

# Impact of Demonetization on Rural Economy of Madhya Pradesh

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**Executive Summary** – The average citizen expected that the businesses, which largely thrived on black money such as luxury goods, real estate and jewellery, will be hit by the demonetization move. But what is less understood is the impact of this move on the rural economy. Most, if not all, of the rural economy runs on cash and with wages hitting the Rs. 300-400 mark in many rural areas, Rs. 500 and Rs. 1,000 notes were an integral part of the rural economy. If it was just a matter of exchanging old notes for new notes, there would not have been so much inconvenience and the economy would not have been affected. But the culprit in the demonetization exercise has been its timing i.e. just after the harvesting season and also the limit on the amount that citizens could withdraw for the few weeks after the announcement. It has seen a lot of flip-flops since the announcement, but the end result of the move has been a sudden withdrawal of liquidity from the system. This descriptive study brings out the short term and long term as well as the severe and small impact on the rural poor of Madhya Pradesh who were the major victim of the cash crunch.

**Keywords:** Demonetization, Rural Economy, Liquidity, cash crunch

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## INTRODUCTION

Among the urban, Anglophone and electronically connected, many tears are being shed for those who share none of the attributes of the rural people. People who are not “financially included” and live in far-flung areas with inadequate banking outreach are said to be at a serious disadvantage due to demonetization. The established nexus of caste-class and power would ensure that the better off among these people would manage as well as our ilk do. While there is much talk about the GDP impact of this decision, a unique feature of this episode is that there may considerable other costs that fall disproportionately upon the poor. The rich have access to electronic payments, employees who will stand in queues to obtain cash, and savings that are used to cope with a decline in income. The poor lack all these. If a poor person suffers an income shock, or is not able to get medical treatment, the consequences are enormous for the individual, but the GDP impact may be negligible. In terms of welfare implications, these costs matter a lot more than the impact on GDP. The junking of high value currency notes has led to an unparalleled situation where the poor are more at risk from exploitation by the corrupt than from any crippling financial loss in the short or medium terms, barring exceptions. Research on the financial lives of the poor was presented in a landmark book, Portfolios of the Poor: How the World's Poor Live on 2 dollars a day, by Collins et. al. in 2009. It found that the ratio of total

transaction value to asset value for poor households is quite large. For the median rural poor household in India, financial turnover was about 33 times the year-end asset value. This shows that even though, at a given time, a poor household has only a small asset base and small savings, they are intensively transacting. They are using a range of informal (e.g. loan to or from friends) and formal instruments (e.g. microfinance loans) – to frequently put in and take out money. The financial lives of poor households are very different from those of the middle class and the rich in one crucial aspect – the intensity and frequency of financial transactions involving cash. The ratio of financial turnover to assets held, during a given period, is much higher for poor households. Financial turnover is the total value of all financial transactions, i.e. putting money in or pulling money out from any informal or formal financial instrument.

Hence, it would be a good exercise to think of the impact of demonetization for the rural poor. The total impact of demonetization on the rural poor has been seen from different aspects in this paper

## Justification of the study

The rural economy, which was the driver of the consumption boom during 2007-12, has been suffering from distress because of various reasons. This got accentuated during the last two years due to falling commodity prices and the back-to-back

droughts. This year witnessed a normal monsoon, and for the first time after three years, farmers had money in their hands. But this will not be the case even this year with the money locked up in bank accounts rather than being available for consumption. Those not fortunate to have sold their harvest are struggling to sell their produce. While it may not impact those who are engaged in farming of field crops and can hold on to their harvests till liquidity eases, it will affect those growing horticultural crops, particularly perishable fruits and vegetables. There are already stories of distress sales from many states.

