filed against the sudden Demonetisation decision in various courts, observed that it "appears to be carpet bombing and not surgical strike" which government repeatedly claims it to be.

Nobel laureate Indian Economist Amartya Sen, severely criticised the Demonetisation move calling it a "despotic action" among other things.

Former Senior Vice-President and Chief Economist of the World Bank, Kaushik Basu, called it a 'major mistake' and said that the 'damage' is likely to be much greater than any possible benefits.

Pronab Sen, former Chief Statistician and Planning Commission of India member, called it a "hollow move" since it did not really address any of the purported goals of tackling black money or fake currency.

Prabhat Patnaik, a former Professor of Economics at the Jawaharlal Nehru University, Delhi called the move 'witless' and 'anti-people'. He criticised the simple way in which black money was

assumed as "a hoard of cash", saying that it would have little effect in eliminating "black activities" while "causing much hardship to common people."

According to Hindustan Unilever, the country's largest private sector company in the FMCG space, Demonetisation and GST have continued to haunt the rural markets. "From double-digit growth in FMCG across urban and rural markets in 2012, the overall segment has fallen to single-digit growth, with rural lagging urban market,"

Earlier in July, Bajaj Auto chairman Rahul Bajaj raised a question to the government on whether the Demonetisation exercise had achieved its aims. "It is questionable if it (Demonetisation) really worked,"

"Demonetisation was a favourite (topic) of our PM, no one criticises it... People voted for him (in the Uttar Pradesh assembly elections) still, saying it is just a short-term pain for long-term gain," he said. "All the economists are waiting for that gain to come. I don't see that yet," ET had reported quoting Bajaj then.

Senior BJP leader and former Finance Minister Yashwant Sinha has said "Demonetisation has proved to be an unmitigated economic disaster, a badly conceived and poorly implemented GST has played havoc". This has resulted in millions of job losses and even sunk businesses, The IndianExpress report said.

#### **Impact of Demonetisation**

##### **Positive Impact of Demonetisation**

##### **Tax Administration**

Demonetization has strengthened tax administrative measures against black money: Demonetization's prime objective was fighting black money. The Tax Department has got information about such people when they saved money in the bank accounts during the Demonetisation period. The ITD has also made advanced tax administration.

##### **Impact on Bank Deposits and Interest Rate**

Demonetisation has boosted digital payments: One of the welcome turnaround in the Demonetisation program was the inseparable link between Demonetisation and digitalization of transactions. Inarguably, demonetization encouraged people to embrace digital methods.

Though itspace is slow as there are several hindrances which certainly are getting reduced, Demonetisation has inaugurated the march towards cashless society with a bang. Popularization of digital payment methods, instruments and institutions prove that Demonetisation has facilitated digital transactions. POS machines, and use of card based payments are very popular now compared to the pre-Demonetisation period. Among the more sophisticated groups, online payments have become common.

##### **Impact on Black Money**

Only a small portion of black money is actually stored in the form of cash. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. Hence the amount of black money countered by demonetization depend upon the amount of black money held in the form of cash and it will be smaller than expected. But more than anything

else, demonetization has a big propaganda effect. People are now much convinced about the need to fight black income. Such a nationwide awareness and urge will encourage government to come out with even strong measures.

##### **Impact on Counterfeit Currency**

The real impact will be on counterfeit/fake currency as its circulation will be checked after this exercise. Demonetization as a cleaning exercise may produce several good things in the economy at the same time; it creates unavoidable income and welfare losses to the poor sections of the society who get income based on their daily work and those who don't have the digital transaction culture. Overall economic activities will be dampened in the short term. But the immeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as a long term benefit.

##### **Negative Impact of Demonetisation**

##### **Banking**

A State Bank of India branch remained open at night, and a long queue of people waited outside the ATM to withdraw money. In the first four days after the announcement of the step, about Rs.3 trillion (US\$47 billion) in the form of old Rs.500 and Rs.1,000 banknotes had been deposited in the banking system and about Rs.500 billion (US\$7.8 billion) had been dispensed via withdrawals from bank accounts, ATMs as well as exchanges over the bank counters. Within these four days, the banking system has handled about 18 crore (180 million) transactions. The State Bank of India reported to have received more than Rs.300 billion (US\$4.7 billion) in bank deposit in first two days after Demonetisation. A spike in the usage of debit card and credit card post Demonetisation was also reported. Between November 10 and November 27, banks reported exchange and deposits of demonetised banknotes worth Rs.8.45 trillion (US\$130 billion) (exchange of Rs.339.48 billion (US\$5.3 billion) and deposits of Rs.8.11 trillion (US\$130 billion)). During this period, an amount of Rs.2.16 lakh crore (US\$34 billion) had been withdrawn by people from their accounts.

