

DEMONETISATION IN INDIA: A STUDY OF ITS' IMPACT ON VARIOUS KEY SECTORS

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ABSTRACT

Demonetization is defined as an act of stripping a currency unit of its status as legal tender. Demonetization is a radical monetary step in which a currency unit's status as a legal tender is declared invalid. This is usually done whenever there is a change of national currency, replacing the old unit with a new one. On November 8, 2016, India has seen a few notable announcements from the Prime Minister's office in next of kin to cancelling the high denomination of 500 and 1000 rupee notes. The high denomination currency notes make about 85% of the total cash circulated in India. In the announcement, PM Narendra Modi declared that use of all 500 and 1,000 banknotes would be invalid after midnight of that day, and announced the issuance of new 500 and 2,000 banknotes of the New Series in exchange for the old banknotes. This paper makes an attempt to do an in-depth analysis of the impact of Demonetization and also described the effect of demonetization on different sectors of the economy.

Keywords : *Demonetization, Economy, growth, decline, corruption, black money, legal tender, monetary, cashless economy, fake currency notes,*

I. INTRODUCTION

"In order to contain the rising incidence of fake notes and black money, the scheme to withdraw legal tender character of the old Bank Notes in the denominations of ₹ 500 and ₹ 1000 was introduced."

Demonetization is not a new concept in the past also it has been utilized by various countries as well as India to curb currency some failed very badly with this move. Zimbabwe, Fiji, Singapore and Philippines were other countries to have opted for currency demonetization.

The demonetization exercise therefore had **two objectives**:

- ✓ **Check black money**
- ✓ **Fake currency notes.**

Of the two objectives, demonetisation has met the objective of **restricting the incidence fake currency notes**. At a single stroke, fake notes of Rs 500 and Rs 1,000 denomination were put out of circulation. The demonetization exercise therefore aimed to target about 92% of fake currency in circulation and would have succeeded.

The other objective was to reduce the incidence of black money. First, let us take a look at the **government's view on black money in** the economy. On 16th December, finance minister Arun Jaitley told the Lok Sabha: *"There is no official estimation of the amount of black money either before or after the government's decision of*

8th November 2016 declaring bank notes of denominations of the existing series of the value of five hundred rupees and one thousand rupees shall cease to be legal tender with effect from 9th November 2016."

II. HISTORY OF DEMONETISATION IN INDIA

First Demonetization - 12 Jan 1946 Following the action in several foreign countries, including France, Belgium and the U.K., the Government of India decided on demonetization of high denomination notes, in January 1946. It is interesting that as early as April 7, 1945, suggested similar action in India as 'one more concrete example for the Indian Government to follow in its fight against black market money and tax evasions which have now assumed enormous proportions.

Second Demonetization - On 16 Jan 1978, the ordinance was announced via All India Radio at 9 AM. The Ordinance provided that all banks and government treasuries would be closed on 17 January 1978 for transaction of 'all business except the preparation and presentation or the receipt of returns' that were needed to be completed in the context of demonetization. This time public was given even lesser time of 3 days to exchange Rs 1000, Rs 5000 and Rs 10000 notes. **Latest demonetization** in India On November 8 evening at 8:15 p.m., Prime Minister Modi, in his televised address to the nation, made Rs 500 and Rs 1000 notes invalid, saying that it was aimed at curbing the "disease" of corruption and black money which have taken deep root. People holding notes of Rs 500 and Rs 1,000 can deposit the same in their bank and post office accounts from November 10 till December 30. All notes in lower denomination of Rs 100, Rs 50, Rs 20, Rs 10, Rs 5, Rs 2 and Re 1 and all coins continued to be valid, and new notes of Rs 2,000 and Rs 500 were introduced. There was no change in any other form of currency exchange be it cheque, DD, payment via credit or debit cards etc. The total value of old Rs.500 and Rs.1000 notes in the circulation is to the tune of Rs.14.2 trillion, which is about 85% of the total value of currency in circulation. This movement rendered everyone surprised as this was momentous decision and unexpected one which was declared without any prior information.

III. LITERATURE REVIEW

Areendam Chanda (2016): noted some shortcomings in terms of dealing with the shortage. The study described that there were some other criticisms such as the near term decline in economic growth particularly when the Indian economy was doing well. **Economic Survey (2016):** A number of follow-up actions would minimize the costs and maximize the benefits of demonetisation. These include: fast, demand-driven, demonetization; further tax reforms, including bringing land and real estate into the GST, reducing tax rates and stamp duties; and acting to allay anxieties about over-zealous tax administration. These actions would allow growth to return to trend in 2017-18, following a temporary decline in 2016-17. **HDFC Bank Investment Advisory Group (2016):** From an equity market perspective, this move would be positive for sectors like Banking and Infrastructure in the medium to long term. This could be negative for sectors like Consumer Durables, Luxury items, Gems and Jewellery, Real Estate and allied sectors, in the near to medium term. **Mr.Sabnavis and Ms Sawarkar (2016):** The RBI will issue Two thousand rupee notes and new notes of Five hundred rupees which will be placed in circulation from 10th November 2016. Notes of one hundred, fifty,

