



## A Critical Analysis of Demonetisation Effects on Indian Economy

**Rekha Garg**

Faculty of Commerce, NAS College (Affiliated to CCS University), Meerut, (U.P.) India  
E-mail Id: rekha.garg.nas2016@gmail.com

### Abstract

PM Mr. Narendra Modi announced demonetization on 8 November 2016. One of the most disruptive actions in India's economic history i.e., the invalidation of 86% of currency in circulation at one stroke. Withdrawal of high denomination notes is a radical measure the government would normally resort to in an attempt to counter currency forgery, one of the reasons Modi cited for the note ban, together with unearthing black money and curbing terror finance. Demonetization was both an economic and a political necessity of India announced the demonetization of all 500 and 1000 bank notes. A year has passed since that momentous decision, let's see how it is planned and executed by the Reserve Bank of India. Demonetization has been billed as the 'Biggest Monetary Experiment' in recent times in the entire world.

**Keywords:** Demonetization, Invalidation, Unearthing, Black Money, GDP.

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## 1. INTRODUCTION

The first anniversary of demonetization, Finance Minister Arun Jaitley called it a drive against black money while former Prime minister Manmohan Singh begged to differ and termed "it an organized loot and legalized plunder."

The Reserve Bank of India (RBI) has in the meanwhile come to indicate the real position of the economy. According to bank wise statics provided by RBI while 56,17,58,369 ATM transactions were made in November 2016, the figures stood at 63,04,70,907 in December 2016, up by 12%.

Interestingly, there is also a rise of 27% in the number of ATM transaction when November 2016's of ATM transaction has almost doubled in the following year after demonetization kicked in and rose to Rs 24,22,646 million.

According to the same date transaction using point of sale(POS) machines at the end of November 2016 were 33,43,78,090, which increased by 58.9% in the next month during the same year to 53,15,44,775.

However, when compared to the September 2017 data the spike comes down to 13.02%. The amount involved in transactions using POS machines amounted to Rs. 8,91,083.7 million, an increase of 51.83% when compared to NOV 2016 and dipped by 16.91% in Sept. 2017 when compared with December last year.

Therefore, RBI clearly indicates that cash is back in the economy and PM Modi's dream of creating cashless economy is in for a further delay.

India's economic growth fell to 6.1 percent in the fourth quarter of 2016-17 primarily because of demonetization adversely affecting economic activity. This was at least a four- quarter law.

The sectors which worst affected were construction industry and financial services sector. Without indirect taxes, growth figures would be more dismal. Gross value added (GVA) the difference between gross domestic product (GDP) and net indirect taxes grew by only 5.6%.

## 2. DEMONETIZATION: WHERE DID ALL THAT CASH GO?

Banks dumped the excess deposits into government securities bringing down interest rates on them and helping the government borrow at cheaper rates.

Total non food credit	Sep 2016	Sep 2017
Agriculture	10.77	6.09
Activities	15.91	5.76
Industry	.87	-0.44
Services	18.38	6.98
Personal Loans	19.69	16.84

Source: center for Monitoring Indian Economy there has been a deceleration in credit growth across all sectors. Scheduled commercial banks-credit growth (year-on year in %)

A year after demonetization, at the end of October 2017, the year- on year increase in bank credit had fallen to Rs. 5.3 trillion, while bank investment in government securities soared to Rs. 4.6 trillion.

Before demonetization, the year in year increase in bank credit was Rs. 5.9 trillion and the rise in bank investment in government securities was Rs. 2.1 trillion. A year later, at the end of October 2017, the year on year increase in bank credit had fallen to Rs. 5.3 trillion while bank investment in government securities soared to Rs. 4.6 trillion.

In effect, banks dumped the excess deposits into government securities bringing down interest rates on them and helping the government borrow at cheaper rates.

As is well known, cash in circulation has decreased and with deposit growth remaining too has come down. At the end- Oct. 2017, year on year M3 growth was 6.5% compared to 10.4% at end October 2016.

Credit growth across all sectors has slowed in agriculture, services, even to industry at end year on year credit growth to end September 2017 was negative compared to a small positive growth at the end of September 2016.

