

# Demonetization and its Impact on Indian Economy

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**Abstract –** When a currency note of a particular denomination ceases to be a legal tender, it is termed as 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. Similarly, on 8 November 2016, the Government of India announced the demonetisation of all ₹500 (US\$7.80) and ₹1,000 (US\$16) banknotes of the Mahatma Gandhi Series. The government claimed that the action would curtail the shadow economy and crack down on the use of illicit and counterfeit cash to fund illegal activity and terrorism. On the other hand, Government wanted the less cash economy because cash is the key of corruption and black money. Demonetisation is going to be a landmark in the history of the Indian economy. The long term effects of Demonetisation are yet to be ascertained. It is expected that it can improve the Indian economy in the long run by increasing tax compliance, financial inclusion, consequently improving the state of the economy. It can boost the GDP by increasing the availability of funds for lending and also by reducing transaction costs if the economy moves to digital modes of payments. In the paper, we try to find out the impact of demonetisation on GDP, daily wage workers, on small scale industry, on black money, on inflation, on terror funding, toward digital economy etc.

**Keyword:** Demonetisation, Financial Inclusion, Terrorism, Black Money, Tax Evasion, Digital Economy.

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## INTRODUCTION

Demonetisation of Rs. 1000, 500 currency notes has been done with the following objectives:-

- Disclose Black Money
- Curtail terrorist funding
- Control inflation
- Curb illegal economic activities- smuggling, drug trafficking, human trafficking.

The decision was guided by the objective of reaping of its huge potential medium term benefits in the form of reduced corruption, greater digitisation of economy, better flow of financial savings and greater formalisation of the economy. All of these would lead to higher GDP growth and high tax revenues that could be used by the government for inclusive, faster and stronger economic growth.

## OBJECTIVE OF THE STUDY:-

- To study the impact of demonetisation on Indian economy.

- To analyse the immediate and long term impact of it.
- To find the positive impact of demonetisation on Indian economy.

## RESEARCH METHODOLOGY:-

This paper is based on secondary data. The data has been collected from different newspapers, magazines, reports, and internet.

## IMPACT ON DIFFERENT ASPECTS OF ECONOMY:-

Immediate impact on money supply: - the pulling out of 500 and 1000 currency notes from the circulation reduced the money supply in our economy. Around 86% of currency value was withdrawn. We can easily understand the impact through this equation:-  $MS \downarrow \rightarrow D \downarrow \rightarrow S \downarrow \rightarrow E \downarrow$

MS- Money supply, D- Demand, S- Supply, E- Employment.

We can understand with the help of this equation that the immediate impact of demonetisation was not good on economy because as we can see in

eq. at the end employment was reduced which is not a good sign for any economy.

**IMPACT ON GROWTH:-**

The growth of GVA was impacted chiefly by the shortage of liquidity. Due to shortage of liquidity there is a decrease in demand because people don't have cash to make payments, it leads to discouragement to investors to make investment. Decline in investment as we know badly hamper the growth of an economy. Again we try to understand it with the help of equation- liquidity (cash) ↓→D↓→I↓→ economy slowdown. (I-Investment).

**Sectoral Indicator**

1 Agriculture						
	2016-17					N.A.
a. Foodgrains production	8.1					N.A.
	Apr-Oct	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17
2 Industry						
a. PMI manufacturing (index)	52	54.4	52.3	49.6	50.4	50.7
b. IIP	-0.3	-1.9	5.7	-0.1	2.7	N.A.
i. Mining	-0.2	-0.9	3.7	5.5	5.3	N.A.
Coal	0.7	-1.6	6.4	4.4	4.8	N.A.
Crude oil	-3.3	-3.2	-5.4	-0.8	1.3	N.A.
Natural gas	-4.0	-1.4	-1.7	0.0	11.9	N.A.
ii. Manufacturing	-1.0	-2.4	5.5	-1.7	2.3	N.A.
iii. Electricity	4.5	1.1	8.9	6.3	3.9	N.A.
3 Services						
i. PMI services	52.6	54.5	46.7	46.8	48.7	50.3
ii. Automobile sales	15.0	8.1	-5.5	-18.7	-4.7	0.9
iii. Commercial vehicles sales	6.9	11.9	-11.6	-5.1	-0.7	7.3
iv. Passenger vehicles sales	11.0	4.5	1.8	-1.4	14.4	9.0
v. Three wheelers sales	11.8	4.4	-25.9	-36.2	-28.2	-21.4
vi. Two wheelers sales	16.0	8.7	-5.9	-22.0	-7.4	0
vii. Cargo handled at major ports	6.3	13.2	10.2	12.9	3.6	N.A.
viii. Railway freight traffic	-1.7	-2.6	5.5	-0.1	0.3	N.A.
ix. Tourist arrivals	10.8	10.4	9.2	13.6	16.4	N.A.
x. Cement production	4.8	6.2	0.5	-8.7	-13.3	N.A.
xi. Steel consumption	2.7	0.3	5.0	5.3	3.1	N.A.
xii. Civil aviation: domestic cargo traffic	7.5	10.6	-0.6	7.5	10.1	N.A.
xiii. Civil aviation: international cargo traffic	9.2	15.6	15.4	12.6	16.0	N.A.
xiv. Civil aviation: international passenger traffic	9.1	7.4	7.7	7.7	8.8	N.A.
xv. Civil aviation: domestic passenger traffic	22.5	23.6	22.0	23.9	25.6	N.A.
xvi. Bank deposits growth	6.4#	9.3	15.7	14.9	13.5	12.6*
xvii. Insurance premium*	31.1	22.4	72.1	21.1	32.1	-4.5**
xviii. Merchandise exports	0.2	9.0	2.4	5.5	4.3	N.A.
xix. Merchandise imports	-9.8	8.3	9.4	0.1	10.7	N.A.

