



## **AN EMPERICAL STUDY ON DEMONETIZATION AND ITS IMPACT ON INDIAN ECONOMY**

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### **ABSTRACT**

*India is world's 3<sup>rd</sup> biggest economy and Asia's second biggest, in purchasing power I the year 2015 at \$7.98 trillion; whereas in nominal GDP, it is the 7<sup>th</sup> largest, at \$2.07 trillion. Demonetization is a tool which is used by government of any country to change national currency. It refers to withdrawal of a particular form of currency from circulation and introduces new denomination to substitute the old unit of currency. In India, the currency was demonetised first time in the year 1946 and second time in the year 1978. In the current year on 8<sup>th</sup> November, 2016 the currency is demonetized for the third time by the present Shri Narendra Modi's Government. Demonetization has a impact on sectors dealing with cash-vendors, auto rickshaw wallahs, taxi drivers, daily wage earners and small traders. The term demonetization is not new to the Indian economy. There is a huge master stroke on corruption, counterfeit currency, terrorism and black money by announcing demonetisation and ceasing Rs.500 and Rs.1000 notes as a part of legal tender in India. Therefore, it is imperative to evaluate the liquidity crunch and medium term impacts that such a shock is expected to have on the economy. The paper explains the impact of such a move on the availability of credit, Impact on black money, consumption, Growth momentum, Impact on bank deposits and interest rate.*



**₹ 500 1000**  
**NOTES CEASE TO BE LEGAL TENDER**

**HERE IS WHAT YOU CAN DO:**

Deposit old notes of Rs 500 or Rs 1000 in bank or post office accounts from 10th November till 30th December 2016 without any limit. There will be a limit on withdrawal of Rs 10,000 per day and Rs 20,000 per week. This limit will be increased in the coming days.

Exchange old notes of Rs 500 or Rs 1000 at any bank, head post office or sub post office while showing ID proof. The limit for this is Rs 4000 upto 24th November

No restriction of any kind on non-cash payments by cheques, demand drafts, debit or credit cards and electronic fund transfer.

Check out RBI notification for more details

On 9th November and in some places on 10th November also, ATMs will not work. In the first few days, there will be a limit of Rs 2000 per day per card. This will be raised to Rs 4000 later.

Modi's demonetization initiative caused a sudden breakdown in India's commercial ecosystem. Trade across all facets of the economy was disrupted, and cash-centric sectors like agriculture, finishing and the voluminous informal market were virtually shut down, with many businesses and livelihoods going under completely not to mention the economy impact of millions of people standing in line of hours to exchange or deposit cancelled banknotes rather than working or doing business. Nearly three dozen people have died in the aftermath of India's bold, surprising move.... Some of these people have reportedly died standing in the long snaking queues, while many others died because hospital, pharmacy shops, and ambulances refused to offer services in exchange of old notes.

A child reportedly died at a hospital owned by union culture and tourism minister Mahesh Sharma, after the staff refused to accept of notes for treatment.... There have been reports of people dying after standing in queues for hours to exchange their old currency notes. A 72 year old man named karthikeyan was pronounced dead Friday when he was brought to a hospital in Alappuzha district in the southern India state of Kerala. The man reportedly stood in front of State bank of Travancore branch for hours.

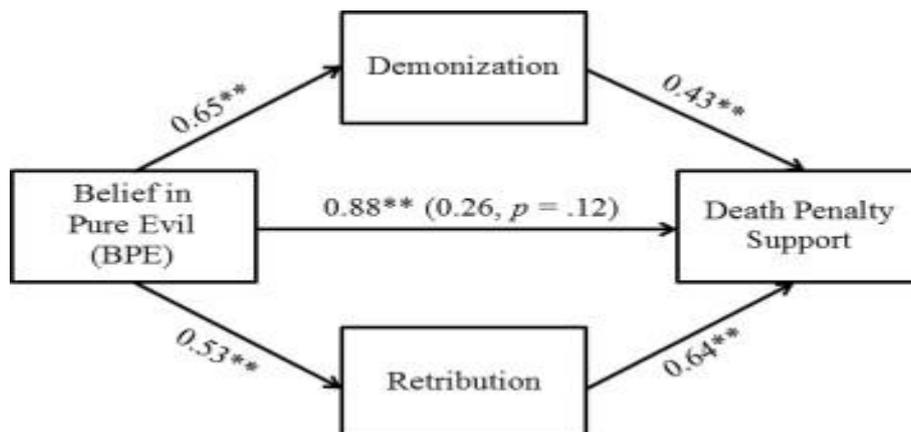
## HISTORY OF DEMONETIZATION AND MICRO FINANCE IN INDIA

Demonetization in India first happened in the year 1946 and then in the year 1978. In January 1946, Rs.1000 and Rs.10,000 bank notes were withdrawn but at the same time Rs.1000, Rs.5,000 and Rs.10,000 notes were introduced in 1954, and were again demonetized in January 1978. The objective behind all the act of demonetization including the current year 2016 move is same, i.e.

