



EFFECTS OF DEMONETIZATION ON DIFFERENT SECTORS OF INDIAN ECONOMY: A DESCRIPTIVE STUDY

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ABSTRACT

One of the courageous steps of 21st century was declared on 8th November 2016 by Hon'ble Prime Minister Mr. Narendra Modi. It was the discontinuance of currency notes of the denomination of rupees 500 and 1000. The reason behind this boldness was to fight against black money, counterfeit notes, terrorism, to control inflation and corruption in Indian economy. The demonetisation policy is regarded as a financial reform in the country. It is treated as a cleansing action for economic growth. It was one of the largest cleanliness drive in the Indian economy. It may have a positive impact on prosperity of the economy but it created chaos among the all the sections of the society. This paper is an attempt to analyse the impact of demonetisation on various sectors of the Indian economy.

Keywords: *Demonetisation, Liquidity, Counterfeit notes, Digital payment, Black money*

1.1 INTRODUCTION

Demonetization is a process of removing the currency from the general use or distribution. The dictionary meaning of demonetize is to withdraw money from use. It is started to replace the old currency with a new one. Demonetisation occurred on 8th November 2016 is not first for the Indian economy. The first demonetisation was happened on 1946 when 500, 1000 and 10000 notes were declared as illegal tender. Again on 1978 under Janata Dal (Morajai Desai leadership), demonetisation was occurred. Both in both case demonetisation was not successful at that time. Finally on 8th November 2016 at 10 p.m. our honourable Prime Minister Narendra Modi announced that on the stroke of midnight all 500 and 1000 rupee notes which constitutes around 86 percent of the total currency circulation would cease to become legal tender. According to the RBI data on 28 October 2016 the total currency circulation in India was rupees 17.77 lakh crore. And also the RBI report showed that on 31st march 2016 the total bank notes circulated all over India was valued rupees 16.42 lakh crore. This measure has been taken by prime minister Narendra Modi is an historical step of the Indian economy to fight against black money and terrorism.

The basic objectives of demonetisation is to bring out the black money, to fight against corruption, to boost the economy, to curb fake notes and also to promote digital and cashless economy. After demonetisation the GDP growth was expected to negative for around six months and also it went down from 7.6 percent to 7.1 percent for the financial year ending March 2017. But now according to the recent economic survey in India there is an improvement in the GDP growth rate i.e. 6.75 percent in the current fiscal year and also IMF projects India to grow at 7.4 percent in 2018 and 7.8 percent in 2019. So the economy should grow between 7 percent and 7.5 percent in the next fiscal year starting 1st April 2018. Till, demonetisation, most of the transactions in India were being done in cash and many traders did not have bank accounts. So due to demonetisation there is a significant boost in financial inclusion by increasing the number of bank account holders. Demonetisation also has brought a great revolution in the field of digitalisation and also in boosting the number of tax payers. It is seen as a cure for corruption and achievement of clean growth.

1.2 REVIEW OF LITERATURE

Rani & Kumar (2017) studied to analyse the impact of demonetization on different sectors of the economy as well as the future impact of demonetization of Indian economy. The author mainly used secondary data for the research purpose which were collected from various journals magazines and newspapers. The findings of the paper showed that demonetisation in Indian economy had negative impact on different sectors of the economy, most of them are short run in nature on the other hand people were also facing problems in the exchange of currency notes even the people were facing such type of problems still they reacted positively towards the problems. At last the author suggested that if the government successfully cleared all the problems, drawbacks associated with the demonetisation, this demonetisation become successful economic revolution in India and can expect a better tomorrow with corruption free India.

Dagar (2017) studied to analyse the impact of demonetization on Indian economy and also to work out the experiences the impact of demonetization on various countries in the past years. He basically used secondary data which were mainly obtained from magazines, journals and newspapers. He concluded that there were both pros and cons of demonetization. That was like a refresh button in the Indian economy and flushed all the dead deposited money into the economy, to the market through proper channels. The effort was for going cash less transactions and many e-wallet companies like Paytm etc. However, the effects of change were emergent from the system itself and cannot be determined beforehand. Hence we can only speculate future macroeconomic effects of demonetization. The author suggested that there was an acute need of educating people about various alternatives available in the market and making the online transaction.

