

Impact of Demonetization on Indian Economy

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Abstract

Demonetization refers to withdrawal of a particular form of currency from circulation. It is necessary whenever there is a change of national currency; the old currency must be removing and substituted with the new currency unit. The currency was demonetizing first time in 1946, and second time in 1978. On 8th Nov. 2016 the currency is demonetized third time by present Modi Government. The disarray was created in every stratum of the society whether upper, middle or lower. Where some welcomed the move as it was seen for curbing black money, many are suffering by this movement. In this paper analyze the impact of demonetization on Indian economy and work out the probable consequences of the demonetization.

Keywords

India, Demonetization, money, movement, economy, consequences.

Introduction

Demonetization is a generations' memorable experience and is going to be one of the economic events of our time. The currency was demonetizing first time in 1946, and second time in 1978. On 8th Nov. 2016 the currency is demonetized third time by present Modi Government. The disarray was created in every stratum of the society whether upper, middle or lower. Its impact is felt by every Indian citizen. Demonetization affects the economy through the liquidity side. Its effect will be a telling one because nearly 86% of currency value in circulation was withdrawn without replacing bulk of it. As a result of the withdrawal of Rs 500 and Rs 1000 notes, there occurred huge gap in the currency composition as after Rs 100; Rs 2000 is the only denomination. Absence of intermediate

denominations like Rs 500 and Rs 1000 will reduce the utility of Rs 2000. Effectively, this will make Rs 2000 less useful as a transaction currency though it can be a store value denomination.

Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc. Demonetization is not a big disaster like global banking sector crisis of 2007; but at the same time, it will act as a liquidity shock that disturbs economic activities.

Objective of The Study

- Liquidity Crunch
- Welfare Loss For The Currency Using Population
- Consumption Will Be Hit, etc.

Methodology

The paper is based on the secondary data. The secondary data was collected from various published sources like reports, magazines, journals, newspapers etc. The dictionary meaning of DEMONETIZE is To deprive (a metal) of its capacity as a monetary standard or To withdraw from use as currency So, demonetization is the act of stripping a currency unit of its status as legal tender. It is the act or process of removing the legal status of currency unit. A currency on which Governor of RBI on behalf of Central Government guarantees by making statement I promise to pay the bearer, the sum of money which empowers it a legal status. From the date of demonetization, all old currencies which are demonetized will cease to be a legal tender. Such currency cannot be used as money to do any transaction henceforth, but to replace with a new currency. The Government of India on the 8 November 2016 announced demonetization of high denomination currency notes Rs 500 and Rs1000. This means that 500 and 1000 rupees notes will be accepted by anyone except the organization declared by the Government. A new redesigned series of Rs 500 and Rs 2000 banknote is in circulation since 10 November 2016.

Liquidity Crunch (short term effect):

Liquidity shock means people are not able to get sufficient volume of popular denomination especially Rs 500. This currency unit is the favourable denomination in daily life. It constituted to nearly 49% of the previous currency supply in terms of value. Higher the time required to resupply Rs 500 notes, higher will be the duration of the liquidity crunch. Current reports indicate that all security printing presses can print only 2000 million units of RS 500 notes by the end of this year. Nearly 16000 mn Rs 500 notes were in circulation as on end March 2016. Some portion of this was filled by the new Rs 2000 notes. Towards end of March approximately 10000 mn units will be printed and replaced. All these indicate that currency crunch will be in our economy for the next four months.

Welfare Loss for the Currency Using Population

Most active segments of the population who constitute the 'base of the pyramid' use currency to meet their transactions. The daily wage earners, other labourers, small traders etc. who reside out of the formal economy uses

cash frequently. These sections will lose income in the absence of liquid cash. Cash stringency will compel firms to reduce labour cost and thus reduces income to the poor working class. There will be a trickle up effect of the liquidity chaos to the higher income people with time.

Consumption Will Be Hit:

When liquidity shortage strikes, it is consumption that is going to be adversely affected first.

Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓

Loss Of Growth Momentum:

India risks its position of being the fastest growing largest economy: reduced consumption, income, investment etc. may reduce India's GDP growth as the liquidity impact itself may last three -four months.

Impact on Bank Deposits and Interest Rate:

Deposit in the short term may rise, but in the long term, its effect will come down. The savings with the banks are actually liquid cash people stored. It is difficult to assume that such ready cash once stored in their hands will be put into savings for a long term. They saved this money into banks just to convert the old notes into new notes. These are not voluntary savings aimed to get interest. It will be converted into active liquidity by the savers when full-fledged new currency supply takes place. This means that new savings with banks is only transitory or short-term deposit. It may be encashed by the savers at the appropriate time. It is not necessary that demonetization will produce big savings in the banking system in the medium term. Most of the savings are obtained by biggie public sector banks like the SBI. They may reduce interest rate in the short/medium term. But they can't follow it in the long term.

Impact on Black Money:

Only a small portion of black money is actually stored in the form of cash. Usually, black income is kept in the form of physical assets like gold, land, buildings etc. Hence the amount of black money countered by demonetization depends upon the amount of black money held in the form of cash and it will be smaller than expected. But more than anything else, demonetization has a big propaganda effect. People are now much convinced about the need to fight black income. Such a nationwide awareness and urge will encourage government to come out with even strong measures.

Impact on Counterfeit Currency:

The real impact will be on counterfeit/fake currency as its circulation will be checked after this exercise. Demonetization as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn't have the digital transaction culture. Overall economic activities will be dampened in

the short term. But the immeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

Impact on Banks and Financial Institutions:

The demonetization effects on banks will be both on the positive side and the negative side. However, In the long run it will be more on the positive side. As per directions of Government people have to deposit their money with the banks which will increase the liquidity of the banks for short term. This liquidity can be used by banks for lending purpose for long run.

As the liquidity of banks increases, they are expected to enhance the borrowing cycle by the lending money at lower rate of interest. However, the negative impact also as the earning of the banks will also take a hit for the next 2-3 quarters. We may not see loan book growing as the banks will be busy in facilitating the demonetization process.

Impact on Tourism:

Cash Crunch badly hits the tourism sector. It is very difficult for people for getting the money from the banks and ATMs. The travel and hospitality industries are facing a tough time. Peak tourism period of November-December badly hit. For tourist destinations beyond metros, business may be down by as much as 40%. Tourism business in metros may go down by 10%. Cash shortage at airports and hotels are a big problem. And many national monuments entry points don't have card payments facilities. Western countries have issued advisories on cash Liquidity in India

Conclusion:

In long run, there are some positive and some negative impact of demonetization but negative impact does not outweigh the positive impact of it. After the demonetization some sectors not affected like Pharma, FMCG, Education, Agriculture, Hospitals, Energy and Telecommunication From an equity market perspective, this move would be positive for Banking and Infrastructure sector in the medium to long term. This would be negative for Liquidity Crunch, Welfare Loss For The Currency Using Population, Consumption Will Be Hit, Loss Of Growth Momentum, Impact On Bank Deposits and Interest Rate, Impact on Black Money, Impact on Counterfeit Currency, Impact on Banks and Financial Institutions, Impact on Tourism. Demonetization can lead to elimination of fake currency and corruption, it can be said that this is a historical step by the Modi Government and should be supported by all. This decision of Government will definitely fetch results in the long term this is the stepping stone towards/ for sustained economic growth in long run.

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