

Impact of Demonetization on Indian Economy

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Introduction

Demonetization is the withdrawal of a particular form of currency from circulation. Through demonetization, the old currency is replaced by new currency. There are multiple reasons why a country demonetized which include to check inflation, to check black money, to curb corruption and to promote cashless transaction.

Objectives of the Paper

- To find out the impact of Demonetization on common man.
- To find out the impact of Demonetization on black money.
- To find out the impact of Demonetization on corruption.
- To find out the impact of Demonetization on terror funding.
- To find out the impact of Demonetization on political parties.
- To find out the impact of Demonetization on towards a digital economy.
- To find out the impact of Demonetization on daily wage worker and employment.
- To find out the impact of Demonetization on small scale industries.
- To find out the impact of Demonetization on industrial growth.
- To find out the impact of Demonetization on agricultural growth.
- To find out the impact of Demonetization on Gross Domestic Product.

Research Methodology

The present paper is mostly based on secondary data and in the opinion of general public. The secondary data have been collected from RBI Publications, Economic Survey of India and Indian Budget 2018-2019 and also help has been taken from Handbook Of Statistics on Indian Economy 2016-2017.

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Demonetization is going to be a landmark in the history of the Indian economy. It was an experience which might create fear in the minds of the people who indulge 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 tender effective from midnight. These notes accounted for 86 percent of the country's cash supply by value.

The term Demonetization is not new to the Indian economy. The highest denomination note ever printed by the Reserve Bank of India was the 10,000 rupee note in 1938 and again in 1954. It was demonetized first in 1946 and then in 1978. Since not many people had access to such notes at the time, this did not have a big impact on the country.

The latest round of Demonetization has undoubtedly affected the common public and bankers. It has had many short term effects which are visible. The long term effects are yet to be experienced and felt.

Impact of Demonetization on the Indian Economy

The impact of Demonetization on the following parameters is explained as below:

- **Demonetization and Gross Domestic Product (GDP):** The GDP growth rate of 8.01% in 2015-2016 fell to 7.11% in 2016-2017 after Demonetization. Cash-intensive industries like manufacturing and construction were affected the most due to Demonetization. Banks were not able to issue loans and current account holders demanded large sums of cash, thereby putting extra pressure on them.
- **Demonetization and Daily Wage Workers:** The informal and casual workers lost their jobs due to dearth of cash during Demonetization. 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 fell to 405 million from 406.5 million during the previous four months.
- **Demonetization and Small Scale Industries:** Textile industry, salons, restaurants, and seasonal businesses are based on less capital demand and work on the basis of liquidity preference. Demonetization led to reduced revenue collection and threatened their existence.
- **Demonetization and Black Money:** Majority black money is stored in the form of physical assets like gold, land, and building and less in cash. But still Demonetization of the rupee 500 and 1000 notes might take out a lot of black money from the economy.

- **Demonetization and the General Economic Situation:** The economic situation went into a great peril after Demonetization. There were huge queues outside ATMs and banks as the need for exchanging old currency notes with the new ones was paramount. Households lacked liquidity which reduced their transaction limits and small shopkeepers who only accepted cash went into losses and some even had to close their shops.
- **Demonetization and Inflation:** Inflation is measured by considering the Wholesale price index (WPI) and the Consumer Price Index (CPI). Demonetization 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% to 182.8 from 183.1 for the previous month. Cash crunch effects of Demonetization can be directly related with this downfall.
- **Demonetization and Terror Funding:** 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, North-East states, and Naxalism-influenced states.
- **Demonetization and Political Parties:** The elections see a huge jump in the use of undeclared cash by political parties. Due to Demonetization such acts might get restricted to an extent and parties will have to formulate new strategies.
- **Demonetization and a Digital Economy:** Absence of liquid cash has led to people making transactions using cheques or account transfers. The surge in usage of digital wallets like Paytm will be helpful to record transactions and thus curb the amount of black money. This might increase the government's tax revenue.