A slowdown in India's growth rate, the bank said, has also affected the growth rate of South Asia. As a result, South Asia has fallen to second place after East Asia and the Pacific. In its India section of the report, the Bank said one-time policy events disruptions from Demonetisation and uncertainty surrounding GST slowed India's economic momentum in 2016. "Real GDP growth slowed to 7.1 percent in 2016, from 8 percent in 15/16, and further to 5.7 percent in Q1 FY2017," it said.

##### **Human Trafficking**

Nobel laureate Kailash Satyarthi and others working to fight human trafficking said that the note ban had led to a huge fall in sex trafficking, but that the trade had already begun rebounding by the following month. Satyarthi said the Demonetisation would be effective in combating exploitation of children as well as corruption and would be a great obstacle to traffickers. However, 2 months later he expressed his disappointment on Rs 2000 notes

being pushed into human trafficking in absence of other concrete steps.

#### **Hawala**

Mumbai Police reported a setback to Hawala operations. Hawala dealers in Kerala were also affected. The Jammu and Kashmir Police reported the effect of Demonetisation on hawala transactions of separatists.

#### **Railways**

As of November 2016, Indian Railways did not have the option to make payment with cards at the counters. After the Demonetisation move, the government announced to make card payment options available at railway counters in the country. The railways placed an order for 10,000 card reader machines in January 2017.

#### **Cash Shortage**

The scarcity of cash due to Demonetisation led to chaos, and most people holding old banknotes faced difficulties exchanging them due to endless queues outside banks and ATMs across India, which became a daily routine for millions of people waiting to deposit or exchange the Rs.500 and Rs.1000 banknotes since 9 November. ATMs were running out of cash after a few hours of being functional, and around half the ATMs in the country were non-functional.

#### **Deaths**

In March 2017, the government stated that they received no official report on deaths connected to Demonetisation. Several people were reported to have died from standing in queues for hours to exchange their old banknotes. Deaths were also attributed to lack of medical help due to refusal of old banknotes by hospitals. As of 15 November 2016, the attributed death toll was 25 and 33 deaths as of 18 November.

#### **Stock Market Decline**

As a combined effect of Demonetisation and US presidential election, the stock market indices dropped to an around six-month low in the week following the announcement. The day after the Demonetisation announcement, BSE SENSEX crashed nearly 1,689 points and NIFTY 50 plunged by over 541 points. By the end of the intraday trading section on 15 November 2016, the BSE SENSEX index was lower by 565 points and the NIFTY 50 index was below 8100 intraday.

#### **Transportation Disruption**

After the Demonetisation was announced, about 800,000 truck drivers were affected with scarcity of cash, with around 400,000 trucks stranded at major highways across India were reported. While major highway toll junctions on the Gujarat and Delhi-Mumbai highways also saw long queues as toll plaza operators refused the old banknotes. Nitin Gadkari, the Minister of Transport, subsequently announced a suspension of toll collections on all national highways across India until midnight of 11 November, later extended until 14 November and again until midnight of 18 November, and yet again till 2 December.

#### **Agriculture**

Transactions in the Indian agriculture sector are heavily dependent on cash and were adversely affected by the Demonetisation of Rs.500 and

Rs.1,000 banknotes. Due to scarcity of the new banknotes, many farmers have insufficient cash to purchase seeds, fertilisers and pesticides needed for the plantation of rabi crops usually sown around mid-November. Farmers and their unions conducted protest rallies in Gujarat, Amritsar and Muzaffarnagar against the Demonetisation as well as against restrictions imposed by the Reserve Bank of India.

#### **Business**

By the second week after Demonetisation of Rs.500 and Rs.1,000 banknotes, cigarette sales across India witnessed a fall of 30–40%, while E-commerce companies saw up to a 30% decline in cash on delivery (COD) orders.

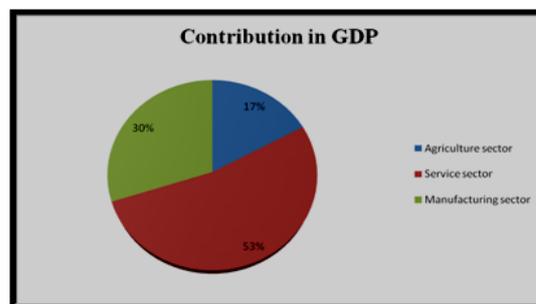
#### **GDP Growth Forecasts**

Global analysts cut their forecasts of India's GDP growth rate for the financial year 2016-17 by 0.5 to 3 percent due to Demonetisation. India's GDP in 2016 is estimated to be US\$2.25 trillion, hence, each 1 per cent reduction in growth rate represents a shortfall of US\$22.5 billion (Rs. 1.54 lakh crore) for the Indian economy.

