

# A Study on Impact of Demonetization on Indian Economy

Rakesh Kumar Nirapure\*

Government Girls College, Seoni Malwa (MP)

**Abstract** – Separation from circulation of units of money is demonetization; units of money are refused legal tender status. Demonetization is characterized as a mechanism in which monetary units are not lawfully tendered. The money notes are not known to be true currencies. Demonetization is a government measure under which currency units are no longer valid. Demonetization is a necessary prerequisite for replacing the national currency. In other terms, demonetization is a currency reform in which new currency units substitute the existing currency. That may entail the release of new notes or coins of the same name or different name. The money in India was demonetized three times. The first was demonetized on 12 January 1946 (Saturday), the second was demonetized on 16 January 1978 (Monday) and the third was on 8 November 2016 (Tuesday). The research aims at explaining the importance and explanations for demonetization, the sectoral effect of demonetization. This analysis offers also a summary of the positive and negative influence of demonetization on the Indian economy. This research is comprehensive and has taken all the necessary and applicable data from different papers, journals and websites. Books were also referred as needed for theoretical knowledge on the subject.

**Keywords:** Demonetization, Indian Economy, Impact on Economy

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## INTRODUCTION

Demonetization involves the abolition of the legal tender status to each money denomination. Money units were lost the legal tender rank. Demonetization is an act to strip any currencies of their legal tender rights. Money units are not known to be true currencies. Demonetization is the method of denying a money's unit with its legal status. Demonetization is a requirement for replacing the old currency for new money units ... It may require the inclusion of new notes or coins of the same name or entirely different terms. The money was demonetized in India three times. The former was demonized on 12 January 1946 (Saturday), the latter on 16 January 1978 (Monday), and the former on 8 November 2016 (Tuesday). For the four key factors, the government believes this currency ban is appropriate. Controlling inflation, fighting abuse, removing counterfeit currencies and stopping the cash trade. Developing countries like India must find the answer to develop the nation from such problems. The government had to hold the decision hidden so that tax evaders might not be informed of this cleanup task until the demonetization announcement was released.

## DEMONETIZATION

The government of India has declared the demonetization of Rs. 500 and 1000 high value currency with the goal of infusing black money and

curbing inflation, counterfeiting currency and terrorism financing. This move is seen as the greatest push for cleanliness against the black cash in the history of Indian economy. The effect of this abrupt change, however, contributes to big cash crushes in the economy that influence ordinary citizens and businesses' everyday needs. Different economists, specialists and academics shared opinion on the economic effects of demonetization and projected its effect on the country's Gross Domestic Product (GDP) by 0,5%-3% in the current 2016-17 financial year. In this background, the PHD Research Bureau of the PHD Chamber of Commerce and Industry conducted a survey to determine the fiscal, sector and human effects of demonetization. The key aim of the survey was to understand the input on the economy, industries and citizens and give the government some advice to enforce demonetization effectively.

## REASONS OF DEMONETIZATION:

### Black money:

Demonetisation was the government of India's aggressive and innovative measures to eradicate black money, with a significant effect on the country's underground economy. This change will distinguish pockets and individuals with black wealth. Any firms including real estate dealers,

jewelers, foreign exchange brokers, private lenders usually keep vast sums of uncounted money as currency notes. Such uncounted capital produced the country's parallel economy. Such illegitimate money is explicitly or implicitly accessible on bank accounts.

#### To hit the fake currency rackets:

Demonetisation was useless Bogus Currency Notes. The removal of highest currency bills from the economy will severely affect bogus monetary unions, thus stopping militant fundraising in Jammu and Kashmir, Naxalite struck and North-East countries. The counterfeit money with perfect equipment and the latest currency notes have been left with high protection, rendering counterfeiting difficult. Demonetisation was a strategic assault on the economy's bogus money. Demonetization has turned these bogus currency notes into papers.

#### Online transactions:

The slogan of demonetization was to support the cashless / digital economy. More and more cash-free or cash-free purchases contribute to further income transparency that raises direct tax collections. Alternative means of payment are urgently required with a decline in cash purchases. Mobile payment systems like on-line purchase, apps transfer, mobile wallets e-banking, debit and credit cards, etc. would definitely see significant demand rises.

#### To hit Maoists:

This move rendered capital meaningless with Maoists. As stated, Maoists in Baster in Chhattisgarh hoarded over Rs.7000 cores. Both these currencies are now nothing more than documents.