Impact of Demonetization on the Indian Economy may be seen from the following Table 1:

**Table 1: Macro - Economic Aggregates at Constant Prices
(Base year 2011-12)**

(Rs. in billions)

Year	GVA at Basic Price	Consumption of fixed capital	NVA at Basic Price	Indirect taxes less Subsidies	GDP at Market Price	NDP at Market Price
2011-12	81069	9172	71898	6294	87363	78192
2012-13	85463	10107	75356	6667	92130	82024
2013-14	90636	11006	79630	7377	98013	87008
2014-15	97190	11807	85383	8180	105370	93563
2015-16	104905	12642	92263	8905	113810	101168
2016-17	111854	13479	98375	10044	121899	108419

As per the data published in hand book of Statistics on Indian economy by RBI, GDP at Market price fall down approximately by 1 percent as compared to previous financial year. Also consistently across all parameters, the annual growth shown from 2015-16 to 2016-17 is less as compared to previous YOY growths which clearly shows the impact of Demonetization.

As per the estimates of the Central Statistics Office, all the sectors of the economy faced different situations in Q1 of the financial year 2017-18. According to these estimates, the GVA at constant prices in Q1 of 2017-18 was rupees 2904128 crores as compared to rupees 2751407 crores in the Q1 of the previous financial year. This shows a decline in growth from 7.6% in 2016-17 to 5.6% in 2017-18 may be seen from the following Table 2.

**Table 2: Quarterly Estimate of GVA at Basic Prices in Q1 of 2017-18
(at 2011-12 prices)**

Industry	GVA for Q1 (Rs. in Billions)			% Change Over Previous Q1	
	2015-16	2016-17	2017-18	2016-17	2017-18
Agriculture, forestry & fishing	3715	3808	3897	2.5	2.3
Mining & Quarrying	873	865	859	-0.9	-0.7
Manufacturing	4581	5072	5132	10.7	1.2
Electricity, Gas, Water etc	553	610	653	10.3	7
Construction	2225	2293	2339	3.1	2
Trade, Hotels, Transport & Communication	4747	5170	5743	8.9	11.1
Finance, Insurance, Real estate & professional services	5948	6506	6925	9.4	6.4
Public administration, defence and other services	2938	3190	3494	8.6	9.5
Total	25579	27514	29041	7.6	5.6

The above table 2 shows that the % increment of GVA at Basic Prices from Q1 2016-17 to 2017-18 has been 5.6% vis-a-vis a 7.6% increment from Q1 2015-16 to 2016-17 which clearly depicts the negative impact of Demonetization on the GVA parameter. Sectors in the economy such as Construction, Agriculture, Forestry & Fishing which employ a large number of daily wage workers and have liquidity preference witnessed a decline in growth. Agriculture grew by 2.3% in Q1 of 2017-18 as compared to 2.5% in Q1 of 2016-17, Construction grew at a rate of 2.3% in Q1 of 2017-18 and witnessed a drop of 0.2% since the Q1 of 2016-17. Manufacturing, which is the most important indicator of economic growth and employment has grown at a very slow rate post Demonetization. It grew by only 1.2% in Q1 of 2017-18 as compared to a massive growth of 10.7% in Q1 of 2016-17.

Conclusion

Demonetization can be analyzed from the prism of both positive and negative impacts of it on the Indian economy. There has been a lot of opposition regarding the implementation of this policy. In the short run, there have been problems related to

liquidity crunch, unemployment, loss of growth momentum, and a temporary halt to major economic activities. All this is evident from the data provided by the RBI. The long term effects of Demonetization are yet to be ascertained. It is expected that it can improve the Indian economy in the long run by increasing tax compliance, financial inclusion, consequently improving the state of the economy. The availability of funds should increase in long run, leading to a boost in GDP as well as the number of digital transactions should also increase, ultimately leading to a decline in black money.

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