



---

## Demonetization and its impact in Indian economy with special reference to Indian banking sector

Mood Prashanthi

Department of Commerce and Business Management, Kakatiya University, Warangal, Telangana, India

---

### Abstract

Demonetization refers to cancellation of legal tender status of currency in circulation. Anticipating positive effects on the economy, nations often adopt demonetization policy. Government of India adopted demonetization policy on November 8, 2016. Prime Minister Narendra Modi announced this policy while addressing the nation in his Mann Ki Baat speech on November 8, 2016. Under this policy, high denomination Indian currency notes of Rs.500 and Rs.1000 were declared to be no longer in use as legal tender which means that these notes were not be acceptable for transaction. Demonetization is a generations' memorable experience and is going to be one of the economic events of our time. Its impact is felt by every Indian citizen. Demonetization affects the economy during the liquidity side. Its effect will be a telling one because nearly 86 percent of currency value in circulation was withdrawn without replacing bulk of it. Demonetization is the most important and necessary when there is a change of national currency. The old unit of currency must be removed and substituted with a new currency unit. Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc. In this context, the exercise may produce following short term, long term, consumption/investment, welfare growth impacts on Indian economy. The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks. Demonetization in India was adopted to fight against various problems such as corruption, black or parallel economy, terror funding, fake currency, money laundering and hoarding, tax evasion etc.

**Keywords:** demonetization, corruption, Indian economy, money hoarding, fake currenc

---

### Introduction

Demonetization is the most important and necessary when there is a change of national currency. The old unit of currency replaced with new currency. Demonetization is the process where government declares the currently running currency notes illegal to be tender after the declaration is made. There are both pro and cons of demonetization in the Indian economy. The reasons for demonetization are to control fake notes that could be contributing to violence, and to challenge or remove the "black economy".

Indian economy is a middle-income developing economy. It consists of mainly three sectors that are Agriculture & allied sectors, Industry sector and Services sector, which contribute 14.65%, 30.19% and 55.17% respectively to the GDP. Since Independence different governments adopted various policies and reforms to boost economic growth and one such reform is Demonetization. Demonetization refers to cancellation of legal tender status of currency in circulation. In India, demonetization policy has been adopted three times. First time, it was adopted in 1946 when Rs.1,000 and Rs.10,000 notes were completely banned by Government of India. After this, in 1954, new currency notes of Rs.1,000; Rs.5,000 and Rs.10,000 were introduced by GOI. Further, in 1978, Government headed by Morarji Desai cancelled the legal tender status of these notes. Recently, on November 8, 2016, GOI headed by Narendra Modi demonetised the Indian currency notes of Rs.500 and Rs.1,000 and introduced new currency notes of Rs.500 and Rs.2,000. To make this demonetization successful, Indian Banking System played a major role.

### Causes behind demonetization

#### 1. Black money

One major cause behind implementing demonetization is to eliminate or reduce huge sum of black money hoarded by people, mainly, owners of big business houses, politicians and bureaucrats.

#### 2. Fake currency

Another reason of introducing this policy is that it helps in flushing out fake currency notes which circulates in market.

### **3. Corruption**

GOI adopted this policy to break the tentacles of corruption. High denomination currency notes are vulnerable to be used for unfair purposes. It is easier to bribe someone in high denomination-high valued currency notes. With demonetization, high denomination currency notes are declared worthless which make it difficult for corrupt people to practice corrupt exercises.

### **4. Digitization**

For making India a cashless economy and to promote digitization, demonetization is adopted. It was assumed that chances of tax evasion and corruption will plummet or reduce as the transactions will be online, recorded and monitored.

### **5. Terror funding**

Black money is used for terror funding and other anti-social activities. Therefore, with a view to reduce such activities, the bold step of demonetization has been taken by the government.

### **Research methodology**

It is a descriptive research paper for which secondary data has been used. The data is taken from reliable sources like RBI, Ministry of Finance etc.

### **Impacts on Indian economy**

#### **Economic slowdown**

With demonetization, consumption demand slacked which further resulted in decrease in production. As cash in hand decreased, consumption was affected adversely. Consequently, post-demonetization there was a sudden drop-in GDP growth rate in the following quarters. Before demonetization, in second quarter of FY 2016-17, GDP growth rate was 8.87% at 2011-12 prices. But, just after demonetization, it reduced to 7.55% in third quarter of FY 2016-17. Furthermore, growth rate of GDP was 7.04% in fourth quarter of FY 2016-17 and in first quarter of FY 2017-18, it was just 5.99%.

Growth rate of GDP showed an erratic pattern after implementation of demonetization. Automobile and real estate sector are among the badly hit sectors due to demonetization as demand for automobiles and properties have reduced. In December 2016, immediately after demonetization, a fall of one-fourth was noticed in sales of two-wheeler industry. Moreover, the leading industries dealing in car manufacturing also witnessed a reduction of 4% in its sales.