- Reduction of black money
- Reduction of corruption
- Removal of fake currency n circulation
- Avoid funding for terrorism activities
- Create a cashless platform for the society

### WHAT IS DEMONETIZATION?

Demonetization is the act of cancellation of legal tender of a currency by making it invalid. It means making a currency no more valid and stopping the circulation of such currency. The current forms of money is pulled form circulation and retired. It will be replaced with New Notes or Coins. All currencies in lower denomination and all coins continued to be valid and new notes of Rs.2000 and Rs.500 were introduced. There was no change in any form of payment like cheques, DD, payment through credit card or debit card etc.



## **DEMONETIZATION OUTSIDE INDIA**

To curb the ill effects of black money or fake currency several countries in the world have followed the demonetization step which is not a new phenomenon. Countries have tried to regulate their currencies, few succeeded and mostly failed. Ghana has demonetized its 50 currency notes in 1982 to reduce tax evasion and manage liquidity. But public lost faith in banking system and moving over to foreign currency. Nigeria as a part of anti- corruption move, Nigerian government took setup of demonetizing by issuing new currency notes in 1984 with new colours so that the old notes would be unusable within a limited timeframe. But the move was a failure. Myanmar, to curb the black market the countries military invalidated 80% of the currency in 1987. Zaire too laid out back to back currency reforms along with a plan to withdraw obsolescent currency from system in 1993. As the response from public was not well it resulted in increasing economic unrest? In Britain pound and pence used as currency government stopped old currency circulation and brought coins of 5 and 10. But this policy failed in other countries except Britain.

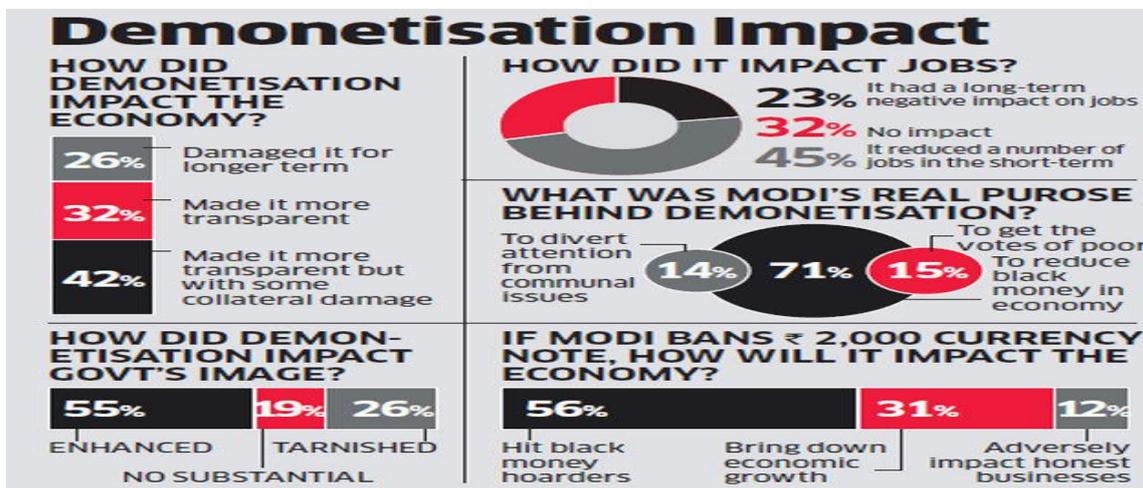
With the above few examples we interpret that reason for demonetization is mostly repetitive in most of nations where public refuses to accept the decision resulting in big failure for government who implemented in the plan.

### **OBJECTIVE OF THE STUDY**

- To study the experience of impact of demonetization in various aspects such as availability of credit, Impact on black money, consumption, Growth momentum, Impact on bank deposits and interest rate.
- To workout the probable consequences of the demonetization.

### **RESEARCH METHODOLOGY**

The paper is based on secondary data. The data has been collected from internet, published in the news papers, journals and various websites.



## COMPARATIVE ANALYSIS OF IMPACT ON DIFFERENT ECONOMIC VARIABLES IN PRESENT SCENARIO

1. Effect on parallel Economy
2. Effect on Money Supply
3. Effect on Demand
  - Real Estate and Property
  - Gold and luxury goods
  - Automobiles
4. Effect on Prices
  - Consumer goods
  - Real Estate and Property
5. Effect on various economic entities with cash transaction
  - Agriculture and related sector
  - Small traders
  - SME
  - Service Sector
  - Households
  - Political Parties
  - Professionals like doctor, carpenter, and utility service providers.
  - Retail outlets
6. Effect on GDP
7. Effect on Banks

