



## **'Demonetization – It's Impact on Indian economy'**

**Dr.Mohit.R.Raut (Asst.Professor) Contact-+919860301630  
Tuljaram Chaturchand College, Baramati. (Pune)**

### ➤ **ABSTRACT-**

Demonetization is going to be a landmark in the history of the Indian economy. It was an experience which might create fear in the minds of the people who indulge in illegal activities like tax evasion or money laundering of any kind. The term demonetization is not new to the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the 10,000 rupee note in 1938 and again in 1954. It was demonetized first in 1946 and then in 1978. Since not many people had access to such notes at the time, this did not have a big impact on the country. The latest round of demonetization has undoubtedly affected the common public and bankers. Demonetization was initiated with a wide array of motives like stripping the Indian economy of its black money, push people to pay taxes for the unaccounted pile of cash, curb terrorism, promote the digital India movement and make India a cashless economy. It has had many short term effects which are visible. The long term effects are yet to be experienced and felt.

**Keywords-** Demonetization, Cashless economy, Black money, Money laundering.

### ➤ **Introduction-**

India has emerged as the fastest growing major economy in the world and is expected to be one of the top three economic powers of the world over the next 10-15 years, backed by its strong democracy and partnerships. India has retained its position as the third largest startup base in the world with over 4,750 technology startups, with about 1,400 new start-ups being founded in 2016, India's labour force is expected to touch 160-170 million by 2020, based on rate of population growth, increased labour force participation, and higher education enrolment, among other factors. India's foreign exchange reserves were US\$ 457.68 billion in the First week January 2020, according to data from the RBI. India's gross domestic product (GDP) is expected to reach US\$ 6 trillion by FY27 and achieve upper-middle income status on the back of digitization, globalization, favorable demographics, and reforms. India's revenue receipts are estimated to touch Rs 28-30 trillion (US\$ 385-412 billion) by 2019, owing to Government of India's measures to strengthen infrastructure and reforms like demonetization and Goods and Services Tax (GST).



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### ➤ What Is Demonetization?

Demonetization occurs when a government removes a currency's *legal tender* status, which means the money is no longer officially recognized as a medium of exchange for meeting financial obligations or settling debts. Typically, old notes are retired and replaced with new ones. In cases where the intent is to stop corruption, demonetization usually targets only large-denomination banknotes. By contrast, if the intent is to cut zeros from existing price levels, introduce policies that dramatically reduce hyperinflation rates, and/or restore public confidence in the monetary system, a government may demonetize by introducing a totally new or renamed currency, as did Germany (1923), Argentina (1983, 1985, and 1992), Brazil (1986, 1990, 1993, and 1994), and Zimbabwe (2010).India (1946, 1978, 2016).

## Share of notes of denomination greater than ₹500 has halved in terms of volume



### ➤ Demonetization and Indian economy-

As per the estimates of the Central Statistics Office, all the sectors of the economy faced different situations in Q1 of the financial year 2017-18. According to these estimates, the GVA at constant prices in Q1 of 2017-18 was rupees 2904128 crores as compared to rupees 2751407 crores in the Q1 of the previous financial year. This show a decline in growth from 7.6% in 2016-17 to 5.6% in 2017-18 (see following table)



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Quarterly Estimate Of GVA At Basic Prices In Q1 Of 2017-18 (at 2011-12 prices)					
Industry	April - June (Q1)				
	(Crore) Gross Value Added for Q1			% Change Over Previous Year Q1	
	2015-16	2016-17	2017-18	2016-17	2017-18
Agriculture, forestry, & fishing	371468	380833	389732	2.5	2.3
Mining and quarrying	87294	86485	85911	-0.9	-0.7
Manufacturing	458128	507223	513139	10.7	1.2
Electricity, gas, water supply & other utility services	55324	61018	65289	10.3	7
Construction	222464	229321	233919	3.1	2
Trade, hotel, transport, communication & services related to broadcasting	474733	516958	574261	8.9	11.1
Financial, insurance, real estate & professional services	594754	650607	692522	9.4	6.4
Public administration, defense & other services	293784	318963	349356	8.6	9.5
<b>Total</b>	<b>2557949</b>	<b>2751407</b>	<b>2904128</b>	<b>7.6</b>	<b>5.6</b>

Source- Handbook Indian Economy-2017-18

Sectors in the economy such as Construction, Agriculture, and Forestry & Fishing which employ a large number of daily wage workers and have liquidity preference witnessed a decline in growth. Agriculture grew by 2.3% in Q1 of 2017-18 as compared to 2.5% in Q1 of 2016-17, Construction grew at a rate of 2.3% in Q1 of 2017-18 and witnessed a drop of 0.2% since the Q1 of 2016-17. Manufacturing, which is the most important indicator of economic growth and employment has grown at a very slow rate post demonetization. It grew by only 1.2% in Q1 of 2017-18 as compared to a massive growth of 10.7% in Q1 of 2016-17.

➤ **Objective of the study:**

1. To take review the Demonetization situation in India.
2. To find out various impacts of demonetization on Indian economy.

➤ **Research Methodology:**

This Research paper is based on authentic secondary data taken from various government reports, newspapers, research papers, journals & websites etc.

➤ **Review of literature:**



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**Chatterjee and Banerji (2016):** Discussed about the short term liquidity problem in Indian economy and substantial increase in the deposits in banks due to demonetization. The study reveals that spending patterns and consumption trends in the Indian economy changed in the short period of time and people changed their attitude to use alternate channels of payment for purchasing.

