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## Impact of Demonetization on Indian Economy

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### **Abstract :**

Demonetisation means withdrawing the legal tender rights of any denomination of currency. Units of money have underprivileged the status of legal tender. Demonetisation is an act of taking away the legal tender rights of any currency. The units of currency will not be considered as valid currency. Demonetisation is the process of ceasing a unit of money of its status as legal tender. This paper focuses on the impact of demonetization on Indian Economy.

*Keywords : Demonetization, Indian Economy, currency*

### **Introduction :**

Demonetisation is the landmark in the history of the Indian economy. It was an experience which might create fear in the minds of the people who pamper in illegal activities like tax evasion or money laundering of any kind.

On November 8, 2016, the Indian government declared that the 500 and 1000 rupee notes will be stripped of their status as legal currency effective from midnight. These notes accounted for 86 percent of the country's cash supply by value. Citizens were given time till December 31, 2016 to credit their old currency notes and exchange them for the new currency notes of rupee 500 and 2000. The government's aim was to root out counterfeit currency, fight tax dodging, curb inflation, eliminate black money and terror-funding, and to promote a cashless economy.

When a currency note of a specific denomination ceases to be a legal tender, it is termed as demonetisation. Legal tender refers to money which can be legally used to make payments of debts or other responsibilities. A creditor is obliged by law to receive such money in payment of due debt to him. The demonetization had impacted largely on the Indian Economy along with the common man. There were many implications of demonetization in the overall Indian Economy.

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## Demonetization

On 8 November 2016, the Government of India announced the demonetisation of all ₹500 and ₹1,000 banknotes of the Mahatma Gandhi Series. It also announced the issuance of new ₹500 and ₹2,000 banknotes in exchange for the demonetised banknotes. Prime Minister Narendra Modi claimed that the action would curtail the shadow economy and reduce the use of illicit and counterfeit cash to fund illegal activity and terrorism.

The announcement of demonetisation was followed by prolonged cash shortages in the weeks that followed, which created significant disruption throughout the economy. People seeking to exchange their banknotes had to stand in lengthy queues, and several deaths were linked to the rush to exchange cash.

According to a report from the Reserve Bank of India, approximately 99.3% of the demonetised banknotes, or ₹15.30 lakh crore (15.3 trillion) of the ₹15.41 lakh crore that had been demonetised, were deposited with the banking system. But the banknotes that were not deposited were worth ₹10,720 crore (107.2 billion), leading analysts to state that the effort had failed to remove black money from the economy. The BSE SENSEX and NIFTY 50 stock indices fell over 6 percent on the day after the announcement. The move reduced the country's industrial production and its GDP growth rate.

Initially, the move received support from several bankers as well as from some international commentators. The move was also criticised as poorly planned and unfair, and was met with protests, litigation, and strikes against the government in several places across India. Debates also took place concerning the move in both houses of Parliament.

## Indian Economy

The economy of India is characterised as a middle income developing market economy. It is the world's fifth-largest economy by nominal GDP and the third-largest by purchasing power parity (PPP). According to the IMF, on a per capita income basis, India ranked 142nd by GDP (nominal) and 124th by GDP (PPP) in 2020. From independence in 1947 until 1991, successive governments promoted protectionist economic policies with extensive state intervention and regulation which is characterised as Dirigism. The end of the Cold War and an acute balance of payments crisis in 1991 led to the adoption of a broad program of economic liberalisation. Since the start of the 21st century, annual average GDP growth has

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been 6% to 7% and from 2014 to 2017, India was the world's fastest growing major economy, surpassing China. Historically, India was the largest economy in the world for most of the two millennia from the 1st until 19th century.

The long-term growth perspective of the Indian economy remains positive due to its young population and corresponding low dependency ratio, healthy savings and investment rates, and is increasing integration into the global economy. The economy slowed in 2017, due to shocks of "demonetisation" in 2016 and introduction of Goods and Services Tax in 2017. Nearly 60% of India's GDP is driven by domestic private consumption and continues to remain the world's sixth-largest consumer market. Apart from private consumption, India's GDP is also fuelled by government spending, investment, and exports. India was the world's tenth-largest importer and the nineteenth-largest exporter. India has been a member of World Trade Organization since 1 January 1995. It ranks 63rd on Ease of doing business index and 68th on Global Competitiveness Report. With 520 million workers, the Indian labour force is the world's second-largest as of 2017. India has one of the world's highest number of billionaires and extreme income inequality. Since India has a vast informal economy, barely 2% of Indians pay income taxes. During the 2008 global financial crisis the economy faced mild slowdown, India undertook stimulus measures (both fiscal and monetary) to boost growth and generate demand; in subsequent years economic growth revived. According to 2017 PricewaterhouseCoopers (PwC) report, India's GDP at purchasing power parity could overtake that of the United States by 2050. According to World Bank, to achieve sustainable economic development India must focus on public sector reform, infrastructure, agricultural and rural development, removal of land and labour regulations, financial inclusion, spur private investment and exports, education and public health.