#### GDP rise:

While diabetes affects sectors such as real estate, housing, and household usage generally, long-term GDP growth benefits are assumed to overshadow the short-term transformation impact. By FY2018-19, we are now headed for 9% GDP development.

### SECTOR-WISE IMPACT OF DEMONETISATION:

#### Real estate and Property:

This industry will be one of the industries most impacted by the ban on documents. Demonetization has ended in the majority of the building firms as a large proportion of their transactions rely not on bank transfer or cheque transactions, but on currency. Like other businesses, marginal builders are negatively affected because the cash components are heavily involved in payment in this field. The most influenced were unorganized workers.

Constructors may experience a cash pinch owing to the sudden decline in revenue to lure customers. Constructors are forced to create attractive deals and other advantages. Demonetisation would directly affect the resale and land market, as cash plays a significant role in these transactions. Much of the declared cash was removed from the economy through Demonetisation.

**Gems & Jeweler:** The major portion of the consumer spending requires cash to purchase jewels, and the effect of Demonetisation is also very heavy in this market. Demonetisation left people with fewer cash accessible to satisfy their day-to-day needs and purchase jewels. Smaller unorganized stores were the most affected, growing demand for jeweler. Some jewelers decided to market gold at an extra premium to use the forbidden notes culminating in a tax attack on such jewelers. Some jewelers have already sent letters. This sector is deeply affected by diabetes because consumers tend to pay in dollars.

#### Banks:

Banks have proven to be the core of this whole demonization campaign and indeed the largest recipients. As for the course of finance, the replacement of old bills with the new one has contributed to a rise in bank liquidity that can be used to lend. Many banks have reduced both deposit and loan rates.

#### Media and Entertainment industry:

Currency ban negatively influenced the television and entertainment sector, as the amount of audiences was limited. The largest part of the decline was seen in the lower middle class. The abrupt demonetization announcement has impacted the film industry. This prevented the production of films. In addition, demonetization is primarily impacting new and small players in the sector.

#### Hospitality and tourism:

The indigenous tourism sector has been badly disrupted because of the demonetization because the bulk of investment is in currency. Many lavish overseas journeys have been funded by black currency. The unorganized industry is most impacted by the incapacity to make payment in cash, and by the downturn in currency, the restaurant company is also confronted with the incapacity to make payments in cash.

#### Luxury items:

The effect of demonetization on this business is going to be dramatic. Most citizens lavish their mysterious wealth on leisure. Following the ban on

the notice, luxury markets and related firms such as clothes, appliances and luxury vehicles would see a huge reversal.

#### **Automobiles:**

Demonetisation has also impacted the automotive industry the big demand decrease has been observed in two-wheelers compared with four wheelers / luxury cars as consumers tend to pay in cash for a two-wheeler. The used car sector is another sector impacted by demonetization, of which many dealers claim abrupt declines of revenue. Payments are not limited in this industry.

#### **Retail:**

The cash crunch contributes to reduced demand for goods from customers. This eventually allows their market rate to decrease. As cash is the chosen form of payment to acquire everyday items, which in turn add to the volume of cash purchases. The effect on small and unorganized traders of demonetization is greater than that of the organized market.

#### **Agriculture:**

Agriculture is influenced by different factors such as manufacturing, storage, promotion and shipping, such factors are primarily based on cash. In addition, demonetization has damaged supply chains, which have been badly impaired by massive diversion of diversion goods. The demonetization also affected smallholder farmers who market their goods every day to wholesale centers, mandis and customers.

#### **Labor-intensive sectors:**

In order to compensate everyday wage workers massive sums of cash, they face trouble purchasing their regular products. The withdrawal caps impact the weekly payment to contract employees in the coal, garment and leather sectors. In addition, regular needs of factory owners are influenced by the cash withdrawal limits. This has a detrimental influence on recruitment and development in this market. However, until cash flow is natural, the condition would improve.

### **IMPACT OF DEMONETIZATION ON INDIAN ECONOMY**

Demonetization also influenced many aspects of the Indian economy. People's everyday life has shifted a lot because of no trade. Many citizens experience problems because the money supply has abruptly decreased. This move itself decreased the country's GDP and seriously impacted cash-based industries such as MSMEs and even stock market falls. The following is the big effect of demonetization on separate fields:

#### **Effect on GDP:**

The rapid decrease in the volume of income and the corresponding rise in bank deposits influenced the short-term demand for spending. This, along with the negative effect on the immovable and informal industries, will limit GDP growth.