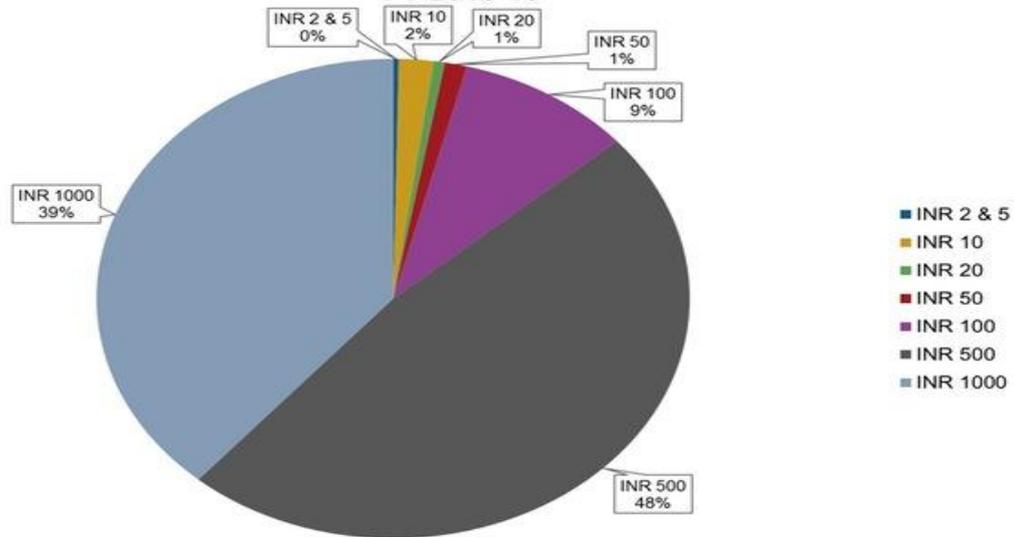
8. Effect on Online Transactions and alternative modes of payment

9. Black Money and Corruption

## **MERITS OF DEMONETISATION**

- The demonetization policy will help India to become corruption-free.
- Those indulging in taking bribe will refrain from corrupt practices as it will be hard for them to keep their unaccounted cash.
- This move will help the government to tack the black money.
- Those individuals who have unaccounted cash are now required to show income and submit PAN for any valid financial transactions.
- The government can get income tax return of rhte income on which tax has not been paid.
- The move will stop funding to the unlawful activates that are thriving due to unaccounted cash flow.
- Banning high value currency will rein in criminal activates like terrorism et.
- The ban on high value currency will also curb the menace of many laundering.
- Now such activity can easily be tracked and income tax department can catch such people who are in the business of money laundering.
- This move will stop the circulation of fake currency
- Most of the fake currency put in circulation is of the high value notes and the banning of Rs.500 and Rs.1000 notes will eliminate circulation of fake currency.

### Percentage Share of Denominations in Circulation by Value in FY 2015-16



Market Realist

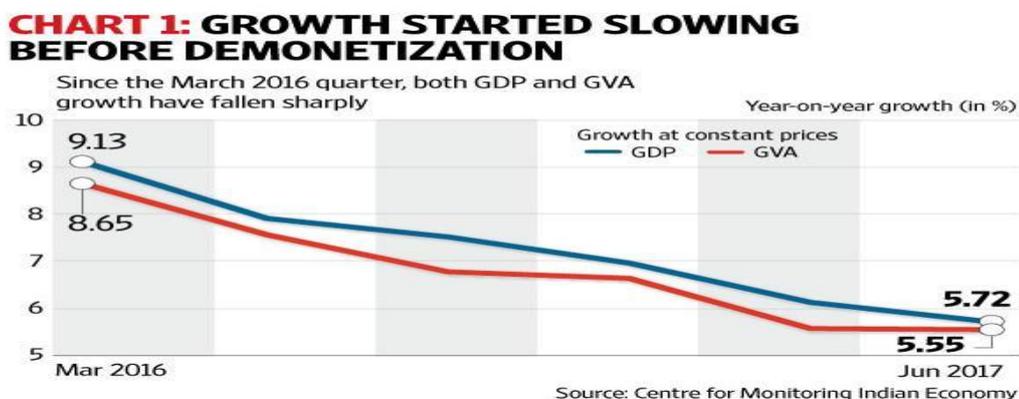
Source: The Reserve Bank of India

## DEMERITS OF DEMONETISATION

- The announcement of the demonization of the currency has caused huge inconvenience to the people.
- They are running to the banks to exchange, deposits or withdrawal notes.
- The sudden announcement has made the situation become chaotic.
- Tempers are running high among the masses as there is a delay in the circulation of new currency.
- It has deeply affected business. Due to the cash crunch, the entire economy has made to come to the standstill.
- Many poor daily wage workers are left with no jobs and their daily income has stopped because employers are unable to pay their daily wage.
- The government is finding it hard to implement this policy. It has to bear the cost of printing of the new currency notes.
- It is also finding it difficult to put new currency into circulation.
- The Rs.2000 rupees note is a burden on the people as no one's likes to do transaction with such high value currency. Some critics think it will only help people to use black money more easily in future.
- Further, many people have clandestinely discarded the demonetized currency notes and this is a loss to the country's economy.