Ganesan & Gajendranayagam (2017) studied to understand the implications of demonetization on various sectors to analyse the impact of demonetization on Indian economy. The study was diagnostic and analytical as well and secondary data were used for the purpose of analysis. Main source of data had been collected from the Central Statistics Office (CSO) and supporting information is taken from the facts released by Reserve Bank of India (RBI) and different websites relating to it. The collected data were analysed with paired sample t - test and regression analysis so as to understand the immediate effect and to measure its impact on Indian economy. The present study showed the impact of Demonetization on different sectors of Indian economy. The gross value added of India is slightly decreasing as compared to the previous years, but during the current financial year the half yearly data were in increasing trend. As per the t-test analysis the positive effect of demonetization between the pre and post period had no significant difference in short term.

Preethi & Sangeetha (2017) studied to analyse the impact of demonetization on Indian economy. The author mainly used secondary data for the research purpose. The demonetization move had created chaos in every strata of the society whether upper, middle or lower. This is because, India is cash based economy and demonetization temporarily decreased the liquidity position. Decreased liquidity leads to less demand which in turn results in low productivity causing a slowdown in consumer market. Without adequate and proper planning, the demonetization-driven cash crunch had rendered Indian economy paralyzed at least for short duration. It had affected the informal sector where cashless transactions were minimal. .

Dash (2017) studied to know the socio economic effect of demonetisation in India. The author mainly used secondary data which were collected from various journals, magazines and websites. The author concluded that the impact of demonetisation was felt more in the social sector and the worst affected was also the poor and common people. Salaried class was not still able to withdraw their salaries from the banks and ATMs as a result of cash deficit. Prime Minister Modi had encouraged doing financial transactions using mobile and other electronic means. It was clearly evident that India was moving towards a cash less economy. That would curb the black money. This will create a positive impact on the social sector in the long run.

Katnal (2017) studied to know the currency system in India as well as to review the Pros & Cons of demonetization in India and lastly to analyse the impact of demonetisation on Indian economy. The demonetization undertaken by the government was a large shock to the economy. The impact of the shock in the medium term was a function of how much of the currency would be replaced at the end of the replacement process and the extent to which currency in circulation was extinguished. While it argued that the cash that would be extinguished would be “black money” and hence, should be rightfully extinguished to set right the perverse incentive.

Ramdurg & Basvaraj (2016) assessed how the tool of demonetization can be used to eradicate parallel economy. Demonetization is one of the big steps initiated by Government in addressing the various issues like black money, counterfeit currency, corruption, terrorism etc. History of demonetization in India and around the world was also addressed. Here the author mainly used secondary data for the study which were obtained from journals, newspapers. Demonetization obviously brought many inconveniences to common people but that was for only short term. However the long term benefits of demonetization overrides the short term challenges.

Mohd (2016) studied the effect of demonetization after the announcement and also studied its needs and challenges faced by the society he used secondary data for the study which were collected from newspapers and websites, he concluded that apart from disrupting daily lives of the common citizens, there were even bigger implications for the economy as a whole. Same was the case with the sectors such as real estate. The rural areas in particular, which did not have formal sources of banking also dealt largely with cash. Unorganised labour, including in urban households, such as domestic workers and drivers were paid in cash, and mostly in those denominations. That was Modi’s biggest move since he was elected as the prime minister.

Singh & Singh (2016) studied to analyse the current and immediate impact of demonetisation of Indian economy at the same time the research papers also aimed to study the experience of the impact of demonetisation of various countries in past years and also to work out the probable consequences of the demonetization. The paper was mainly based on secondary data which were collected from internet. The author also used graph and percentile method in order to analyse the data. The author concluded that if its short term impact were considered then it was seen that there was a disruption in the current liquidity situation as households were likely to get affected by the note exchange term laid by the government and also the paper showed that there will be a negative GDP impact in the current quarter as consumption gets a shock in the immediate term.

Gajjar (2016) studied the present status of black money in India and its future challenges. He also aimed to understand the sources of black money, to show the flow of black money in market, to know about the problems of layman with reference to black money and lastly to analyse the solution for decrease in black money. He basically used secondary data for the research purpose which were mainly collected from newspapers magazines and various websites and journals. And the findings of his study showed the frame work, policy option and strategies that Indian government should adopt to tackle with this issue and also describe the future challenges to be faced by the government and lastly the paper showed the main reasons behind the generation of black money, the ongoing issue of black money in our country and its future course of action.