#### **Effect on Bank:**

The 500 and 1000-Rupee bills, which at the same time ceased to be legal offers, had to be deposited or traded in banks, as ordered by the government (subject to certain limits). This will potentially contribute to further investments in commercial banks' savings and current accounts. In exchange, this will boost the banks' liquidity status and then be used for lending purposes.

#### **Effect on Parallel Economy:**

The money of the above denominations comprises around 86 percent of the money in circulation's overall worth. It was anticipated that black money would be cut out, since the holders would not be able to deposit it into accounts, briefly stop the influx of vast amounts of counterfeit currencies and curtail the financing of anti-social activities such as piracy, insurgency, spying, etc.

#### **Effect on ATM Withdrawals:**

In the first few days, ATMs not recalibrated had a withdrawal limit up to Rs 2000/- per day while those recalibrated had a withdrawal limit of Rs 2500/- per day.

#### **Effect on gross domestic product:**

GDP development was mainly influenced by the liquidity shock, i.e. restricted access to the currency as a means of trade for the economic activity. The adverse impact on GDP growth was pushed down by a decrease in demand due to a lack of cash to pay and interrupt the development activities due to the man-hour losses incurred by some employees, especially those who earn pay in cash in the unorganized sector. India is historically an economy dominated by currency. It is projected that about 78% of all customer purchases are made in cash in India. Consequently, it was clear that during the demonetization era the currency deficit had a negative effect on economic activity and development. GDP development projections of several pre- and post-demonetization organizations in 2016-17 and 2017-18 GDP growth.

#### **Impact on financial sector:**

Demonetization impacts the banking market. It appeared to be a positive thing for banks. The deposit of the bank note has risen to absorb Rs. 500 and Rs. 1000 and anyone with no bank

account must open their account. According to India Today's article, this was a gift for a sector with Rs. 8 lakhs of crore of bad loans. Because of demonetization competition in the financial sector, internet prices have increased and decreased. Such a rise in liquidity in the bank was, however, an unwanted and temporary outcome of demonetization. Demonetization impacts the Pradhan Mantri Jan Dhan Account greatly. 23.3 million new accounts opened under Pradhan Mantri Jan Dhan Yojana (PMJDY), of which the bulk was public (80 percent). 53.6 percent of the latest Jan Dhan accounts opened in urban and 46.4 percent in rural regions.

PMJDY deposit shows that the number of deposits and deposit volume will increase shortly after demonetization. It is impossible to believe that such savings would last long. These changes are mostly allowed to transform old notes into fresh notes. When completely new currency stocks emerge, they are turned into productive reserves by the savers. This indicates that the bank's fresh savings represented in PMJDY are a short-term deposit.

#### **Tax Compliance:**

Demonetization contributed to higher enforcement with taxation. Income Tax returns rose, according to India Today, from 6.7 million in 2015-16 to 8.4 million in 2016-17, a rise of 27 percent. Central government tax collection grew 18% to Rs 17,1 lakh crore, which ended 31 March 2017. Excise duty collection increased by 33.9%, and sales tax collection increased by 20.2%. This increase occurred despite slowing GDP rise, which is a positive outcome.

#### **Impact on Real Sector:**

According to some experts the real estate market was under strain and its issue has been exacerbated by demonetization. The commercial business is a company that utilizes black capital the most. Some figures indicated that up to 30% of all Rs. 6.5 crore transactions (2014 estimate) were made with non-recounting currency. Demonetization shifts into the real sector the flow of black money. The effect is a sudden fall in the price of land and buildings. What is worrying is that the price of property falls, but the demand has not increased correspondingly.

#### **Effect on Terror Funding:**

Terrorism is induced by falsified currencies and hawala transfers. Going ahead with demonetization has affected fear by impacting counterfeit currency and hawala. The instability in Kashmir Valley lasting four months is on a back burner owing to demonetization. After the declaration of demonetization, no stone pelting on the security forces has been recorded in Kashmir. According to approximate information, Pakistan sends Rs. 1000

crore to the separatists each year for disruption in Kashmir. The money is transferred through hawala. The separatists are now confused as hawala transfers are absolutely shocked up. It won't be unfair to inform Modi that his stone called demonetization absolutely killed the Kashmir turmoil.

#### **Impact of demonetization on Digital Transaction:**

A significant goal of demonetization was to transform the Indian economy into a cashless economy where only digital transaction is possible. The digital activity has risen since demonetization. According to RBI numbers, after demonetization from wallets to cards and Internet transactions the digital transaction increased in amount and value from a year earlier. Point of Sale (PS) payment purchases at retail terminals have risen, opposing a favorable effect on the economy as more consumers start using their debit cards rather than cash withdrawals at ATM.