## CHALLENGES FOR GOING DEMONETIZATION

- Inadequate infrastructure only 14 lakhs POS machine
- Creating awareness in semi urban and rural areas
- Digital literacy and security issues.



## PURPOSE OR NEED OF DEMONETIZATION

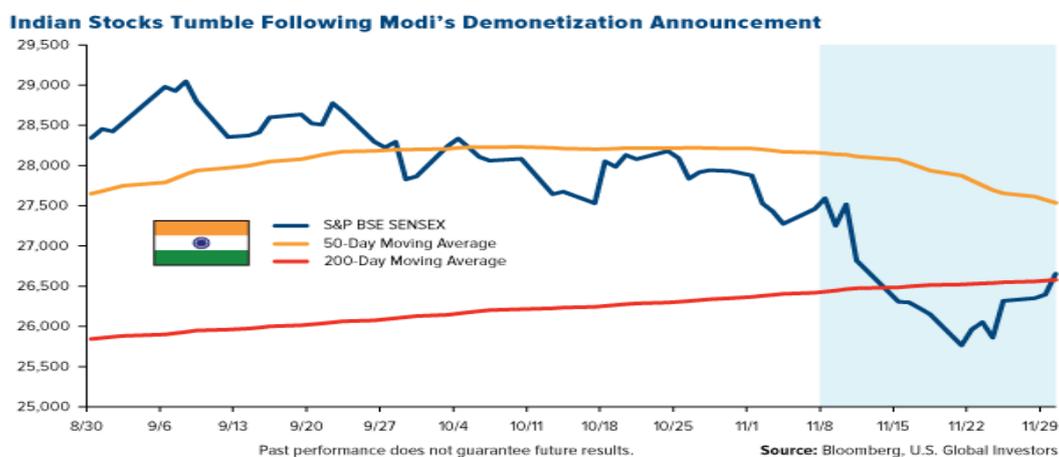
- High denomination notes are known to facilitate generation or circulation of black money.
- In value terms, 500 and 1,000 banknotes together accounted for 86.4 percent of the total value of banknotes in circulation.
- Total number of banknotes in circulation rose by 40% between 2011 and 2016.
- Increase in number of notes INR 500 denomination was 76% and for INR 1000 denomination was 1095.
- Infusion of new series bank note is being regulated by RBI.
- The world bank in July, 2010 estimated the size of shadow economy for India at 20.7% of GDP in 1999 and rising to 23.2% of GDP in 2007.

## LITERATURE REVIEW

- According to Investopedia, Demonetization is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency.

The current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins.

- In the year 2016, Indian Banknote demonetization, According to Professor Anil Sasi and Professor P. Vaidyanathan Iyer, New Delhi reported on “Demonetisation effect: Unbanked villages, small businesses badly hit as currency crisis continues” on November 21<sup>st</sup> 2017. A report by Indo Asian News Service on “How demonetisation has hit small traders hard” November 15, 2016
- A report by Credit Analysis and Research Limited on “Effects of Demonetization of Rs.500 and Rs.1000 notes.
- According to professor Ashis das in the year 2010 in their article, cashless payment system in Indi- A roadmap cash as a mode of payment is an expensive proposition for the government.
- According to professor Bhargava in the year 2004, A new generation plastic money, analysis that debit cards are fast catching up with the customers.



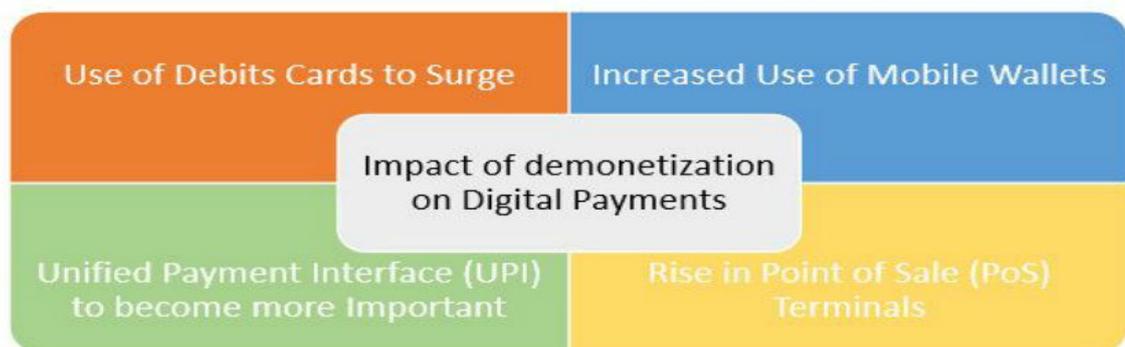
## GOVERNMENT IS WORKING AT VARIOUS LEVELS TO REDUCE THE DEPENDENCE ON CASH

- Financial inclusion – opening bank accounts for the unbanked (PMJDY) was one of the first initiatives.