1.3 OBJECTIVES OF THE STUDY:

The present research has the following objectives:

1. To study the causes of demonetization in India.
2. To analyse the impact of demonetisation on Indian economy.
3. To understand the result of demonetisation on various sectors.

1.4 RESEARCH METHODOLOGY

The present research paper is descriptive in nature. The study is mainly based on secondary sources data like research journals, articles and different websites relating to the subject matter.

1.5 DEMONETIZATION

Demonetization is the act of removing a currency unit of its status as legal tender. It occurs whenever there is a change of national currency. In case of demonetisation, the current form or forms of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes, a country completely replaces the old currency with new currency.

Features of demonetization

- i) To fight against inflation
- ii) To tackle with corruption as well as crime
- iii) To discourage a cash-dependent economy
- iv) To facilitate trade

Demonetisation in India

The Indian government decided to demonetize the 500- and 1000- rupee notes in 2016. The two biggest denominations in its currency system; these notes accounted for 86% of the country's circulating cash. India's Prime Minister Narendra Modi announced to the country on Nov. 8, that those notes were worthless. Effective immediately – and they had until the end of the year to deposit or exchange them for newly introduced 2000 rupee and 500 rupee bills.

1.5.1 Causes of Demonetisation

The reasons behind such an adventurous step like demonetisation in India are black money, fake currency, currency storage and most importantly, corruption. The use of high denomination notes for storage of unaccounted wealth has been evident from cash recoveries made by law enforcement agencies from time to time. These notes are known to facilitate generation of black money. In this connection, it may be noted that while the total number of bank notes in circulation rose by 40 per cent between 2011 and 2016, the increase in number of notes of Rs.500 denomination was 76 per cent and for Rs.1000 denomination was 109 per cent during this period. According to the data of Swiss Bank in 2011, India has been topped the list with almost \$1500 billion of its black money deposited with them. The amount of black money is increasing year to year significantly (Ramdurg and Basavaraj, 2016). The rationale behind 2016 demonetization in India was mainly to eliminate counterfeit currency, to shrink the size of the parallel economy and black money in India, to reduce corruption and lastly to curtail terror financing. A parallel shadow economy corrodes and eats into the vitals of the country's economy. It generates inflation which adversely affects the poor and the middle classes more than others. It deprives Government of its legitimate revenues which could have been otherwise used for welfare and development activities. So, in order to curb the menace of black money, various measures have been taken by the Government which includes,

- Constitution of a Special Investigation Team (SIT) under the Chairmanship of a former Supreme Court Judge B.P. Jeevan Reddy and implementing some of its recommendation.
- Enactment of a new law viz., 'The Black Money and imposition of Tax Act, 2015' to deal with black money stashed abroad.
- Introduction of 'Benami Transactions Amendment Bill 2015' enabling confiscation of Benami property.
- Enhancing the sharing and exchange of information with foreign countries and proactive involvement in international efforts to combat tax evasion/black money.
- Introducing Income Declaration Scheme, 2016.
- Use of information technology for mining of information.
- Prescribing requirement of PAN numbers on high value transactions.

- Taking action again hoarders through enforcement agencies, and
- Constitution of Multi Agency Group with members (investigation) of CBDT for speedy investigations against Indian persons having undisclosed foreign assets.

1.5.2 Effect Demonetisation on the Indian Economy:

The demonetisation resolution was not very welcoming. It not only slowed down the economic growth of various sectors, but also gave people nightmares of waiting in long queues in both banks and ATMs. The common was become unable to spend cash freely. Now, the effect may have somewhat reduced but the Indian economy is still struggling a little to cope with it. On the bright side, demonetisation curbed the black money and also making India cashless and digital. The effect of demonetisation on different aspects of the economy are as follows:

Tax Payments:

Demonetisation resulted in more deposits in the accounts and also the tax payments in the country. As per government reports, the Indian economy witnessed an 80% rise over the normal yearly rise which meant 9.1 million new tax payers into the slab in the post demonetisation era. There was also a small rise in the filing of income tax returns and payment of advance tax.