## REVIEW OF LITERATURE

- Lokendra Singh Chouhan in his article named *"Critically analyse likely impact of demonetisation on parallel and main economy"* has summarized the impact of demonetization for short and long term on parallel and main economy. He described that finance of terror and other unsocial organization have destroyed overnight because of sudden invalidation of cash and it will be hard time further for parallel economy to sustain with limited cash availability. Demonetization is beneficial step for main economy and will be helpful to curb the corruption and black money also money coming from informal economy to formal economy will increase liquidity for banks which further decrease interest rate and help for banks to handle their NPA.

Insights, in the article titled *"The Big Picture- Impact of Demonetization"*, November 16, 2016, said that this is a historical step and should be supported by all. One should look at the bigger picture which will definitely fetch results in the long term. This is what the people have been asking for a long time which has finally happened.

- Dipankar Dasgupta, in his research work named *"Theoretical Analysis of Demonetization"* explained that as Robert Lucas has predicted long back, demonetization policy has an adverse impact on the income/employment creation and therefore may shrink economic activity in the short and medium term. He said that this possibility was well predicted by our former PM Prof Manmohan Singh in his Rajya sabha lecture. The article also explains very well the conceptual frame work of analyzing such a possibility.
- Rao, C. H. Hanumantha, in his article titled *"Declining Demand for Food grains in Rural India"* highlighted the causes and implications of the declining demand of food grains in India in past few years
- Sagar Satya, in his article *"Death By Demonetisation"*, November 17, 2016 stated

that there is a growing consensus among economists both within and outside the country that demonetisation is a foolish measure and will hurt the Indian economy badly – especially farmers, small businesses, labour and anyone part of the country's informal sector – and operates on a daily basis through cash transaction. The informal sector constitutes over 30 % of the Indian economy in value and 92% in terms of workforce employed.

## RESEARCH METHODOLOGY:

The study is done with special reference to rural poor of Madhya Pradesh. For this purpose an exploratory as well as descriptive method has been adopted as it helps us to investigate any problem with suitable objectives and it is also important for clarification of any concept.

## OBJECTIVE OF THE STUDY:

- To study the impact on the short term future incomes, expenditure, savings and capital asset transactions of the rural poor of Madhya Pradesh, and
- To study long term impact on various economic area of the rural Madhya Pradesh

## Data Collection:

The researcher has collected information from primary source i.e. through the interviews taken from the local residents from different parts of rural Madhya Pradesh including Berasia, Sehore, Ichhawar, Nasrullaganj, Rehti, Gairatganj, Bareilli, Bakhtara, Sultanpur, Obedullahganj, Shivpuri, Panna, Khandwa, Mandla and Umaria to find that rural people are the ones most badly hit by the currency ban decision. Various secondary sources like published reports; newspapers, magazines and websites were also studied to make a framework of the research.

## Limitations:

The current study has been done for preceding two months only which is very short period to judge the impact of such a big decision.

## FINDINGS

Even as hullabaloo was on about the hour's urban people are spending in bank or ATM queues to get some usable money; the demonetization decision of the Modi government has almost crushed the rural economy in Madhya Pradesh. The ground level information gathered, revealed that either the villagers are going totally cashless and thus severely wanting in daily essentials, or they are being fleeced by traders or middlemen in the name of accepting or

exchanging the banned currency notes. It was tried to present the finding in a way that the impact on rural people of Madhya Pradesh could be understood easily. So the impacts are divided in short term and long term which explained in detail as under:

### **Short term Impacts**

#### ► **Impact on Short term income:**

The rural poor and others get their short term incomes from sale of the produce or labour. There are two classes of produce: the once in a season sort of produce like grains, pulses, oilseeds, cotton, etc., and there is a class of produce like milk, eggs, birds, vegetables, etc., which are sold far more frequently. Not more than 10% of the 240 million MT cereals are ready for the market and in any case rural poor produce barely enough to feed their families on their smallholdings. So the impact on them through this route is minor. The impact on their income arising out of transactions in milk, vegetables, etc., was more significant as they were to exchange it for cash in short time cycles. Indeed, the impact was severe on a very small proportion of the rural poor producers who were dependent on their bread for the vegetable such as okra sold on that day.

