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## **THE IMPACT OF THE POLICY DEMONETISATION ON THE INDIAN ECONOMY**

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### **Abstract**

Demonetisation is the act of suspending the current currency from circulation in the market and re-establish it with an updated currency . It can also mean withdrawal of a certain note or coin from the market. The Indian government has implemented demonetisation three times in its history in 1948 in 1976 and in 2016 ( Fatima, 2017) , however this was the biggest demonetisation recorded . On November 8<sup>th</sup> 2016 prime minister of India announced the ban on notes of INR 500 and INR 1000 from 9<sup>th</sup> November. The specified notes accounted for 80-86 % (Krishnam, Siegel (2017) of the circulating currency and as 70-80 % of the transactions in India are cash based (Krishnam, Siegel (2017) the impact it had was very big . The objective of the demonetisation was to tackle problems like counter fit bills , illegal financing for terrorist activities , reduce black money in the market and encourage the economy to move towards a cashless economy. It also had other impacts on the economy, a fall in consumer spending would reduce the inflation rates. Demonetisation will also encourage people to store their incomes and wealth in banks, as deposits will increase the strengths of lending power of banks will increase, people will enjoy lower interest rates. This paper analyses the impact that demonetisation has and how successful it was to achieve the objectives planned to achieve. The primary objective of the paper is to analyse how successful the implication of demonetisation has been and whether it has achieved the objectives it had. The secondary objective of the paper is to examine the effects of demonetisation policy in the India economy. The research is descriptive in nature and is built on secondary sources of data acquired from different Newspapers, relevant websites, books and journals for further making the research more effective. The paper uses an analytical approach throughout the paper to arrive at a appropriate conclusion. Demonetisation failed to achieve the objectives it had due to the lack of digital banking infrastructure in the Indian economy. By investing more in the strengthening of digital infrastructure the Indian government will encourage digital transactions helping India achieve the aims of demonetisation.

Keywords : Demonetisation, Black money , Currency

Literature review

Demonetisation was aimed to reduce black money and therefore lead to a reduction in terrorism financing and informal sector. In the long run government will benefit from a rise in



government revenue , because of people declaring more income than previous years. Hereafter because of an increase in bank deposits, which will increase the banks capacity to lend would strengthen the banking system of India .

Also on 23 December 2016, a month and a half after the demonetisation was announced, the currency in circulation was just around half of the pre-demonetisation level (Mazumdar 2016). There was also a significant deficit in the total amount of cash available for circulation. As a result, banks were forced to place serious restrictions on withdrawals of cash. People were permitted to withdraw no more than 2,500 rupees (~\$40) from ATMs on any given day, and the total weekly withdrawal of cash in any form (ATM, bank tell us). (Banerjee, A., & Kala, N. (2017)). The liquidity shortage that business faced that impacted their business performances , a fall in the FMCG industry and fall in the real estate market . (Uke , 2017 ) The immediate impact was on the poorer society, they were greatly impacted due to their high use of cash transactions. Amongst these, people who were self employed had seen a fall of 44 % in their incomes. The positive impact it had was that it encouraged people to store money in banks thus strengthening the power of banks to lend . ( Krishnam, Siegel, 2017 ) Past shows us that demonetisation in developing nations tend not to be successful in achieving the aims however in developed nations the policy has proved to be successful.

Black money is usually stored in the form of gold, land or foreign assets, demonetisation does not affect these markets directly therefor the impact on reduction of black money is smaller. ( Krishnam, Siegel, (2017)) Demonetisation saw government reduce subsidies and grants in the economy and greater demand shortage in the economy. ( Mahajan , Singla , 2017)

This is the first step towards a cashless Indian economy which in the long run is very beneficial but in the short run this also gives rise to security problems of net banking hacking and taking away data . Demonetization also had an effect in some of the elections making them more clean. However in the end there were still ways people found to convert black money to white reducing the successfulness of demonetisation and as result the common man had to suffer. ( Fatima 2017 ) Demonetization has encouraged people to move towards cashless transactions even small vendors now have the facility of online payment this will benefit the economy as it will become formal and transparency.