Black Money:

Demonetisation was not liked by almost all the sections of the society. But the one reason that pushed people to support this reform was the end of black money problem. Black money is one of the most important reasons for the slow growth of Indian economy. People who possessed huge amount of black money were forced to deposit the money as they became a pile of trash.

Personal Finance:

Demonetisation turned the piggybanks of people into account deposits. Public tried to raise their bank balances instead of stashing it for emergency. One of the remarkable effects of demonetisation is that people started believing and making digital payments and because of the revamped currency system common man started to use their idle cash balance by investing it in a productive way. Finally, people have started accepting plastic money and became tech friendly.

Terror Funding:

Curbing terrorism by obstructing terror funding was the second reason people supported demonetisation. It is well known that terrorist organisations use fake Indian currency notes for funding their projects and during the demonetisation period the Income Tax department seized Rs. 474.37 crore in new and old currency. Although it was not clear if this money was associated with any terror group. But, there is no doubt that the cash reserves of various terror groups were severely hurt during the early period of demonetisation.

Digital India:

Another reason for demonetization was to make India a cash less economy. Before the dawn of demonetization there were less number of digital transactions. But after the economy was demonetized people started making more digital transactions for everything from buying groceries from a road side vendor to paying utility bills. There was a surge in digital transactions and use of cards instead of cash. Now, the situation has been reversed. People are accepting paperless transactions and also using apps & e-wallets to deal with their daily transactions. The economy is surely moving towards a cash less economy.

GDP:

One of the key contributors to the economic downturn was the ban on old notes. The fact that demonetization slowed the economic growth cannot be ignored. The World Bank has reduced the India GDP growth forecast to 7% for 2017-18 owing to demonetization and GST (Goods and

Service tax). The slowdown is one of the delayed consequence of demonetization and while there are various other reasons at play, the steep decline has been credited to be an effect of demonetization.

1.5.3 Impact of Demonetisation on Various Sectors of Indian Economy:

1. Agriculture and Related Sectors

Basically in agricultural sectors high cash transactions are involved so this sector has been affected mostly due to shortage of cash. The farmers could not be able to make payment in time due to shortage of cash, which would hurt various related companies in the short run. In 2014-2015 the agricultural growth in India was 0.2% and grew no more than 1.2% in 2015-2016 due to droughts and other reasons. As per CRISIL report it was expected to grow 4% in the year 2016-2017, but due to demonetisation the farmers could not be able to buy seeds, fertilizers, equipment and wage payments to workers, only because of cash shortage. Daily transport system has also been affected for shortage of cash and which was result in 25% to 50% reduction in sales. The agriculture sector was mainly affected due to the following reasons i.e. farmers are not educated and aware about how to work on e-payment system, and in most of the villages proper banking system is not developed yet and villagers are need to go to cities for the same. According to the RBI data 8% of the total population do not use interest in which almost 80% to 85% are farmers.

2. Service Sector

According to Nikkei India on November 2016, the service business activity index sharply fell to 46.7 from 54.5 in October due to demonetisation. The index has registered a contraction for the first time since June 2015 and marked the sharpest reduction in output in almost three years, leading to a solid reduction in activity. According to Nikkei six service related sub sectors are mostly affected. Financial intermediation, hotels, restaurants and renting and business activity showed a decrease in the activity. According to the PMI figure the Indian service sector shows that companies were heavily impacted by the 500 and 1,000 rupee notes ban. Furthermore, the currency scarcity also weighed on manufacturing performance where growth of new work flows slowed.

3. Banking Sector

Boost in Deposits

Due to demonetisation the amount of deposits in banks has been increased to a great extent. The size of bank deposits increased due to flow of the unaccounted money in the form of 500 and 1000. It helped the banks to take the deposits and increase their deposits. Loans and advances extended by banks increased by Rs. 1008 billion. The incremental credit deposit ratio for the period was only 18.2 per cent. The commercial banks mobilised their additional deposits by deploying them in liquid assets.

Cost of Funds Declined

Due to demonetisation the deposits were increased. So it led the banks to keep a major part of deposits in the form of cash deposits. PSU Banks have a lion share (over 70%) of the deposits and biggest gainers of the rise in deposits, leading to lower cost of funds.