### **Impact of Demonetization on Indian Economy**

**On Gross Domestic Product (GDP):** The Indian economy is a cash-driven economy and demonetisation has largely affected its growth. The GDP growth rate of 8.01% in 2015-2016 fell to 7.11% in 2016-2017 after demonetisation. 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 holders demand large sums of cash.

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**On Daily Wage Workers:** A major portion of the Indian workforce is a part of the informal economy. They use cash to meet all their expenses and demonetisation has resulted in a lot of them losing their jobs due to unavailability of cash. According to CMIE's Consumer Pyramids Household Surveys (CPHS), approximately 1.5 million jobs were lost during the final quarter of the financial year 2016-17. The estimated employment during this period was 405 million as compared to 406.5 million during the previous four months.

**On Small Scale Industries:** Businesses like the textile industry, salons, restaurants, and seasonal businesses are low capital enterprises and work on the basis of liquidity preference. Demonetisation gravely impacted their revenue collection and threatened their existence to an extent.

**On Black Money:** Though only a small portion of black money is stored in the form of cash and majority is in the form of physical assets like gold, land, and building, demonetisation of the rupee 500 and 1000 notes might take out a lot of black money from the economy.

**On the General Economic Situation:** Till months after demonetisation 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.

**On Inflation:** The Reserve Bank of India (RBI) considers the Wholesale price index (WPI) and the Consumer Price Index (CPI) to measure inflation. Demonetisation is expected to reduce inflation as consumers have cut down on spending and aggregate demand has considerably fallen. According to government press releases, the official WPI for 'All Commodities' (Base: 2004-05=100) for the month of December, 2016 declined by 0.2 percent to 182.8 (provisional) from 183.1 (provisional) for the previous month. The index started rising during the month of January and rose by 1.0 percent to 184.6 (provisional) from 182.8 (provisional) for the previous month. This may be correlated with the availability of cash with people which led to increased spending.

**On Terror Funding:** Demonetisation was aimed as a clean-up of the economy where Fake Indian Currency Notes (FICN) would be checked. It is aimed at rendering all fake notes of rupees 500 and 1000 useless and thus drastically affecting illegal funding of terror groups in Jammu and Kashmir, states in the North-East, and Naxalism-influenced states.

**On Political Parties:** Many Political Parties use large amounts of undeclared cash to campaign for elections and meet other requirements. Due to Demonetisation such acts might get restricted to an extent and parties will have to formulate new strategies.

**Towards a Digital Economy:** Absence of liquid cash has led to people making transactions using cheques or account transfers. They have also switched to virtual wallets like Paytm which allows electronic transfer of money. All this might result in a digital economy where transactions are being recorded and the economy has more white money. This might increase the government's tax revenue.

### Quantitative Analysis Of The Impact Of Demonetisation On The Indian Economy

**Table 1: Macro-Economic Aggregates at Constant Prices  
(Base Year: 2011-12; Amount in Rs Billion)**

Year	GVA at Basic Prices	Consumption of Fixed Capital	NVA at Basic Prices	Indirect Taxes Less Subsidies	GDP at Market Price	NDP at Market Price	GDP Growth Rate
2011-12	81069.46	9171.75	71897.71	6293.83	87363.29	78191.54	6.5
2012-13	85462.76	10106.61	75356.14	6667.41	92130.17	82023.56	5.46
2013-14	90636.49	11006.1	79630.39	7377.21	98013.7	87007.6	6.39
2014-15	97190.23	11807.24	85382.99	8179.61	105369.8	93562.6	7.51
2015-16	104905.1	12641.93	92263.21	8904.88	113810	101168.1	8.01
2016-17	111854.4	13479.37	98375.03	10044.14	121898.5	108419.2	7.11

Source: Handbook of Statistics on Indian Economy 2016-17

As per the data published in hand book of statistics on Indian Economy by RBI, GDP at Market price fell approximately by 1% as associated to previous financial year. It registered a growth of 7.11 % from previous year as compared to the 8.01% growth witnessed during 2015-16. Table 1 indicates that GDP vanished its growth streak of 4 years in the financial year 2016-17. GDP growth rate increased from 5.46% in 2012-13 to 8.01% in the year 2015-16.

### Conclusion

Demonetisation has been acclaimed as well as criticised on various grounds. There has been a lot of opposition regarding the demonetisation policy. In the short run, there have been

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problems related to liquidity crisis, unemployment, loss of growth momentum, and a temporary halt to major economic activities. All this is obvious from the data provided by the RBI.

The move by the government to demonetise old currency and replacing it with the new one has taken the country by surprise and it impacted in long run on people and the economy.

The long term effects of Demonetisation are yet to be determined. It is expected that it can improve the Indian economy in the long run by increasing tax compliance, financial inclusion, consequently refining the state of the economy. It can boost the GDP by increasing the availability of funds for lending and also by reducing transaction costs if the economy moves to digital payment modes including paytm, valet, cards, etc..

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