#### **Scarcity of cash**

Demonetization creates sudden and short-term shortage of cash. This results in decrease in economic activities. This also put many challenges in front of people as Indians prefer to hold cash for transaction purposes. Even their simple daily chores were badly affected as some people had no cash even to buy their daily pre-requisites. Some even had to take off from their jobs just to stand in queues to exchange their old currency notes. Consequently, the daily wage earners were greatly affected. Also, demonetization was announced when the Indian wedding season was at its peak. Therefore, people faced many difficulties because of shortage of cash. It even led to some extreme consequences/outcomes as there was news of people dying because of shock when they had no money to marry their children or fatigue due to standing in queue for a long period and working for long hours in banks.

#### **Effect on black money**

On November 8, 2016, while introducing demonetization, Prime Minister Narendra Modi says, "Our generation did not get the opportunity of fighting for the freedom of our nation but today we have the historic opportunity to weed out the menace of corruption and black money to secure the future of our nation."

#### **Impact on counterfeit (fake) currency**

Counterfeit currency is also known as fake currency. One of the objectives of demonetization was to kick out fake currency from circulation as it is used for funding terrorism which cripples down an economy. With demonetization, counterfeit currency is eliminated automatically as this currency can't be used for transactions. Graph below shows that after demonetization amount of fake currency diminished over time.

#### **Digitization**

Demonetization promotes Digital India program. It helped in promoting e-commerce and e-payment methods. As cash in hand reduced, people suffered problems to meet their daily basic transactions. This shortage of cash led to automatic inclination of people to the digital modes of payment. People had to pay for their transactions via e-wallets and plastic cards. Graph below shows that spending via cards increased after demonetization.

#### **Impact on Employment**

Employment is also affected by demonetization. The Centre for Monitoring Indian Economy (CMIE) has estimated that over 1.5 million jobs were lost after demonetization. In the manufacturing sector, medium and

large-scale industries reported job-loss of 5% and revenue loss of 20%. In the informal sector, many daily workers were rendered jobless due to paucity of cash in the system. For example, thousands of people lost their jobs in tea gardens of West Bengal and Assam. 90% of bangle factories of Firozabad, UP had to shut down because of cash crunch. However, e-commerce and digital payment platforms witnessed unexpected boost. Example can be given of Razorpay which witnessed 150% hike in the morning after the demonetization was announced, which by afternoon, shot up to 200%. Also, Paytm received more than 25,000 signups. Hence, it can be concluded that demonetization had mixed effects on employment. On one side, it adversely influenced daily wage-earners, MSMEs, contract workers while on the other side, e-commerce and digital payment platforms experienced hike in its users.

### Conclusion

Demonetization method is like two faces of a currency because one side it will benefit the nation and other side it's going to make some provisional and long-term problems, most of the business in India has money deal with less than 2 per cent business deals taking place electronically. Demonetization can be a chance for a fresh new start, or it can be something that causes unnecessary confusion for a country. Slowdown in GDP growth rate is also a bitter fruit of demonetization. Former RBI Governor Raghuram Rajan and Nobel Laureate Abhijeet Banerjee are also of the view that the slowdown in the economy is structural and because of a deficiency of demand. This lack of demand was also because of demonetization. There are some positive effects also as fake currency is reduced by a noticeable amount. It also promotes digitization and transparency in the transactions and banking operations which further helps in reducing tax evasion as all transactions are now recorded.

### References

1. Dinesh TM, Reddy KK. Demonetization and its Effects on Digital Payments, *Economic Affairs*, 2018;63(2):407-411.
2. IAS Score. Employment and Demonetization. IAS Score, [ias.score.in/topical-analysis/employment-and-demonetization](http://ias.score.in/topical-analysis/employment-and-demonetization).
3. Veerakumar K. A Study on People Impact on Demonetization”, *International Journal of Interdisciplinary Research in Arts and Humanities (IJIRAH)*, 2017.
4. Katke K, Kamat A, Kalal M. Impact of Demonetization on Indian Automobile Industry: A Special Reference to Car Industry, *International Journal of Scientific Engineering and Research*, 2017, 5(3).
5. Kumari S, Zaidi N. Impact of Demonetization on the Banking Sector: With Reference to the Meerut Region, *International Journal of Advance Research and Innovative Ideas in Education*, 2017, 3(4).
6. Ministry of Finance, Government of India.
7. Monthly Bulletin on Foreign Trade Statistics April, of Ministry of Commerce and Industry, Government of India, 2018.
8. Narsaiah N. Demonetization Impact Over Banking Loans & Advances- A Case Study, *Business Excellence & Management*, 2019, 9(1).
9. Nerkar AD. Demonetization: Impact on Indian Economy, *International Journal of Advanced Engineering Research and Science*, 2016, 3(12).
10. Prabhu M, Girish V, Mamatha R. Demonetization and its effect on Banking Sector, *IOSR Journal of Business and Management*, 2017, 20-22.
11. Sharma P. Demonetisation: Its Impact on Indian Economy, *European Journal of Molecular & Clinical Medicine*, 2018;5(1):180-184.
12. Sunil, Demonetization at Glance in Indian Scenario: A Conceptual Study”, *International Journal of Applied Research*, 2017.