

# Impact of Demonetisation in India

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**Abstract**— This paper has posited an endeavor to assess how the tool of Demonetization can be used to exterminate economical imbalances. Demonetization is one of the big steps initiated by Government of India in addressing the various issues like black money, counterfeit currency, corruption, terrorism etc. Lesson from historically demonetization guides us how to restructure the economical system of country by overcoming the earlier causes for failure. Demonetization brings various inconveniences to common people, it is imperative to evaluate the short run and medium term impacts on the economy. This paper elucidates the impact of such a move on the availability of credit, spending and lots of activity relating to the government finance system.

**Keywords**- Demonetization, Indian economy, Black money, Parallel economy, Cashless transactions, Counterfeit currency, Corruption

## I INTRODUCTION

### What is demonetization?

Demonetization is the act of taking back of a currency unit of its status as legal tender. Demonetization becomes indispensable whenever there is a permutation of national currency. The old unit of currency is retired and replaced with new ones. This decision determines the great impacts all over the citizens of the country because overnight all the money you have become of no use until and unless you change it with new currency units or deposit it in the banks. In order to comprehend demonetization better let's look at merits and demerits of demonetization –

#### Advantages of Demonetization-

1. The main advantage of demonetization is to find out or track those people who have unaccounted cash or cash on which no income tax has been paid.
2. People disclosing their income by depositing money in their bank accounts the government collects a huge amount of money as a tax revenue, which further are used by the government for building the nation, social economic condition and strengthen the education, medical and transportation system.

#### Disadvantages of Demonetization-

1. Initially it sometimes may create law and order problem and disorganized situation at banks and ATMs which are the only medium to change the old currency units to new currency units.

2. Destruction of old currency units and printing of new legal tender fresh units engross overheads which has to be borne by the government and if the costs are higher than benefits then there is no use of demonetization.

## II DEMONATIZATION HAPPENS IN THE WORLD-

In 2015, the Zimbabwean government demonetized the Zimbabwean dollar as a way to combat the country's hyperinflation that was recorded at 231,000,000%. The 3-month progression occupied expunging the Zimbabwean dollar from the country's financial system and solidifying the US dollar, Botswana pula, and South African rand as the country's legal tender in a bid to stabilize the economy.

One more case of demonetization occurred when the nations of the European Monetary Union adopted the euro in 2002. In order to switch to the euro, authorities first set exchange tariff for the different nationwide currencies into euros. When the euro was introduced, the old national currencies were demonetized. However, the old currencies remained convertible into euros for a while so that an even conversion through demonetization would be assured.

The Coinage Act of 1873 demonetized silver in support of adopting the gold standard as the legal tender of the United States. The pulling out of silver from the financial system resulted in slimming down of the money supply, which subsequently led to a 5-year economic depression in the country. In response to the terrible state of affairs and demands from silver miners and farmers, the Bland-Allison Act remonetized silver as legal tender in 1878.

## III OBJECTIVE

1. To get idea about demonetization and its impact on the Indian market.
2. To know the quantum of currency circulation.
3. To analyze the impact of black money
4. To understand its positive and negative effect on economic growth of the nation.

## IV LITERATURE REVIEWS

Anil I Ramdurg and Dr. Basavaraj CS ( 2016) conducted a study on Demonetization: Redefining Indian economy. This article has made an attempt to assess how the tool of Demonetization can be used to eradicate parallel economy. They also studied that Demonetization is a general measure to mitigate the problems of black money and counterfeit notes, though there are specific measures to tackle the same menace. Demonetization is, usually, immediately or



simultaneously followed by remonetisation, as there is no other way.

Dr. Harvinder Singh Bhalla, Ms. Harpreet Kaur And Mr. CP Meena (January 2017) Researched on Impact of Demonetization & Implications in which they focused on the Demonetization is an established practice in monetary policy to tackle black money. It was meant to be suddenly implemented. In the past, demonetization has taken place twice but it fails because the idea is to tackle the black money existing in circulation. So they concluded that In order to control the black money, it is necessary for the country to take methodology through which this can be controlled by swapping as well as by changing the denomination. Demonetization put a great impact on the economy growth rate.

Sukanta Sarkar (2010) conducted a study on the parallel economy in India: Causes, impacts & government initiatives in which he focused on the existence of causes and impacts of black money in India. According to him, the main reason behind the generation of black money is the Indian Political System i.e. Indian govt. just focused on making committees rather than to implement it. So, he concluded that laws should be implemented properly to control black money in our economy.

CA Lalit Mohan Aggarwal (2012) edited the White Paper on Black Money studied that violation of laws by central and state government leads to criminal activities which in turn leads to generation of black money in Indian economy.