Apart from the almost total disappearance of cash in hand that has caused near collapse of retail market and pushed the poorest of people to brink of starvation, agricultural activities have taken a major hit in most areas. In some areas, harvesting was still on, but in many monsoon crop was ready to be sold and with Mandis (agriculture produce markets) closed for a week due to cash crunch, no cash in exchanging hand. Farmers readying for Rabi sowing were hit particularly hard as they did not have valid cash to purchase seeds, fertilizer, pesticides or even diesel to run their water pumps. Also they were not able to get electricity connections restored. "Much of the village economy is cash based and naturally every single activity right from purchase of daily edibles to agriculture activities has been affected badly. People in rural areas confirmed that "Villagers have to travel average 20-25 kms in any of these areas to get their old currency deposited or exchanged and spend hours doing it. Many are sleeping on roads in this cold weather because it gets too late to return". Most of the villagers do not have ATMs and any savings they have are held in cash. Small shopkeepers are finding it difficult to keep afloat. Some of them reported that their sales have dipped from Rs 25,000 per day to Rs 5,000 per day.

In Panna, tribal people have little land holding and thousands are dependent on manual labour in stone quarries (Patthar Khadan, Panna). Similar is the case in other cities too with the daily wage labourers

working at construction sites. But either work or payments have stopped as contractors do not have cash to pay. People are literally left without any money and even food in many cases.

The payment cycles for most of the others were a week or longer and apparently they got their payments in new currency notes. Hence, there's overall small impact.

#### ► **Impact on Short term expenditures:**

Aside from the class of landless and migrant wage earners, these impacts were again small because most of the rural consumption occurs in the form of purchases made on credit. And the wages of these very poor categories seldom exceed Rs 500 per day, so if any the impact on them needs to be seen only arising out of the last category where someone is taking them for a ride.

#### ► **Impacts arising out of money stock they have:**

The so-called "piggy bank savings" of the rural folk or more pertinently the savings hidden by rural woman are too small to cross the limit where they would need to worry. Considering that exchange and deposits would be possible virtually without limit for their savings, the impact is restricted only to the extent of loss of their wage earning for the period they spend in queues in front of banks. For them this would be significant, say a day's wage.

As for availability of money hardly about a dozen ATMs are available at the villages. People were waiting for long hours only to find there was no cash in it. They had no money to buy even food for the day. Moreover they didn't even know how to operate their ATM cards.

Some of them travelled as far as 100 km to deposit/exchange cash available at their home. But they were not aware that the day was a bank holiday. They were literally aghast when they came to know as they did not even have enough money to take bus back home.

Rural bank branches do not have enough cash to dispense.

In all probability, this was to be resolved via arbitrage by their moneylender or someone who agreed to stand in a queue on their behalf and a guess is that this would be of the order of half a day's wage or about Rs 100 per affected household. Some 30-40 million households in the rural countryside could

experience a loss of Rs 100 is simply a guess. The impact would be moderate to severe.

#### ► Impacts on incomplete capital asset transactions:

Large parcels of land are being purchased on a huge scale across the country for peri-urban housing, for construction of industrial sheds, for farmhouse or weekend houses and, of course, by the State for public purposes. Barring the last, transactions for most others are occurring between private individuals and the landowners. While it is possible to argue that the rural sellers of the lands would be sufficiently savvy about the risk of hoarding cash, those in the far-flung areas perhaps would be more affected. But on the whole the number of people so affected is likely to run into thousands rather than millions and the moral justification for outrage if they suffer because their stash of cash is difficult to become legitimate fund is limited.