- Granting license to new finance banks and payments to bring innovative banking products.
- Recently launched Unified Payments Interface by National Payments corporation of India makes digital transactions as simple
- Promotion of Mobile banking services.
- Incentive to new POS machine
- Withdrawal of surcharges and discounts or offers.
- Demonetizing INR 500 and INR 1000 notes which aimed at curbing Payments Corporation.

### STEPS TAKEN TO DEMONETIZE THE HIGH DENOMINATION NOTES

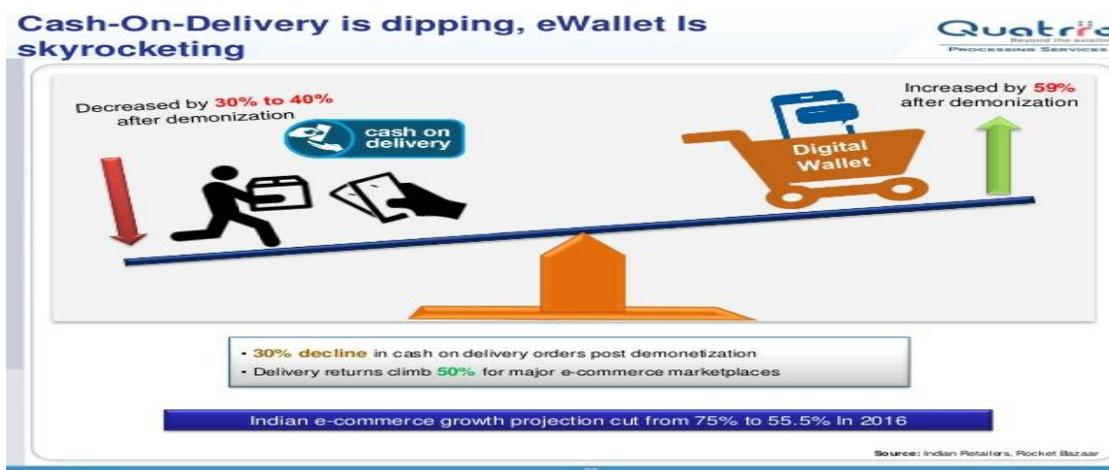
- ❖ Curb financing of terrorism through the proceeds of fake Indian currency notes (FICN)
- ❖ Curb the use of FICN funds for subversive activates such as espionage, smuggling of arms, drugs and other contrabands into India.
- ❖ For eliminating black money which casts a long shadow of parallel economy on our real economy.
- ❖ To lower the cash circulation in the country this is directly related to corruption in our country.
- ❖ India's economy relies predominantly on cash, the effects will be far greater
- ❖ ATMs are scarce, and few rural Indians have a credit or debit card.



## STATEMENT OF PROBLEM

There is no doubt on the capability of the cashless economy in transforming the lives of people in India if well implemented. But there are certain challenge which have to be tackled efficiently for the success of it.. The paper is an attempt in highlighting the hurdles to go completely demonetization and also to show the state of acceptability of going demonetization by the people.

Currently demonetization is having average impact on banking sector and its customers most of them are in the middle income group as the worst hit. For sincerity purpose most of transactions happens digitally like PAYTM, Debit card, Credit card, Online NEFT, RTGS. But meeting daily transactions which is mainly consisting of low denomination currency were badly in defect and the poor always prefer hard cash rather than in electronic cash. Even if it is willing by everyone, necessary education, training is this regard id essential.