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twenty, ten, five, two and one rupee will remain legal tender and will remain unaffected by this decision. This measure has been taken by the PM in an attempt to address the resolve against corruption, black money and counterfeit notes. **Syamsundar Palanisamy (2016):** Considering the importance and the influence of Indian economy in the global financial markets and the growth rate of India's GDP, this article attempts to document the historical importance of the demonetizations and their impact on the export and import. The study revealed that, India will achieve a significant growth by adapting the demonetization strategy and it will create a huge positive impact on the entire economy. **Tax Research Team- National Institute of Public Finance and Policy New Delh (2016):** The argument posited in favor of demonetisation is that the cash that would be extinguished would be "black money" and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy. It is imperative to evaluate the short run and medium-term impacts that such a shock is expected to have on the economy. Further, the impact of such a move would vary depending on the extent to which the government decides to demonetize.

IV.OBJECTIVES OF THE STUDY

1. To know the basic agenda behind demonetization.
2. To know the impacts of Demonetization on various key sectors of the economy.

V. RESEARCH METHODOLOGY

This research is solely based on secondary Sources. To collect secondary information various journals, research articles, research papers, review papers are used.

VI. IMPACT OF DEMONETIZATION

- (1) Well timed and well executed. Political credibility enhanced. Politically astute too.
- (2) Timing this after the end of the tax amnesty scheme was logical.
- (3) No capital flight and no 'rupee is toast'. Over stated. Everything else being equal, withdrawal of currency in circulation, in the short-run, will actually drive up interest rates. May not happen as not all things are equal. Capital flight is not that easy anymore. Tax authorities around the world co-ordinate and there is uncertainty in every currency and perhaps more so. Therefore, 'rupee is toast' is far from a likely scenario.
- (4) What Professor Kenneth Rogoff (Harvard) suggested for the USA was extreme financial repression in the context of zero and negative rates. That was a very bad and toxic suggestion. Here, it is not the case. Nor is this an act of 'financial fascism' or that of a totalitarian state. Those are wrong characterizations. No. Citizens are entitled to redemption of old currency notes and they can do so. If ill-gotten and concealed, then where is the right that is being deprived?
- (5) Short-term liquidity squeeze could be severe and hence economic activity could suffer. Can last up to two or three quarters. If less, well and good. CLSA and Credit Suisse seem to think that (adverse) economic impact could be significant.

(6) Further, with the eventual design of the GST looking more complicated than originally envisaged and with the timelines getting shorter, uncertainty could be compounded. That risk is non-trivial. That is why GST should have been more concerned with simplicity, ease of use and implementation rather than revenue considerations. Bold thinking was always needed and more so, in the light of this announcement.

(7) In other words, a lot of learning is required of private sector participants to adapt to the new regimes - GST and de-monetization. It will cause dislocation and uncertainty while learning happens and, two, it takes time.

(8) The government could have and should have (it still might) come up with additional economic stimulus too, to offset the dampening effect. Just thinking aloud here: (a) accelerated reduction in corporate income tax along with withdrawal of exemptions; (b) ending uncertainty on GAAR and retrospective taxation or any other blockbuster measure that they might be working on, that would offset the initial adverse economic impact.

(9) Whether this would boost eventually economic activity that is formal remains to be seen. But, orders of magnitude are very difficult to establish and hence, any claim of such improvement in formal economic activity with consequent beneficial tax impacts and other social economic multipliers must be deemed wholly speculative at this stage.

(10) This will not release money for RBI to recapitalize banks. A flow diagram of how it would happen - with money going from RBI to GOI and from there to banks, as a result of this de-monetization and consequent reduction of currency in circulation – would be helpful. Otherwise, it is fanciful. I have not seen one.

(11) Sovereign credit rating - no impact. Indeed, the risk of a downgrade is as real (or more real?) as that of an upgrade, if short-term impact on economic activity dampens government revenues and widens deficit. No government debt is being cancelled.

(12) Tempting to imagine economic benefits immediately from a structural reform. But, these things usually come with a long lag, if they do and, in the short-term reform or deviation from 'business as usual' usually results in pain and uncertainty. That is the reality.

VII. DEMONETISATION IMPACT ON VARIOUS SECTORS

These sectors are given below with impact and solution:

❖ ECONOMY

IMPACT: Demonetization torpedoed India's economy just when it was getting into a cruise mode, fired by good monsoon-led rural demand and Seventh Pay Commission-enabled urban buying. The 8% growth that looked within grasp in FY17 is beyond horizon now. Only about a quarter of currency cancelled is back in circulation, and that too is being stashed away for emergency. Lower denomination notes are not available to facilitate transactions. The fall in demand will further dent already weak investments. The sharpest crash in services PMI since November 2008 in the aftermath of the global financial crisis underscores the risks. Ambit sees growth falling to a low of 3.5% in FY17. Others are not so pessimistic, penciling in about 7%.