#### ► Impact due to chicanery and cheating by the powerful:

Stories are circulating about how locally powerful men have lent thousands to members of self-help groups free of interest, asking them in return to deposit the sums in their accounts and then repay them months later. There are stories also of unscrupulous miners and industrialists distributing large cash to loyal employees to go deposit in their accounts and return much of it later to the bosses. In Umaria, villagers were getting essentials worth 70-80% of the cost of the money if they paid in the banned currency. Many retail shops in semi-urban areas are remaining closed. In Khalwa of Khandwa, tribal from remote villages coming to the weekly markets are getting totally fleeced. Those wanting to sell their produce in small quantity are getting very poor prices (Rs 900 per quintal of Soybean in place of Rs 1100 or Rs 2500 per quintal of Udad pulse in place of Rs 5000). Since most of them make their purchases after selling their produce, they are forced to bear the loss. Similarly, those carrying the bigger denominations were getting the essential things (tribal purchase their vegetables, grains and any other needed material for entire week from the weekly markets) only if they make purchases close to the round figure (Rs 500 or Rs 1000). Else they are made to go back. Since tempos and private transport vehicles were also demanding change money, many villagers were walking back. There were multiple versions and variants of such ruthless behaviour. This route appears to have the highest potential of negative impact on the rural poor.

#### ► Impact on KCC holders

The latest decision of the Reserve Bank to not allow the local cooperative banks to accept Rs 500/1000 notes has come as an additional blow to the rural economy. This means that farmers holding the Kisan Credit Cards cannot make any transactions at the 38

district cooperatives banks and their 635 agriculture branches, as announced by chief minister Shivraj Singh Chouhan. This would almost completely block their fund requirements for Rabi sowing. There are also these attacks on FCRA (the government's cancellation of several licenses that were given under the Foreign Contribution Regulation Act, 1976 to various non-governmental organizations), which has such a dichotomy.

#### ► Impacts on the informal sector in the short term

The informal sector will be mostly finished. [According to the Economic Survey of 2007-08,] 93 percent of the Indian workforce is in the informal sector. Many of the people who work in this sector live from hand to mouth, and cannot handle a situation where their access to cash is squeezed and cut off. Workers in this sector depend on daily work payments and cash transactions. This will also have a direct detrimental impact on the small and medium-scale industries that support the informal sector. The impact will eventually be felt right down the line acting like a forced recession that will take months to restart. There was not very significant difference between rural informal sector and the urban informal sector. In fact, the distress is probably more acutely felt in an urban space, because in rural areas one can still drag themselves out a little bit more, because there is that little bit of land and social security.

### LONG TERM IMPACTS

#### ► Impact on social security (Banking system v/s Moneylenders)

There was a time when banks used to give preferential interest rates to people who were very poor, and a concerted effort was made to open branches in rural areas. Today, the banks have opened zero-balance accounts under intense pressure, but they have no will to service them. Quite apart from the obvious crisis created in the banking sector by the quantum of Non-Performing Assets (NPAs), banks themselves see little reason for paying attention to the needs of the poor. During demonetization, the poor are unable to get more than Rs 2,500 of their own money [the daily limit on ATM withdrawals] from the bank. In fact, the only place from where the poor can get cash credit today is from moneylenders who have somehow managed to get access to even large sums of money. This phase has made banks the adversaries of the people, especially of the poor.

Today, even if the poor get a loan from a bank, they pay 13 percent interest and those with fluidity [good credit history] pay four percent interest on housing loans. The system is entirely tilted against the poor, so even if they have bank accounts, it is not a solution. Today, there are new kinds of debt bondage. They are bound to the mining company,

the construction company or the brick kiln. The bondage is not so much to the moneylender anymore, and the issue is not the land anymore—it is a range of labour and employment based on natural resources. So, there has been a dramatic shift.