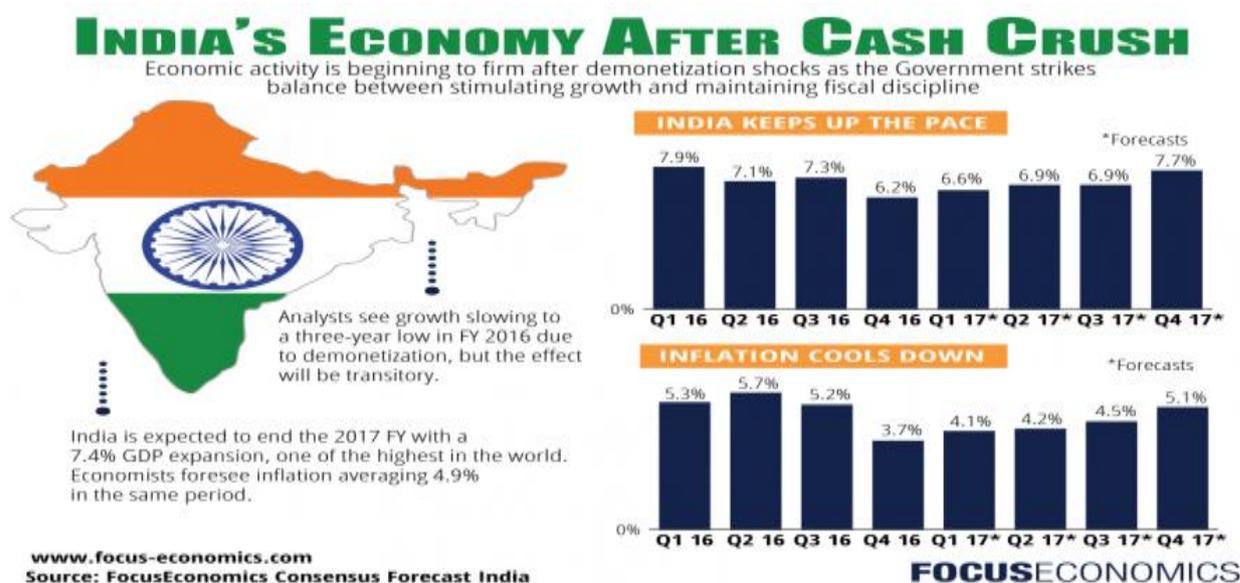
## SIGNIFICATION OF THE STUDY

Indian banking sector always stood as the backbone for the growth of the Indian economy which is on the brink of major transformation with several policy initiatives enhancing spending on infrastructure, speedy implementation of projects and continuation of reforms are expected to provide further impetus to growth. All these will definitely poised for robust growth in Indian banking sector by turning most of the growing business units for

their credit needs. The study presents some suggestions and recommendations of post Demonetization effect.

## RECENT STATUS REGARDING DEMONETISATION

The number of currency notes in circulation is far higher than in other large economies. India had 76.47 billion currency notes in circulation in 2012-2013 compared with 34.5 billion in the US. The ratio of cash to Gross Domestic Product is one of the highest in the world 12.42 in 2014 and 10.6% at the end of March 2017, where 9.1% in china in 2015 and 3% in Brazil. As per current available data on cashless transaction in India, we can come to a conclusion that it is still in a budding stage and the reasons for this are many factors such as, second thought on using online transaction are not only in illiterate class but also in some called educated class.

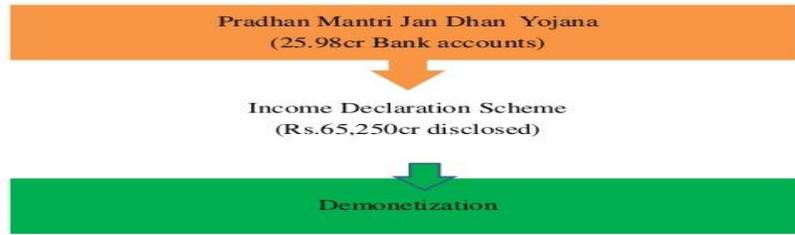


## DISCUSSIONS

Digital payments giant, pay tm has put out large scale advertisements to promote cashless payments for major transactions. With 39% of the market share in digital wallets, let's hope people throng to use UPI (United payments interface) and Pay tm. There was no any skill based programmes to create awareness of cashless transactions. People roll back to the same old traditional banking practice after the economy rolls back to the normality.



# Phases of Demonetisation



## LIMITATIONS

The concepts of demonetization have not even sufficiently studied in India, especially its influence on common man. Further empirical research can make significant contributions to the research and practice's Scholars can develop new research agenda first to identify the nature of effects it might have on common man which can boost the ultimate goal of the demonetization. For this reason, various alternatives can be measured, and based on the findings, appropriate RBI interventions could be designed and implemented for improving the alternatives to the cash. Finally, the sample size of the study is considered small. Further research should be conducted in large sample thus it can provide better generalization. Hopefully, this paper would raise the levels of interests among scholars to conduct more impact of demonetization related studies that may contribute to the new dimensions particularly in the contexts of recent episodes of scandals and ethical violations. In this regard, this research could be a stepping stone for conducting further studies in relevant fields of studies for advancing the knowledge.

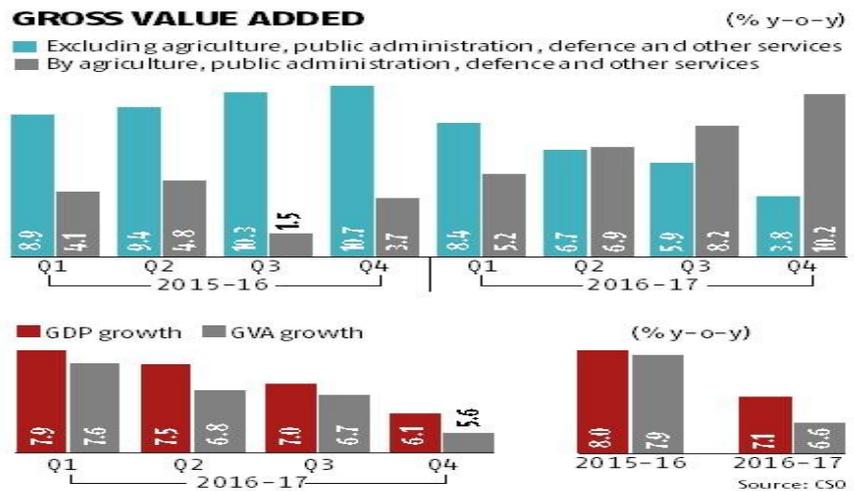
## SHADOW OF DEMONETISATION

**CHINA RACES AHEAD**

India lost the crown of the fastest growing major economy to China, which grew at 6.9% in the January to March quarter