#### **Findings**

Now we talk about the impact of Demonetization on Indian Economy Sector. First economy can be bifurcated in three broad segments Agriculture Sector, Manufacturing Sector and Service sector all these three sectors contributed in Indian GDP. Agriculture Sector Contribute 17% in GDP Manufacturing Sector Contribute 30% in GDP Service Sector Contribute 53% in GDP After Demonetization all the three sectors faces negative impacts-

#### **Sector Wise Contribution in GDP**



#### **Source-Internet**

#### **Impact of Demonetization on Agriculture Sector**

Agricultural growth in India contracted 0.2% in 2014-15 and grew no more than 1.2% in 2015-16, largely because of back-to-back droughts. It was expected to grow at 4% in this year as per CRISIL Report, but due to Demonetization this forecast is proven wrong because Farmers are running out of Cash to buy Seeds, Fertilizer, Equipments, and Wages payment to workers and Commission to Agents etc. Because of Cash shortage daily supply transport system has also suffered which was result in 25 to 50 % reduction in sales. Following is the main reasons;

1. Farmers are not educated and aware about how to work on E-Payment System, Recent study by RBI Says 78% of the population do not use internet in which almost 80 to 85 % are Farmers.
2. In most of the Villages Proper Banking system is not Developed yet and Villagers are need to go to

the cities for the same because of that Farmer's most of the time is engaged in exchanging the old notes in Banks.

#### **Impact of Demonetization on Business Sector**

As per the study IPP says Growth in Business sector 0.7% in October 2016 but after 8th Nov.2016 Demonetization shows a different picture because of this decision labour turnover is also increased as lack of Production because of law demand of products people were purchase only if it necessarily required, for this I have studied on following business sector

#### **Textile Industry**

Most of the Brands and Retailers Report 40 to 60 % drop in sales after Demonetization in first few weeks but from December onwards this drop is slightly decrease, but still we can say the impact of this decision has affect the industry in 2017 also for at least 3 to 4 months.

#### **Real Estate**

Demonetization smashed the real estate market and it will result in 50% drop down and it will remain for further 5 to 6 months. While the short-term impact is negative, Experts hoping that rate cuts in the coming months would boost home sales.

#### **FMCG Products**

Consumer expenditures also affected by that decision now only those products are purchased which was necessary for daily consumption and mostly the small traders like 'kirana store', 'small bodies', 'thelawala' etc. they all have done their daily transactions only in cash and because consumer has less cash in his pockets the daily sells of these traders drop down by 20 to 30 %. It is also a short term impact in future things get normal.

#### **Impact of Demonetization on Service Sector**

Service sector is hit very hard by Demonetization decision in November 2016 worst Slump in nearly three year is noted. The Nikkei India Services Purchasing Managers' Index (PMI), which tracks services sector companies on a monthly basis, stood at 46.7 in November, down from 54.5 in October. The Index slipped into contraction territory for the first time since June 2015 and pointed to the sharpest reduction in output for almost three years. On other hand if we talk about Banking Sector this is the only sector which was benefited by that decision in many aspects, this move will pull a large chunk of first time users to banks, who will have to use the system at least once to exchange their old notes for new ones. According to a study conducted by Moody's, people tend to continue using banking services once they have crossed the 'first-time user' mark. This development will increase bank deposits by 1 to 2 percent compared to what they were before the demonetization scheme.

#### **Conclusion**

So, this highly impact-full step has both sorts of effects (i.e. positive and negative) over the economic as well as social atmosphere of the country. But, as per our impartial evaluation, the conclusion is that, the bad effects would be only short term and the country will regain its growth momentum in one or two years time, depending mainly over the government's

future course of actions. On the other hand, the positive effects will continue to contribute in the improvement of the economy as well as socio-political scenario of the country.

The present study shows the impact of Demonetization on Indian economy's different sectors. GDP of Country slightly decreases as compare with the previous year but we cannot say it will be same in future also. —This intervention is a one-time draining of this current stock of black money but unless the root causes of corruption are removed, corruption will continue. It is sort of like a dialysis, more of a short term cleaning up than a solution of the problem. It needs to be repeated periodically.

#### **Scope for Future Research**

This study was limited only to Indian Economy but there is still scope for future research in the following areas:

1. To measure the impact of Demonetization on individual sector of the Indian Economy.
2. To measure the impact of Demonetization at International level.

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