But simply having a bank account does not mean that the person is a part of banking services. Many people have joined the banking system, but they receive very poor-quality services. The dramatic shift happened years ago with the NREGA [National Rural Employment Guarantee Act] because the government insisted on [NREGA workers getting] bank accounts. However, the accounts only received money whenever the people got work, and most often the payments were inordinately late. Similarly, many of the zero-balance Jan Dhan accounts have remained zero balance because the poor continue to be excluded and ignored by the formal banking system. People know that banking facilities and credit services are mainly for the affluent. The fact that only the poor have had to stand in lines to deposit or withdraw cash has cemented that understanding.

#### ► **Impact on the NREGA workers**

People employed under the NREGA are already used to the banking system. In the last two years of the previous government there was already a massive shift. Even Tamil Nadu shifted from weekly payments in cash to using the banks for payment under the previous government. There are tremendous problems because of delayed payments; banks have remitted money into the wrong accounts and so on.

#### ► **Impact on fair price shops**

Another big impact would be on the fair price (public distribution system) shops that work under these cooperative banks and therefore they would not be able to accept Rs 500/1000 notes. The government has made an announcement that PDS (ration shops) will be turned cashless. This goes to show how one arbitrary and disastrous move is being followed by another. As it is, according to our estimation from the data available on the website of the Madhya Pradesh government's food department, the introduction of compulsory Aadhar biometric authentication has resulted in the exclusion of 30 lakh entitled families in M.P.

The grocery shops in the market have also been very severely hit. They had an annual turnover of almost Rs 5 crores from the grocery stores [before demonetization], just by selling groceries. The Mazdoor Kisan Kirana Store it is called, and as far as that is concerned, sales have plummeted. The sales have plummeted to half or maybe even a little less

than that. These are shops that should run even in this situation of a cash crunch.

#### ► **Impact on the work of rural women entrepreneurs**

This is going to impact them severely. Almost all the women who run petty businesses or self-employed women run on the basis of cash. Their customers are too busy working out how to buy food. If you cannot buy food, you are not going to buy handicrafts [sold by the rural women entrepreneurs]. If you are unable to purchase what is necessary, it is impossible to purchase things that are optional. Rural entrepreneurship run by women cannot sustain [their livelihoods because of the impact of this demonetization] which is expected to last for a year.

### **CONCLUSIONS**

It was private spending due to good agricultural fortunes in the years after the financial crisis which sustained rural demand for construction and other non-farm sector goods and services. This not only helped workers take home higher wages but also kept the economy going. The effect of the distress is already visible with rural incomes at an all-time low and rural wages declining in real terms since November 2013. Most farmers had postponed their investment plans waiting for this year's income. Now with their money locked up in bank vaults, it will not only delay their spending plans. The inability to sell their produce may also hurt their incomes. Those who are celebrating a fall in inflation should also remember that while it may help the urban consumers, it hurts the poor farmers if prices of agricultural commodities fall. They are already struggling with low international prices and this will further hit profitability in the farming sector. Demonetization is as good as an undeclared emergency. In the previous emergency, institutions meant for the policing were creating fear. This time the government has instilled fear and insecurity in everyone about cash. Even the most honest citizen is being harassed and told they have no control over their own cash. They had to put it in the bank, and now they can't take it out, even for an emergency. This is even worse than the obvious authoritarian nature of the emergency.

The rural people deemed the introduction of the 2,000-rupee note as "inexplicable," given the government's rhetoric about high-value currency being used to hoard black money. They condemned the government for not taking into account the fact that a significant portion of the Indian population does not have access to the banking system. The distribution of banks in India is highly skewed, with a third of all bank branches being spread out in only 60

tier-1 and tier-2 cities and towns. The statement emphasized that people in rural India, who often suffer from inadequate information, have become the worst victims of demonetization.

To sum up, it does not appear as though the demonetization would have significant negative consequence for the rural poor. The worst damage is likely to be on those who are ill informed and gullible or impressionable and hence, targets for manipulation by the more wily and unscrupulous people around them. It is perhaps incumbent upon all those of us who mean well by the rural poor to warn them of these pitfalls and to caution them against wily schemes of the ruthless.

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