Personal loan growth has been the least affected of the growth in non food credit in the year to end September 2017, personal loans contribution 61%, loans to services another 28% while agricultural credit contribution the rest.

Growth in credit to the services sector too fell from 18.4% in September 2016 to 6.98% in a year later. Similarly, growth in agriculture loans has gone down from 15.91% in September 2016 to 5.76% in September 2017.

### **3. DEMONETIZATION THE REAL EFFECTS**

Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization is necessary when there is a change of national currency. The old unit of currency must be retired and replaced with a new currency cost.

According to former PM Dr. Man Mohan Singh "Demonetization is not an appropriate response to black money issue. The answer to black money problem was to simplify our tax, land registration and the administration systems. That was the only way in which the country move forward in a society where there was less role for black money generation. Demonetization had caused a lot of distress to farmers, small industrialists and many people died while standing in queues in front of banks to get cash because of the ban of Rs 500 and 1000 currency notes last year."

Demonetization has put the economy in a state of stagnation. There are people who believe that the economy will soon recover its normal speed but my own feeling is that the next one year the economy will remain in the doldrums and, therefore, demonetization has harmed the process of economic development to that extent.

Nobel laureate Richard thaler thinks that the Indian governments decisions to demonetize high value currency notes was a good concept but its implementation was "deeply flawed" He further says that the move to introduce Rs. 2000 notes during the remonetisation exercise was "puzzling" and undercut the purpose of noteban, considering that it aimed to crack down on the parallel economy and transform India into a less-cash society.

### **4. DEMONETIZATION AND HIGHER COST BLEED SMALL FINANCE**

One year since demonetization, micro finance institutions and even those that have turned into small finance banks are still reeling under the blow.

Microfinance institutions (MFI) turn into small finance banks, have now realized that it didn't guarantee smoother business, Instead things seen to have forgotten worse for them.

Eight out of the 10 who got a license have begun operations now. The latest being AU small finance Bank in September 2017.

Equals Holdings which changed itself to a small finance bank in 2016 the first to become one has seen its profits come down to first a shadow of what it used to make as an MFI. For the September quarter this fiscal, equities reported a net profit of Rs 10.9 crore a silver of the Rs 61.17 crore it had made in June 2016 as an MFI. Its Micro credit disbursements dropped by 27%.

Ujjvan financial services that holds Ujjvan small finance Bank reported a loss of Rs 11.95 crore for September quarter this year made a lot cry from the profit of Rs 73.01 crore it had made in last year. Ujjvan had morphed into a bank in February 2017. AU small finance Banks net profit was 21% lower than what it made as an MFI two quarters ago.

In all respects demonetization as lethal as Andhra Pradesh state's clamp down in 2009. One year since the purge of cash, MFIS and even those that have turned into small finance banks, are still reeling under the blow. One of the main bruises was the surge in bad loans. Gross bad loans have swelled to about Rs 900 crore for the three listed banks forcing them to make cumulative provisions of Rs 156.21 crore in the last three quarters following demonetization.

The benefits have been slower to come.

#### **5. RBI CLAIMS MAJOR DROP IN CASH PAYMENTS AFTER NOTE-BAN**

The note ban has resulted in a "fundamental shift" in the payment habits in the economy a move away from cash payments to and a wider adoption of retail electronic payments, card usage at merchant terminals and cheques, and RBI study has found that "the demonetization has impacted the inter bank payments and settlement system significantly in moving cash transactions to non-cash modes of payments in three segments-retail electronic payments, card usage at POS terminal and cheques."

As per the study, cheques volumes and values contracted during the pre-demonetization period but recorded positive growth during demonetizations as well as post-note ban months.

The increase in usage of cheques could be an effect of demonetization as cash availability was restricted and cheque become a convenient instrument to transfer funds.

There was a sharp growth in card transaction at points of sale terminals for both demonetization and post demonetization period.

#### **6. DEMONETIZATION EFFECT**

Weddings getting smaller, payments going digital

A year after demonetization, the big fat Indian weddings are being replaced with more muted and cautious ceremonies with an emphasis on digital Transaction and conservative spending. Spending is down by 30-40% and business has taken a knock.