Demand for Government Bonds

After demonetisation there was a sharp rise in deposits. So the banks started lending such surplus deposits to the RBI under the reverse repo options. PSU Banks, particularly, invested the excess funds in government bonds. There is a return on bond investment is likely to add 15 to 20 per cent increase in the earnings of banks.

Hang Down in Lending

Even after demonetisation the lending growth of banks was considerably less. Banks have tried to lend the money to the needy group by reducing their interest rates, but it shrunk over the last few months.

4. Automobile Sector

The automobile sector has also been affected due to demonetisation. The sale of two wheelers, commercial vehicles and tractors has been declined due to demonetisation. Almost 60-70% of two-wheeler sales in India are done in cash, and most of those transactions happen in rural India. Remonetization is happening at a far slower pace among India's rural and semi-urban areas as compared to its larger cities. Demand for Commercial vehicles short-term, mainly due to cash shortage in India's rural areas as well as urban areas. Passenger vehicles segments largely unaffected by Demonetization.

5. Retail Sector

The retail sectors has also been effected due to lack of sufficient liquidity in the economy in the short term. But mainly the small traders and the unorganised retailing segments like low cost retailers such as local small vending shops, owner manned general stores, pan and beedi shops, convenience stores were effected to a great extent due to insufficient liquidity. But the effect of demonetisation was considerably less on organised retailers like reliance retail, big bazar etc. Pankaj Mohindroo, national president of the ICA, said the drop has been in the range of 40-60 percent in different markets. The impact has been more in rural areas and relatively less in urban areas.

6. Textile Industry

Approximately there was 40-60 percent drop in sale after demonetisation in case of textile industry. But from December onwards that drop was slightly declined but still the impact of demonetisation affected the industry in 2017 also for at least 3 to 4 months.

7. FMCG Products

Due to demonetisation there was a short term shortage of cash in the economy so the consumers only purchased those products which were necessary for daily consumption and mostly the small traders like thela wala, small vendors. These small vendors basically do their business on cash basis, but due to demonetisation their daily sales dropped down to 20 to 30 percent.

8. Real Estate

The demonetisation also effected the real estate market. There was 50 percent drop down in this sector for further 5 to 6 months after demonetisation.

9. E-Commerce

In the few weeks after demonetisation, the gross merchandise value of retail market fell by 40 to 50 percent. High value items like smart phones were sold less. Products returned were up by 50 percent. Due to cash crunch after demonetisation the total sales were declined in e-commerce business like flipkart, amazon etc.

10. Tourism

Demonetisation badly hit the pic tourism period of November and December. For tourist destination beyond metros business may be down by 40 percent and tourism business in metros may go down by 10 percent. Cash shortage in airports and hotels are a big problem. Many national monuments entry points do not have card payment facilities. So the tourism sectors was also affected considerably due to demonetisation.

11. Aviation Sector

In aviation market the growth fell below 20 percent from an average 23-24 percent growth recorded in the previous year. Flight bookings dropped drastically after demonetisation. It also hit the offline travel agents, who took cash. Flight to small towns, where cash payments are the norm, are also badly hit, may post negative growth.

12. Telecom Sector

Mobile phone shipments fell by 26 percent in November, compared to the previous month. Smart phone shipments are down by 23 percent. Big sellers who do card and online transactions less badly hit. IDC analysts expect sales for feature phones to drop by 25 percent in the quarter, and smart phones to fall by 17.5 percent.

1.6 CONCLUSION:

The Indian economy is mainly based on cash system. The liquidity position of the economy has been temporarily slowed down due to the demonetisation. The demonetisation has created many difficulties in every strata of the society whether upper, middle or lower. Due to decreased liquidity the demand has been declined and that leads to low productivity and causing a slowdown in consumer market. Without any proper planning the demonetisation-driven cash crunch has rendered the Indian economy paralysed for a short period it has affected basically the informal sectors like agriculture, transport service small workshop, where cash less transaction are minimal. However the demonetisation move by the government will hamper the economic growth for three to four quarters of the financial year, but it would be beneficial for the economy for run. Unless the prime objective of demonetisation i.e. curbing black money and counterfeit notes is achieved the long run benefits would remain a distant dream, the success of demonetisation depends upon the efficiency of the government and administration of the country in eradicating corruption.

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