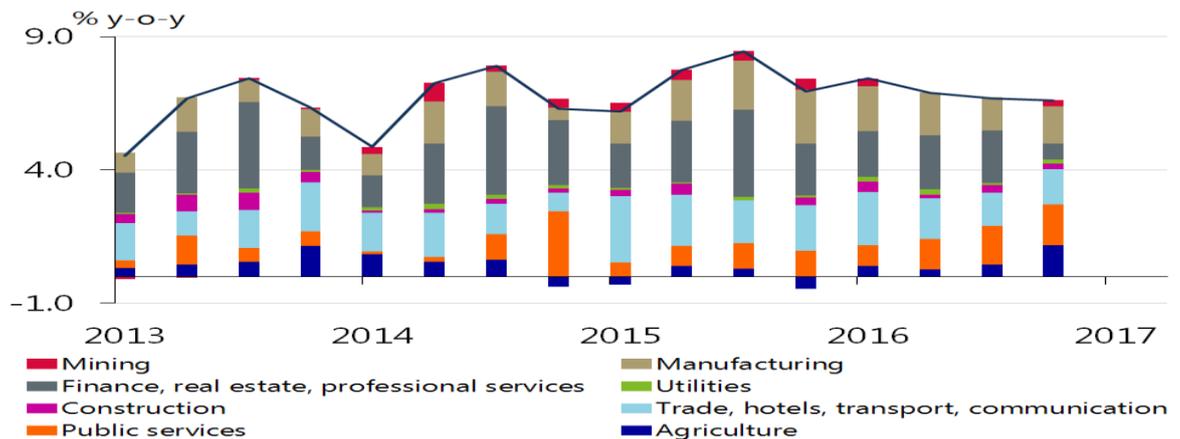
**INSIDE**

- Monetary policy panel may change rate stance, say economists 22 ▶
- Govt meets 3.5% fiscal deficit target in FY17 22 ▶
- EDIT: A hard fall 11 ▶



## SUGGESTIONS

- Encouraging and educating the customers to use more digital banking facility.
- To encourage cash less economy other modes of payment like online transactions, debit and credit card as well as mobile wallets should be enforced.
- More constraints in the availability of cash transactions will need to be performed through banking channels which put restrictions on black money.
- Since there was a significant amount of counterfeit currency in the economy is demonetized currency which was primarily distributed to fund terrorist and anti-national activities.
- There has been spurt in the cash deposits of demonetized notes at the bank, taxman can detect tax avoiders and collecting the money via the tax base widening would increase the fund available for reducing fiscal deficit.