Demonetization and GST hard Nut to crack. GST is now based on self declared tax return. The assessee decides on his own how much tax liability he has and claim input tax credit as per his own calculations.

#### **6.1 Demonetization- A historic and Multi-Dimensional success.**

- 1) India's highest ever unearthing of black money.
  - (a) 0.00011% of India's population deposited almost 33% of total cash in the country.
  - (b) 17.73 lakh cases where cash transaction did not match tax profile.
  - (c) Cash deposits of Rs 3.68 lakh crore in 23.22 lakh accounts under suspicion.
  - (d) High denomination notes brought down by about Rs 6 lakh crore.

- 2) Decisive blow to terrorism and naxalism.
  - (a) Stone- pelting incidents in Kashmir reduced by 75%.
  - (b) Incidents of left wing Extremism down by more than 20%.
  - (c) 7.62 lakh counter feet notes detected.
- 3) Massive cleaning of India's financial system.
  - (a) Maze of shell companies dealing in black money and hawala Transactions uncovered.
  - (b) In a surgical strike on shell companies, 2.24 lakh companies struck off.
  - (c) 58000 bank accounts belonging to 35000 companies caught transacting Rs 17000 crore after demonetization.
- 4) Big push towards formalization, better jobs for the poor.
  - (a) Direct transfer of salary into bank account for the workers.
  - (b) 1.01 crore employees enrolled with EPFO.
  - (c) 1.3 crore workers registered with ESIC, thus, bringing social security and health benefits to them.
- 5) Unprecedented increase in tax compliance due to demonetization.
  - (a) New tax payers increased by 26.6% from 66.53 lakh in 2015-16 to 84.21 lakh in 2016-17.
  - (b) Number of e-return filed increased by 27.95% from 2.35 crore in 2016-17 to 3.01 crore in 2017-18.
- 6) Cleaner economy for the Nation through 'Less Cash' behavioral shift.
  - (a) In August 2017, number of digital Transactions stands at 138 crore against 87 crore in August, 2016, an increase of 99%.
  - (b) From having a total of 15.11 lakh POS machines till demonetization, more than 13 lakh POS machines were added just in 1 year.

## 6.2 Positive Effects of Demonetization

A significant new study has found that 63% of retailers in the country side may be inclined to use the cashless system of payment.

The study reports a marked jump in the number of rural consumers willing to use mobile payments post- demonetization on par with true than urban counterparts. In locations with moderate consumption levels there is also a significant increase in shops that are prepared to pay a transaction charge in excess of 1%.

## 7. ADVANTAGES OF DEMONETIZATION

The advantages of demonetization areas follows:

1. **Black money tracking:** This move will help the government to track unaccounted black money or cash on which income tax has not been paid. Individuals who are sitting on a pile of cash usually do not deposit the amount in the bank or invest anywhere as they would be required to show income or submit PAN for any valid financial transaction they would hide it somewhere and use it as and when necessary. Banning high value currency will impact people who will have no option but to declare income and pay tax on the same as destroy the cash somehow it is not positive to hide the money as the notes have been declared invalid.