# : Relate to Oct. 27, 2017 over Mar. 31, 2017. \*: Data pertain to February 17, 2017.  
 \$: Pertains to total bank credit to commercial sector. @: Data source: Central Accounts Section (CAS), Nagpur.  
 N.A.: Not Available. \*: Pertains to life and non-life insurance premiums.  
 \*\*: Pertains to life insurance premiums alone.  
 Sources: Reserve Bank of India; Ministry of Agriculture, Market Economics, CSO, SIAM, IRDA, CMIE.

**POSITIVE IMPACTS OF DEMONETISATION ON INDIAN ECONOMY:-**

Over Black Money: - it is a parallel economy, which can hit the foundation of any country. We can consider it as a cancer for any economy. It is estimated in India that total money in circulation is 17 lakh crore, out of it 3 lakh crore is in the form of black money .with the help of demonetisation black money either will be destroyed or come to account book.

Over Bank Deposit: - Demonetisation of 500 and 1000 currency notes made people deposit their money into banks. RBI has declared bank had received rs. 5.12 trillion Worth of deposit until 18<sup>th</sup> November. This can boost Indian GDP by 0.5% to 1.5%.

Over Hawala Transactions: - with this single stroke of demonetisation hawala rackets has badly affected.

Hawala refers to that practice in which transfers without any actual movement of money. With black money suddenly being wiped out of the market, hawala operators have come to a grinding halt.

Over real estate cleansing: - the extent of black money circulation in this sector is huge. It is often said that real estate industry is built on black money. As we discussed in our 1<sup>st</sup> point that demonetisation helps in destroying black money which leads the shortage of black money for this sector, hence curb the flow of black money into this sector.

Over financial inclusion: - the demonetisation of higher denominated notes might impel cash deposited in Jan Dhan Accounts. It will make these account holders to be accustomed to banking system. 23.3 million new accounts were opened under the PradhanMantri Jan DhanYojna (PMJDY). Deposits under these accounts increased significantly after demonetisation. On Dec 7, 2016 the total balance in PMJDY was peaked at rs. 746 billion. It is an increase of 63.6% as against of rs. 456 billion as on November 9, 2016. According to reports these accounts were used as to convert black money into white. The government issued a warning against such misuse of these accounts.

**Table: Deposits under PMJDY: Number of Accounts**

(in million) Bank-Group	Ason November 9, 2016			Ason March1, 2017			Variation		
	Rural	Urban	Total	Rural	Urban	Total	( March1, 2017 over November 9, 2016)		
							Rural	Urban	Total
Public Sector Banks	114.3	89.3	203.6	122.1	100.8	222.9	7.8	11.5	19.3
							(6.8)	(12.9)	(9.5)
Regional Rural Banks	37.1	6.0	43.1	40.0	6.4	46.4	2.9	0.4	3.3
							(7.8)	(6.8)	(7.7)
Private Sector Banks	5.3	3.1	8.4	5.4	3.6	9.0	0.1	0.5	0.6
							(1.3)	(16.8)	(7.0)
Scheduled Commercial Banks	156.7	98.4	255.1	167.5	110.9	278.4	10.8	12.5	23.3
							(6.9)	(12.7)	(9.1)

Source: -PradhanMantri Jan DhanYojna website.

Over government finances: - the unaccounted money will make way into the formal channel. This will make the income tax collections.

\* This raised fund can help the government to reduce its fiscal deficit.

\* This move allows the economy to shift from unorganised sector to organised sector.

\* It can also facilitate the implementation of GST scheme.

\* Government can use this fund for the welfare of public.

Over digital modes of payment: - Demonetisation encouraged the different modes of digital payment. Digital activities were low in the starting weeks of the demonetisation because people were busy in exchanging SBNs. But in Dec 2016, digital payment actively increased. Government also ensured that transfer charges related to these modes shall not be passed on consumers, this step helped people to move from cash to digital.

**Growth in Select Electronic Modes of Payments**

Category		(y-o-y growth in per cent)				
		Oct-2016	Nov-2016	Dec-2016	Jan-2017	Feb-2017
NEFT	Volume	16.2	23.3	39.0	38.0	34.5
	Value	37.6	38.3	40.8	60.2	49.5
CTS	Volume	-1.1	23.0	58.4	52.7	20.2
	Value	2.9	8.6	13.0	19.3	0.8
IMPS	Volume	116.7	89.6	157.2	177.7	150.4
	Value	150.7	135.9	186.6	196.7	184.2
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

**CONCLUSION:-**

After analysing we can say that demonetisation impacted various sectors of our economy; however the unfavourable impact was short lived as it was felt mainly in Nov and Dec 2016, just after demonetisation.

According to the report of CSO (Central Statistical Organisation) the overall impact on GVA growth was modest because of stronger growth in agriculture, manufacturing, electricity and mining. With remonetisation, the unpleasant impact is expected to have reversed. Growth of GVA is expected to recover appreciably in 2017-18 and so on.

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