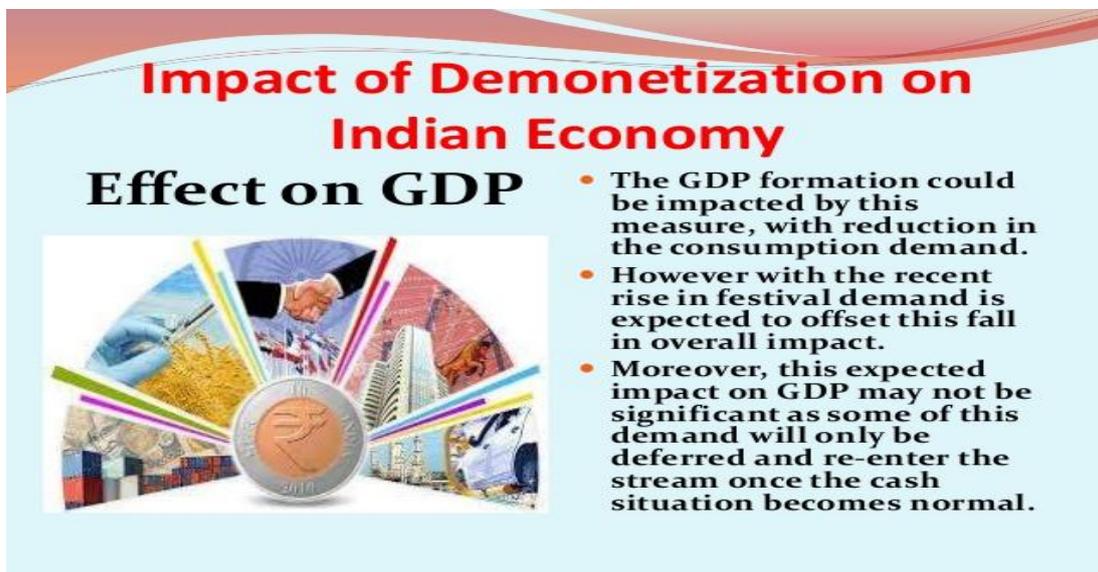
## IMPLICATION

Through the finding of this empirical study, it is hoped that it can provide some preliminary assessment and knowledge of the impact of demonetization on common man. This would be vital for various banking sectors to develop relevant policies regarding enhancing the flow of money in economy. Findings from this study may create awareness and interest about the significance of demonetization and further studies can be developed to identify the extent of cash less alternatives that may cater to the life of common people for their day to day activities. Public would be concerned about the proper use and control of alternatives of cash, while they are running out to cash. However, using alternatives like

Paytm Mobikwik, Ola money, Freecharge, Flipkart wallet etc., can enhance the knowledge of common man in the usage of cash less society. The findings of the study would provide guidance of the need to use different strategies for the development of cashless society. Finally, this study would add to the literature on the study of Demonetization.

## **NEED TO BE DONE BY GOVERNMENT**

- Create a culture of saving and faith in financial system among the rural poor.
- Tax rebates for consumers and for merchants who adopt electronic payment.
- Making electronic payment infrastructure completely safe and secure so that incidents of cyber crimes could be minimized and people develop faith in electronic payment system.



**Impact of Demonetization on Indian Economy**

**Effect on GDP**

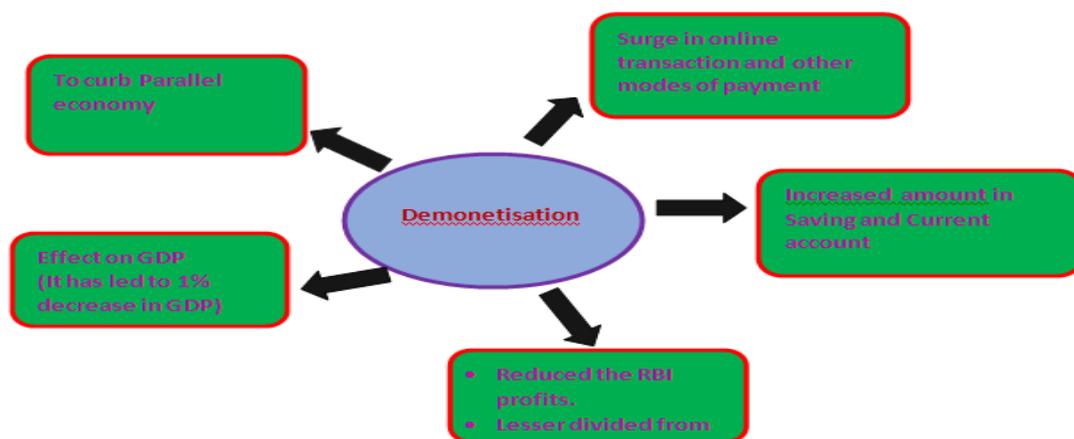
- The GDP formation could be impacted by this measure, with reduction in the consumption demand.
- However with the recent rise in festival demand is expected to offset this fall in overall impact.
- Moreover, this expected impact on GDP may not be significant as some of this demand will only be deferred and re-enter the stream once the cash situation becomes normal.

## **CONCLUSION**

- The demonetisation undertaken by the government is a large shock to the economy. The impact of the shock in the medium term is a function of how much of the currency will be replaced at the end of the replacement process and the extent to which currency in circulation is extinguished.
- The Indian “piggy banks” maintained by each and every poor household is completely damaged, which will create uncertainty and vulnerability to those families during any emergency need. 100% formal way of expenditure will increase scope for providing

maximum benefits to big business houses and will damage the hope and aspires of road side vendors.

- Farmers lost their bargain power during sale of their produces, as at present there no proper pricing system nor their does existence of any system at the rural market to sale their produces with fare price.
- The digital banking system will be the biggest mistake and it will be promoting cybercrime and cheating as more than 80% of the people of this country are not aware about internet services and it will be easier for criminals to theta them.
- The original assumptions underlying the decision remain unclear, but it seems to be causing considerable harm. All this harm is likely to buy us only a small dent on black money problem and the elimination of a few hundred cores of fake currency.
- The government would do well to reflect on the failures of the policymaking process that led to what appears to be bad decisions. If this was indeed a genuine mistake, and government's assumptions turned out to be wrong, it would be unwise to risk making more of such mistake in an impatient pursuit of lofty goals.
- Our government's capitalists to run complex programmes is very limited, and it is best expended on higher priority problems such as building the criminal justice system, achieving public health goals, I proving learning outcomes in primary education , building a credible defence apparatus, ensuring provision of sound infrastructure, ensuring clean air and water and so on.



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