#### **IMPACT OF DEMONETIZATION ON COMMON PEOPLE**

Demonetization is one of today's most important economic cases. Every Indian citizen feels its effect. The demonetization of Rs. 500 and Rs. 1000 notes had a significant effect on the average citizens.

There was a major shout for demonization, as people were standing in the bank in long lines to swap their old currencies or deposit old currency bills in the banking. Again, there were long lines before ATM to only withdraw the money the citizens wanted. The per capita withdrawal was reduced and this was a huge concern for many citizens, because of their personal issues, including marriage, health, land, etc. Some would had trouble preparing for wedding and other special events and even some marriages were delayed because there was a shortage of funds.

Some citizens including regular wage earners in rural areas and some farmers could not reach banks or post offices appeared desperate to swap old notes. It was noticed that some people, particularly women, stockpile money at home in rural areas to save, but they either deposited their money on the bank or established an account to deposit money after demonetization. Many everyday wage employees are not willing to function because of the employers' shortage of funds. Street traders and small companies are cash focused. They market cash goods and purchase cash items. People would slash spending because banks restrict dollars, which hurts the shopkeepers and suppliers' companies.

Since the Indian economic structure operates mostly in currency, less currency implies economic

activity disturbance. Consequently, government policy to counter fake money and falsified currency has struck the average citizens hard. Yet life slowed down a little as time passed. The banks' queues were reduced, ATMs were carried with liquidity, new currency circulated and the whole thing was stabilized.

The research thus examined the immediate effect of demonetization on average people —

1. Because of currency shortage, people 's appetite decreased.
2. People were presented with issues with cash collected / deposited from the bank / ATM.
3. Another significant issue confronted by citizens was the shortage of cash on banks and ATMs, accompanied by closed ATMs.
4. Long waits and hours of sitting before banks and ATMs.
5. Bank maladministration and business workers lack of cooperation.

## **IMPACT OF DEMONETIZATION ON INDIAN ECONOMY: ADVANTAGES AND DISADVANTAGES**

### **ADVANTAGES:**

#### **Black money:**

Prime Minister Narendra Modi has squeezed black money on a single line. Rs 3 lakh crore is measured as black cash out of the overall money, which is Rs 17 lakh crore. Black money traders operate a counter economy that weakens the country's currency. Modi's decision to demonize the bank contributed to the accumulation of massive deposits, all unexplained capital was either put in banks with a strong penalty or only lost.

#### **Economy:**

This demonetization proved to be a turning-point for the economy by cleaning up black currency, which in turn contributed to enhanced treasury funding, higher growth and a rise in Indian GDP. Investment prospects have also been resurrected and the transport and development markets have been improved. A large volume of capital invested in banks contributed to decrease interest rates and lower income tax rates.

#### **Real estate:**

It is claimed that real estate is a black money business. The sum of illicit money involved in this business is immense. An estimation reveals that at least 40 percent of real estate transactions in Delhi-

NCR are colored. Modi's demonetization change limited the funds influx into the real estate market. This will continue to reduce the usage of black capital in immovables, contributing to a decline in land and property values.

#### **Hawala transactions:**

Demonetisation was a massive hawala thrash. Without its real movement, money is exchanged in Hawala. Hawala has been a means of promoting money smuggling and terror finance. Rackets from Hawala operated on black currency. The rapid removal of black money from the economy was an activity for hawala operations. Destruction by hawala operators of currency bills has also been recorded.

#### **Counterfeit currency:**

Demonetisation was a devastating blow to the falsified Indian currency. Currency was lost with a labor union leader in and outside the region. Fake currency is one of the key factors behind the devaluation of Indian currency's real value. In the Indian Statistical Institute, fake currency notes of R 400 crore is published at any time in the economy, and around Rs 70 crore fake currency notes are published annually in the world. Although the exact amount may be even higher. With the move of Prime Minister Modi to suspend the old Rs 500 and Rs 1,000 currency notes and substitute them with a new one, the supply of the bogus money has been completely swept away. As new currency bills come with sophisticated security features that are hardly replicable.

#### **Terror financing:**

The primary source of terrorist funding is falsified currency and hawala. It functions like that. Fake currency is sold through the hawala network. This hawala operators have a link to players and weapons and drug traffickers. They all wind up funding extremism indirectly. Moreover, terrorists get big funds through contributions through hawala transfers. All militant funding outlets are also restricted to the influence of counterfeit money and hawala operators.