#### **V HISTORY OF DEMONETISATION IN INDIA-**

This is not the first time that the government has taken this step to demonetize the currency of India. Historically, previous Indian governments had demonetized bank notes. In January 1954, banknotes of 100 and 1,000 rupees were withdrawn and new notes of 100, 500 and 1000 rupees were introduced in 1954. The Janata Party coalition government demonetized banknotes of 1000, 5000 and 10,000 rupees on 16 January 1978 as a means of limitation forged money and black money. In 2012, the Central Board of Direct Taxes had recommended against demonetization, saying in a report that "demonetization may not be a solution for tackling black money or economy, which is largely held in the form of "benami" properties, bullion and jewellery". In terms of value, the annual report of Reserve Bank of India (RBI) of 31 March 2016 stated that total bank notes in circulation valued to 16.42 trillion (US\$240 billion) of which nearly 86% (around 14.18 trillion (US\$210 billion)) were 500 and 1,000 banknotes. In terms of volume, the report stated that 24% (around 22.03 billion) of the total 90266 million banknotes were in circulation. The Government of India demonetized Rs 1,000, Rs 5,000 and Rs 10,000 notes back in 1978 too.

#### **Demonetization in India by PM Narendra Modi-**

On November 8 evening, Prime Minister Modi, in his televised address to the nation, made Rs 500 and Rs 1000 notes invalid, saying that it was aimed at curbing the "disease" of corruption and black money which have taken deep root. People holding notes of Rs 500 and Rs 1,000 can deposit the equal in their bank and post office accounts from November 10 till December 30. All notes in lower denomination of Rs 100, Rs 50, Rs 20, Rs 10, Rs 5, Rs 2 and Re 1 and all coins continued to be valid, and new notes of Rs 2,000 and Rs 500 were introduced. There was no change in any other form of currency exchange be it cheque, DD, payment via credit or debit cards etc.

#### **Indian Scenario and Impacts of demonetization**

Today, more than 75% of all transactions in India are conducted in cash. India is the leading ready money concentrated economies of the world with Cash to GDP ratio of 12%. i.e. the value of notes and coins in circulation as a percentage of GDP. Whereas for example Cash to GDP ratio is just 3.93% in Brazil, 3.73% in South Africa, and 5.3% Mexico. It will gear up and accelerate the demand for gold as safe store of wealth. This would result in gold imports and it will impact balance of payments. It will be a big boost for e-wallets. E-wallet is an online prepaid account where one can stock money, to be used when required. You can go by on the reimbursement of your e-wallet to your friends and family as well. It will be a big boost for credit cards. India is still a hugely un-banked nation. Countless among the underprivileged do not have bank accounts. To imagine them to use plastic legal tender is impractical. In hinterlands of India modern banking system is rudimentary so it will be a tough situation for small traders.

#### **Impact on black money**

- 1) Demonetization of Rs 500 and Rs 1,000 currency notes will address issues like black money and corruption and also help the economy become more digital.
- 2) It has great impact on eradicating the corruption that is prevailing in India and also on financing of terror activities in India.

#### **Impact on inflation**

- 1) Rise and fall in prices are closely linked to the money supply in the market. If the supply of currency increases, its worth decreases and outcome into price rises. The reverse case is deflation, if money supply goes down, the value of money increases results into deflation.
- 2) The headline Consumer Price Index hit a two year low of 3.63% for November 2016, it was 5.41% in November 2015. The major contributor to the decelerate in worth gains was the food and beverages group, where price rises eased to 2.56% largely on the back of a slump in the prices of vegetables, a highly perishable commodity.
- 3) In the backdrop of demonetization, due to restricted access to cash, the discretionary spending on goods and services in the CPI excluding food and fuel have been affected.



**Positive scenario-  
Radical groups-**

The Demonetization has badly punch Maoist and Naxalites as well. The give up rate has reached its uppermost since the demonetization is announced. It is said that the money these organizations have collected over the years have left with no value and it has caused them to reach to this conclusion. The shift also reportedly crippled Communist guerrilla groups (Naxalites) financing through money laundering.

**Real estate cleansing-**

It is believed that real estate is a business built on black funds. The extent of black money floating around in the sector is huge. According to an estimate at least 40 per cent of real estate transactions are in black. Demonetization move will curtail the flow of black money into the real estate sector. This will help in making the much needed correction in the sector. The impact: An unexpected dip in land and property prices.

**Black money-**

Of the Rs 17 lakh crore of total currency in circulation in the country, black money is estimated at mind-boggling Rs 3 lakh crore. Black money is nothing but a plunder of the country. Black money operators run a parallel economy which shakes the very institution of the Indian economy. With demonetization move, all domestic black money will either be deposited into the banks with heavy penalty or be simply destroyed.

**After effects of demonetization-**

**Cash shortage-**

The scarcity of cash due to demonetization led to chaos, and most people holding old banknotes faced difficulties exchanging them due to continual lines outside banks and ATMs across India, which became a daily practice for millions of citizens waiting to deposit or exchange the 500 and 1000 banknotes since 9 November.

**Deaths-**

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.

**Stock market crash-**

As a combined effect of demonetization 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 demonetization 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 halts-**

After the demonetization 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.

**Agriculture-**

Transactions in the Indian agriculture sector are heavily dependent on cash and were adversely affected by the demonetization of 500 and 1,000 banknotes. Due to scarcity of the new banknotes, many farmers have insufficient cash to purchase seeds, fertilizers and pesticides needed for the plantation of Rabi crops usually sown around mid November.