In his qualitative research study of the general public during the days of Dr. Arun Mittal (Mittal, 2017) Demonetization discovered that in the early days , people faced liquidity problems and discovered all In addition to small currency notes, potential methods of cashless transactions have supported each other .Changing their pattern of conduct in spending, such as reducing their costs and saving cash for urgent expenses.



Bhalla (2016) discusses how India's demand for physical cash is higher than Emerging Other Markets. Indeed, most big emerging economies from 2008 to 2016 There was either a constant or decreasing share of currency in the stock of money . Yet during the same time India experienced a sharp rise in currency circulation.

Demonetisation has changed the spending patterns, people tend to save more and as a result inflation rates are lower – government should maximise this by increasing the government spending on infrastructure so more jobs are created and lower interest rates which will lead to people to take more loans and invest and spend more if not this could lead disinflation / deflation . Having negative impact on the productivity of the nation will see a fall in GDP . (Vij 2018 )

#### Purpose of Demonetisation

##### 1.Reducing black money and corruption in the economy

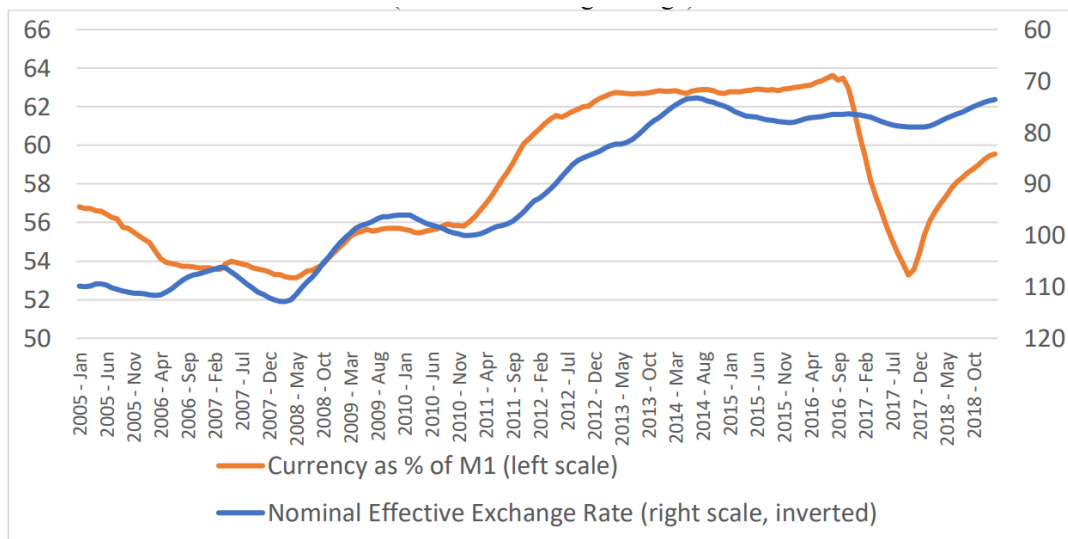
This was the government's primary objective as expressed by the government. However by analysing the study by (Prof. Arun Kumar) research about the Black Economy it shows a distinction between black money, black economy and black wealth. Targeted black money by the government only accounted for 1 % of the total black wealth in the country. (Vij 2018 ) Many reports suggested that people converted their black money by raising the wages of their staff and by depositing in some family members account breaking it into smaller chunks and also by purchasing luxury items like gold , jewels . This is backed by the fact that 15.31 lakh crore out of 15.44 lakh crore had been deposited into banks.( Economic Times India)

However further analyse is made on the effect on black money by presuming that there are two main ways that black money is stored offshore accounts and real estate.( Thiruvadanthai Bhasin 2019)The Reserve Bank of India has started creating residential property price index from 2010, the data will not be particularly accurate as recorded price will differ from the actual transaction price. Even though it is interesting to note that the proportion of currency seems to be related with an increase in real home prices.