2. **Reduction in illegal activity:** Banning high value currency will halt illegal activity as the cash provided for such activities has no value now. Black money is usually used the illegal activity, terrorism and money laundering.
3. **Tax payment:** Most of the businessman who have been hiding some income are ready to pay advance tax as current years income. Tax payers who have been hiding some income can come forward to declare income and pay tax on the same. Individuals are required to submit PAN for any deposit above Rs 50000 in cash which help tax department to track individuals with high denomination also deposit up to Rs 2.5 lakh well not come under income tax scrutiny.
4. **Financial Inclusion Jan Dhan Yojana:** Now individuals are depositing enough cash in then JAN DHAN accounts while they well reluctant to do so few days back the account deposited can be used for the betterment of the country.
5. **Elimination of counterfeit currency:** By demonetizing the highest currency notes India could almost eliminate 100% fake currency out of circulation in one stroke.
6. **Abolish black money:** People having black money generally keep their black money in highest denomination using currency notes. This step would abolish black money from the economy as the owners will not be in a position to deposit the same in the banks.
7. **Strengthen Indian banking system:** This will automatically lead to more amounts being deposited in savings and current account. Cash lying out of economy flow is now coming into circulation. This in turn will enhance the liquidity position of the banks which can be utilized further for lending purposes.
8. **Deflation:** Price level is expected to be lowered only marginally and temporarily due to moderation from demand side. Small vendors who generally deals in cash would now start using cashless modes for transaction or digital methods.
9. **Price cut in real estate:** From the step of demonetization almost - all that black money would get out of circulation from this sector. Eventually the sky touching prices of properties will come down to the reach of a common man.
10. **This step will make rupees strong:** Currency exchange rate of any country depends upon reserve assets which includes a country holding of foreign currency and deposits securities gold IMF and other special drawing guides (SDRs) reserve positions and other readily available claims.
11. **A speed breaker for corruption:** This step of government well subdue corruption upto a certain level and for a considerable time period which in return will attract foreign investor to Indian market has been the first choice of investor considering its large size and huge number of consumers. Till now they were reluctant to invest in Indian market because of prevalent corruption and Red tapism. Now we can say that India has overcome both the business.
12. **Bank rate cut:** Larger the money in circulation result in better the conditions of banks. Now banks no longer for a considerable time from now face liquidity issue. They will result into lower bank rates we advantages have to pay less interest on EMIs.

## 8. DISADVANTAGES

Apart from disadvantages are as follows:

1. **Adverse impact on informal sector-** Player of informal sector as they mainly deals in cash only are saving tough time due to this demonetization scheme already sudden removal of cash from market put their business on a dormant phase.
2. **Plight of Primary producers-** Lack of liquidity would result in distress to primary producers who don't have much money, so that they could hold their produce for long and on the other side due to lack of currency in flow they are afforded very less by the buyers in the market.
3. **Non- acceptance of old currency regardless Government orders-** Many prescribed business houses and establishment are not accepting old currency notes from common people thus leaving them helpless. The fact that such people have no remedy against such people/business houses make the situation worst. Milk Bottles, chemists, Petrolpumps and safal stores etc are among others. These are dealing with basic necessities of common people.
4. **Positively of breaking Riots-** There are many antistate elements present in the society who are trying to spread unrest in the society. They can exploit the situation and incite those disheartened people to make a platform to break riots.
5. **Excessive burden on bank employees-** This is a clear fact that there is an excessive burden on bank employees to cope up with the situation and after working so hard they are not able to satisfy the need of people.
6. **Decrease in Demand-** This is a fact that black economy do support the real economy from demand side, that is to say that black money used by the consumers to buy goods or services increase demand for those.
7. **Violation of rule by general public-** Many people are entering ATM's and using 3-4 different ATM cards and withdrawing 4X cash than the limit prescribed by the government.
8. **Chances of incarnation of Defacto currency-** Defacto currency is the currency that is not recognized by the government as legal tender, but is accepted by a majority of population. The US Dollar for example is accepted in Combodia as a defacto currency.

## 9. CONCLUSION

Demonetization is forcing the declaration of hoarded black money. The goods and service tax will also remain till the scale against tax evasion. Demonetization of old currency notes surely has had some positive impact like reducing the cash flow to terror organizations, dismantling of counterfeit currency infrastructure, better income tax and indirect taxation boost to digital economy. However, it has come at a huge social and economic cost.

Demonetization costs are estimated at Rs 1.28 lakh crore to the economy for the 50 days time period till the end of depositing period of old currency. This includes a cost of Rs 17,000 crore towards the government and the RBI for implementing the demonetization process in India.

Demonetization is one time event and will not have much long-term effect. It alone is not sufficient to counter black money and corruption in the country rather other measures are more crucial like bringing the off shore tax evaders to book whose names figures in the Panama papers, raid on benanai properties, making donations to political parties open to public scrutiny and

making it mandatory for all donations above Rs 2000 to political parties and religious places to be through digital means only.

This entire exercise seemed more like a carpet bombing than a surgical strike where the vast majority of honest and law abiding citizens had to undergo terrible hardships in order to cash the few black sheep who have hoarded black money and who also managed to convert their black money into white.

#### **FUTURE SCOPE**

This study is of great important today and also in future because no one can keep black money in high denomination notes and also not use it for doing harm to the nation.

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