**Banking-**

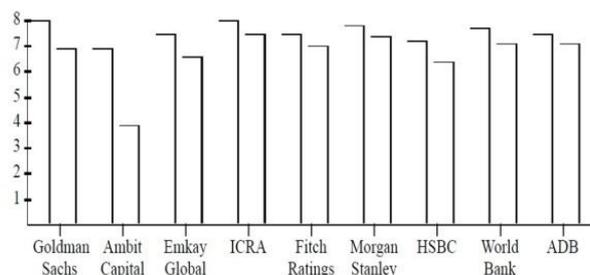
In the first four days after the announcement of the step, about 3 trillion (US\$45 billion) in the form of old 500 and 1,000 banknotes had been deposited in the banking system and about 500 billion (US\$7.4 billion) had been dispensed via withdrawals from bank accounts, ATMs as well as exchanges over the bank counters. Within these four days, the banking system has handled about 180 million transactions.

**Business-**

By the second week after demonetization, cigarette sales across India witnessed a fall of 30–40%, while Ecommerce companies saw up to a 30% decline in cash on delivery (COD) orders. Several ecommerce companies hailed the demonetization decision as an impetus to an increase in digital payments. The demand for point of sales (POS) or card swipe machines has increased. Epayment options like PayTM and PayUMoney has also seen a rise. According to data of Pine Labs, the demand for its POS machines doubled after the decision. Further it states that the debit card transactions rose by 108% and credit card transactions by 60% on 9 November 2016.

**Reduction in GDP growth**

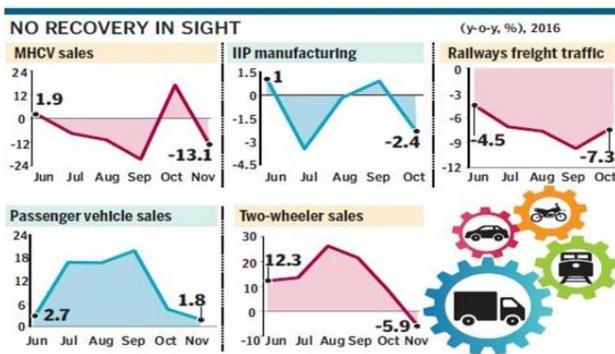
Global analysts cut their forecasts of India's GDP growth rate due to demonetization. India's GDP in 2016 is estimated to be US\$2.25 trillion, hence, each 1 per cent reduction in growth rate represents a shortfall of US\$22.5 billion (Rs. 1.54 lakh crores) for the Indian economy.



□ Before demonetisation | ■ After demonetisation

### Drop in industrial output-

There was a decline in trade and manufacturing output as industries were knocking by the hard cash crisis. The Purchasing Managers' Index (PMI) fell to 46.7 in November from 54.5 in October, recording its sharpest reduction in three years. A reading above 50 indicates growth and a reading below shows contraction. This indicates a slowdown in both, manufacturing and services industries. The PMI report showed also showed that the reduction in inflation in November was due to shortage in money supply. The growth in eight core sectors such as cement, steel and refinery products, which constitute 38% of the Index of Industrial Production (IIP), was only to 4.9 percent in November as compared with 6.6 percent in October.



Source: [financialexpress.com](http://financialexpress.com)

### Evasion attempts

#### Gold purchases

In Gujarat, Delhi and many other major cities, sales of gold increased on 9 November, with an increased 20 to 30% premium surging the price as much as 45,000 (US\$670) from the ruling price of 31,900 (US\$470) per 10 grams (0.35 oz). Income Tax officials raided multiple branches of Axis Bank and found bank officials involved in money laundering acts, exchanging old notes for gold.

#### Donations

Authorities of Sri Jalakanteswarar temple at Vellore discovered cash worth 4.4 million (US\$65,000) from the temple hundi, or cash collection box.

#### Municipal and local tax payments

As the use of the demonetized notes had been allowed by the government for the payment of municipal and local body taxes, it led to people using the demonetized 500 and 1,000 notes to pay huge amounts of excellent and advance taxes. As a result, revenue collections of the local civic bodies jumped. The Greater Hyderabad Municipal Corporation reported collecting about 1.6 billion (US\$24 million) in hard cash expenditure of outstanding and advance taxes, within 4 days. The tax collection by local bodies have surged over 260% and more than 15000 crore more after 14 days of demonetization. The total indirect tax

collection rose to 14.2% only in the month of December according to Finance Minister Arun Jaitley.

### VI CONCLUSION

As one can assume from the above article that the demonetization has both pros and cons it can be also said that this is the historical step taken by the government of India, and should be supported by the habitants of the nation. It will draws the positive result in future form the equity market perspectives, this move may bring some fall in the sectors like jewellery, consumer durables, currency items and real estate it may be a milestone to improve the tax policy system, the complete eradication of fake currency and sustained economical growth is an integral part of it.

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