#### **Maoism:**

Modi's demonetization campaign was described by Maoist backers as a "undeclared financial emergency." There are explanations. There are factors. The currency ban was a severe assault on the Maoist movement. Black money is Maoist 's primary stream of funds. Maoists used to collect rupee crores by ransom last year. This uncounted money is used to buy arms and explosives. All black monies are reduced to scraps of paper with Modi's demonetization drive. No big incident of violence has occurred in countries such as Andhra

Pradesh Odisha, Telangana, after the ban on notes Chhattisgarh.

#### **Kashmir violence:**

Stone pelting has plummeted in Cashmere owing to the prohibition of notice. After highest currency bills were removed from the economy, no stone pelting was registered in Kashmir. According to news. Intelligence services give 1,000 crores annually to the separatists in Kashmir to build confusion. The money is transferred to the separatists through hawala. With hawala transactions leaving separatists absolutely curtailed. Modi disrupted Kashmir's agitation through his operational action name demonetization

#### **DISADVANTAGES:**

##### **Liquidity crisis:**

Demonetisation created a money crisis because it was impossible for citizens to get enough cash to satisfy their daily needs. The marginal division of the business relies primarily on cash for its everyday purchases. Of the overall circulating money, 500-rupee notes accounted for close to 49 percent in volume. The longer it takes to resupply Rs 500 billion, the more the money problem continues.

##### **Loss of well-being:**

The majority of citizens in the lower middle and lower class use their currency to perform their everyday expenses. Cash is often utilized by the tier of society, such as everyday wage-earners, small traders and other poor segments of society. Both divisions of the business also reduced their sales through cash shortages. Cash shortage forced businesses to slash labor expenses and thus reduce the wages of the lower middle class.

##### **Consumption:**

Cash shortages have negatively impacted Indian people's buying conduct. Market long-term sales are likely to be disrupted in the short term, particularly unorganized transactions by cash purchases. Most retailers' sales are by currency, which decreases their amount of trade.

##### **Decrease in GDP:**

Withdrawal of the largest currency bills lowers the economic development rate. Dismantling decreases habits of usage, wages, savings, etc. This could delay India's growth pace, provided that the liquidity crisis itself could last 3-4 months.

#### **Interest rate and Bank deposits:**

The bank's deposit will increase in the short term due to demonetization, but decrease in the long term. Any liquid cash invested in the bank by individuals cannot be believed to be saving for the long run in that volume of money until held in the banks. These capitals can only be deposited in savings to turn old notes into new ones. This are not cooperative investments targeted at raising investment, but rather at demonetization. It would be removed by the savers until the new currency is supplied. This means the current investments are for the short term only, and could be encased in the future at the right moment. It cannot be assumed that demonetization would produce significant savings in the financial sector over the long term and can, in the short but not long term, lower interest rates.

#### **Black money:**

One of the key factors behind demonetization was to curb black currency, however just a limited volume of black currency is currently deposited in notes. Much black cash is held as property, gold and buildings etc. The sum of unrecounted currency deposited with the banks thus corresponds to just the amount of cash deposited. Countrywide recognition among citizens is generated to combat black money.

#### **CONCLUSION**

The government's decision to demonetize the old currency and substitute it with the new one stunned the world. That was an attempt to cope with the problem of counterfeit funds, coercion, terrorism finance and falsified data. The decision to demonetize the old currency was called an operational attack towards the undeclared money in Indian Economy past, but this may also be a step into the cashless economy. Demonetization follows a currency crisis throughout the world, with banks and ATMs suffering extreme cash shortages with adverse consequences on many small businesses, agriculture and transport. The currency ban from the Indian government triggered confusion in the short term, with the majority of citizens with old currency bills experiencing trouble exchanging them for long queues outside the Indian banks and ATMs. The gross circulated value of old currency notes was Rs 14.2 trillion, reflecting about 86 per cent of the overall circulation volume. Black currency has been paid for either by high taxation and fines or through overt or indirect routes to the bank accounts. Demonetization will allow a significant effect on the Indian economy because it supports statistical payment systems such as e-wallets and applications, online e-banking transfers, the use of plastic money etc. Demonetization helps the medium to long-term economy.

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### Corresponding Author

**Rakesh Kumar Nirapure\***

Government Girls College, Seoni Malwa (MP)