Among the alternatives of storing of black money is offshore accounts therefore analyses on it is done by seeing the relationship between currency as a percentage of M1 and nominal effective exchange rate. If black money is rising then the value of rupee is likely to depreciate as transferring money to offshore accounts is likely to increase supply of rupees in the market and result in a depreciation of rupee. Results show that in the duration from 2006 to 2016 was a tight negative relationship between the broad nominal exchange rate and proportion of currency in M1 ( chart 1). ( Thiruvadanthai Bhasin 2019)



Chart1 : Currency as a percentage of M1 AND Nominal Effective Exchange Rate (12 months moving average)



Source: Handbook of Statistics on the Indian Economy, Reserve Bank of India

## 2. On terror funding

The second aim of demonetisation was to end terror funding in Jamun and Kashmir areas. For the starting few months after demonetisation there had been a halt seen in the stone throwing events however they have risen again. Data from the Ministry of Home Affairs shows that the stone throwing incidents have increased and in 2019 have recorded the most times the stone throwing occurred. ( The Hindu )

## 3. Tackling Counterfeit currency

The government stated that the new currency notes would offer greater security features making it difficult to counterfeit or to duplicate . However in the recent years data by RBI shows us that there has been an increase of 121 % in detection of counterfeit bills for rupees 500 and a increase of 21.8 % in detection of counterfeit bills for rupees 2000 in 2018-19.



#### 4. Encourage online transactions

Demonetization has surely encouraged citizens to move towards a cashless economy which was seen by the increase in the use of digital wallets like Paytm, Bhim app, Mobiquik and many more. Mobilink saw a 15-fold increase in tariff, shopclues business from town and cities increased by 15%, online food ordering and delivery start-ups are seeing an increase in sales by 40-50% (Dinesh, Reddy, 2018). There was a rise in the number of point of sale machines which reached 1.6 million in 20 years, leaped to 62% in the six months from October 2016 to April 2017. (Nilekani, 2017).

Post demonetisation a survey found that digital transactions have reached 113 crore by the Information and Technology ministry this meant an increase of 60% (DJ N. 8., 2017). However a recent report shows that the cash transactions rose early 2018, following numerous shoppers immediately shifted away from digital payments and favoured cash on delivery. In the report from RBI payment record we see that in late November 2018 India that 72% of e-commerce transactions in India are still paid from cash.

#### Effects of demonetisation

The agricultural industry which contributes 17% to the Indian GDP and provides employment to over 60% (Kekane Maruti 2013) of the population. In this industry most of the transactions occur in cash was greatly impacted by demonetisation.

The service sector is central to India economic growth by contributing 62% of its gross value added growth in 2016-17, provides employment to 28.6% people contributing 37.9% in total exports. (Eco survey vol 2, 2016-17). The industry growth was only 7.7% in contrast to the 9.7% in 2016-17. The cause of this is due to the slowdown in services like transport, hotel and communication and services. Demonetisation has discouraged tourism due to many factors one of them being the bad experiences that tourists had due to waiting in line to exchange old notes causing an inconvenience. (Vij 2018).

also an increase in the number of cyber crimes according to the NCRB report of 2017. Due to rise in digital transactions because of demonetization large amount of general public and who were yet not well informed about the cyber crimes, the police force inadequately equipped were taken advantage by cyber hackers.



## Conclusion

Demonetisation had the right aims however it failed to have achieved most of them making it a failed attempt by the prime minister. It is very difficult to analyse the exact outcomes that have occurred due to demonetisation as the government introduced general sales tax in order to make the whole market more organised which led to the structural change in the economy. The government can further move towards digital India by investing in the infrastructure therefore making it more convenient for the citizens to use it. Government should remove the fee charged by banks on digital transactions which reduces the disincentive that consumers have of paying through digital transactions. Government should specifically invest in increasing the security of digital transaction which could be through equipping cyber forces with up to date technology or by providing incentives for banks to increase their security standards this will reduce the number of cyber crimes and will gain the citizens trust on digital transactions. By moving towards a digital India the benefits the economy will have are immense.

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