**Shukla, Bal Govind and Gupta, Hariom (2018):** In their paper entitled “An Exploratory Study of Business Students Perspectives on Demonetization in India: With Special Reference To Allahabad City”. They used primary data for their study and concluded that the people actively support any initiative taken by the government which is basically targeted to eradicate corruption, black money, and any other threats like terrorism and naxalism in the country.

**Bansal and Jain (2018):** Examined the significant changes in the utilization of digital banking services in India after demonetization using paired sample T test and revealed that the usage of digital banking services in both the terms i.e. volume wise and value wise has been increased after demonetization.

**Kapila (2017):** Investigated impact of demonetization in terms of rationale, the aftermath, the short & the long term economic impact on the social & political fallout.

### ➤ Demonetization- Impact on key sectors of the Indian economy-

**1. On Gross Domestic Product (GDP):** The Indian economy is a cash-driven economy and demonetization has largely affected its growth. The GDP growth rate of 8.01% in 2015-2016 fell to 7.11% in 2016-2017 after demonetization. This was largely due to less availability of cash in cash-intensive industries like manufacturing and construction. It has also adversely impacted the primary function of banks to issue loans and has put pressure on them as current account holder's demand large sums of cash.

**2. On the General Economic Situation:** Till months after demonetization the general economic situation was disturbed. The public had to queue up outside banks to exchange their old currency for new ones. Households lacked liquidity and could not do transactions for daily items. Small shopkeepers who only accepted cash went into losses and some even shut down.

**3. Digitization:** The government pushed for a less-cash society by increasing infrastructure to allow digital payments. In most of the tier-II and tier-III towns, digital payments had doubled since demonetization. From global tech giants such as Google, WhatsApp, to few of the country's biggest mobile wallets, including Paytm, MobiKwik all adopted the digital payments system around the time demonetization took place. Till December 2018, UPI managed transactions of more than Rs 1.02 trillion. National electronic funds transfer (NEFT) transactions saw an upsurge from Rs 9.88 trillion. Mobile banking payments also saw a spike since September 2015. All the digital transactions collectively registered an increase of 440 per cent since demonetization.

**4. Real Estate:** The total number of developers in the top nine Indian cities shrunk by over 50 per cent by 2017-18. While Gurugram witnessed a decline of 76.8 per cent in the number of developers from 82 in 2011-12 to 19 in 2017-18, Noida registered a plunge of 73.2 per cent –



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from 41 to 11. Financial distress of small developers, lack of execution capability and over-supply of inventory played a key role in the downturn. According to analysts, a large number of fly-by-night developers were forced to leave the market after demonetization. All major cities with significant potential for real estate development – Mumbai, Pune, Thane, Kolkata, Bangalore and Hyderabad – saw a decline in the number of developers.

**5. Farm Income & Wages:** Both farmers' incomes from crop cultivation as well as wages of farm labourers contracted in 2016-17 despite the above-normal monsoon season. On the positive side in agriculture as a whole, output from fishing and livestock grew the fastest in 2016-17. The growth was nearly 10 per cent over the previous year. In a period of low supply of cash, input suppliers demanded higher prices. Demonetization was carried out briefly after the harvest of the kharif season entered the markets, and when the entire rabbi output was yet on the fields. On the other hand, agriculture had grown (gross value added) the fastest since 2012 in the demonetization year due to a bumper crop.

**6. Factory Investment:** In the year when the demonetization was implemented, investment in the country's factories contracted 10.3 per cent over 2016-17, showing their worst performance since 2002-03. In the year immediately after the note ban exercise, even as factories in the organized sector witnessed job growth and wage rise consistent with previous years, their ability to channel funds in productive capital was severely dented in 2017-18.

**7. Jobs:** According to Labour Bureau's- 2016-17, when the government demonetized old currency notes. In 2017-18, the country's unemployment rate stood at a 45-year-high of 6.1 per cent, according to the (NSSO's) periodic labour force survey (PLFS). Moreover, demonetization caused a 2-3-percentage-point reduction in jobs and national economic activity in November and December 2016, according to a research. Between 2016 and 2018, five million people lost their jobs and the labour force participation started declining suddenly between September and December 2016 for both urban and rural men. The rate of decline slowed down by the second half of 2017, but the general trend had continued and there had been no recovery.

**8. Income Tax Payers:** During 2017-18, there was some positive impact of demonetization on the widening of the tax base. The Income Tax department said it added 1.07 crore new taxpayers while the number of dropped filers' came down to 25.22 lakh. The Central Board Of Direct Taxes (CBDT) said 6.87 crore Income Tax Returns (ITRs) were filed during FY 2017-18 as compared to 5.48 crore ITRs filed during FY 2016-17, translating into a growth of 25 per cent. Also, during FY 2017-18, the number of new ITR filers increased to 1.07 crore as compared to 86.16 lakh new ITR filers added during FY 2016-17.

**9. Curbing anti-social activities:** Usually, anti-social elements like smugglers or terrorists use cash as a mode of transaction. When the government decided to demonetize 500 and 1000 rupees notes, they were the highest denomination notes in circulation. By demonetizing them, the government forced these anti-social units to find ways to get rid of the old notes. This allowed the government an opportunity to get a better control over the unaccounted money in the economy and curb anti-social activities.



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