❖ JOBS

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IMPACT: Hiring experts say jobs at senior levels are not and won't be impacted. But overall hiring is down right now, as managers seek to protect revenue/profit targets. No job cut plans as of now. Variable pay/increment amounts may be impacted. Job numbers are difficult to estimate, experts say, but sectors where hiring is most hit are retail, consumer goods, real estate, infrastructure, logistics (for ecommerce especially), auto consumables, and building products. Hiring by mobile wallet and fintech companies are up, though.

❖ REALESTATE

IMPACT: Insiders say there's a 40%-plus drop in enquiries and sales across key markets of Mumbai, Delhi, Bengaluru and Pune. Deals in secondary market have come to a standstill. In Bengaluru, drop in deal closings is as much as 60%. Most homebuyers are waiting for big price reductions. With fear of black money transactions and cash crunch added to an already slumping real estate sector, near future is bleak.

❖ E-COMMERCE

IMPACT: Mostly bad, some good. For the online retail market, gross merchandise value (GMV) of players fell by 40-50% in first few weeks after demonetisation, in the middle of their biggest quarter for sales. Things may remain bleak till March. Even high-value items like expensive smart phones are selling less. Products returned are up by 50%. And experts feel consumer sentiment won't improve quickly. But the boost to digital payments (100% jump in transactions) has led industry to hope for a bright medium term. Also, grocery and food delivery set-ups are doing better since they sell essential items. Some saw new customer orders jump to 25%, from the usual 15-16%.

❖ AGRICULTURE

IMPACT: Interestingly, villages have adapted in some ways better than cities. GOI allowing tax free deposits of any amounts for farmers have led to many of them getting 20% premium from traders when transacting. Informal credit for daily purchases and use of old notes for key inputs and selling produce have kept rural economy going. Crop planting increased 20-35%. Every week after demonetisation and remained higher than last year in all weeks after November 8. But a lot depends on cash supply improving quickly in the new year.

❖ SMALL BUSINESS AND SERVICE INDUSTRY

Demonetization affects every sector in different way. The small business and service industry is facing various problems in their day to day life. Their sales have been slow down due to lack of currency in the market. The middle class families are still not used to cards or payment gateways for meeting their daily needs. Cash transactions play a very important role in the life of service industry.

IMPACT ON BOND MARKETS: Surge in deposits will create more demand for government bonds and other high rated bonds in a situation of tepid demands for credit, leading to lower bond yields especially in the shorter end of the curve. At the same time, a reduction in leakages in systemic liquidity will reduce the scope for open

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market operation purchases in the coming days. We believe that the RBI will continue to sterilize excess liquidity from the banking system to keep the short term rates aligned with the policy rate.

❖ AUTOMOBILES

IMPACT: Negative Demand has been hit. Most firms expect to see a decline in sales. In two-wheelers, where transactions are through cash, sales have taken a massive hit. Hero Moto Corp Ltd, for instance, sold 480,000 units in November, down from a monthly average of 600,000 units.

❖ TOURISM

IMPACT: Mixed

The most difficult period of demonetisation sits squarely in the busiest season for the tourism industry. There was a slump in hotels and associated services bookings in the first week after the currency withdrawal. However, the premium hotel segment has not seen any impact as bookings are mostly done in advance and online. So the hit has mostly been confined to the unorganized sector.

❖ REAL ESTATE: REALITY HITS HOME

IMPACT: Negative

Developers and consultants say that home sales have slowed down significantly as consumers defer home purchases. Land transactions are at a standstill. Developers have deferred launches of premium projects while prices of land and properties, particularly luxury homes, are likely to drop in the next 3-6 months. Even secondary (resale) property markets sales have dropped by 50%, say brokers and analysts.

❖ BANKS: IN THE MIDDLE

IMPACT: Mixed over short-term, neutral to positive in the long term

A big surge in low-cost deposits will help banks in the short-term. It means lower cost of funds and better margins. The rise in balance sheet size will also help when credit growth picks up. As yields fall, owing to excess liquidity, banks stand to book treasury gains too. However, on the flip side, loan disbursements are stagnating. With production estimates reduced, there is no need for working capital either. Lenders will be hard pressed to find incremental credit demand even during the busiest of the seasons. And asset quality could worsen as the economy slows.

❖ CONSUMER PACKAGED GOODS: NO DISCRETIONARY SPENDING

IMPACT: Negative

Consumers have cut back on discretionary spending. The whole business has been hit because it is largely dependent on cash. The traditional trade has been hit hard, especially wholesalers and *kirana* stores where transactions are largely in cash. Still, things are recovering; sales are now down only 20-25% on a year-on-year basis compared to 50% in the first week after the note ban. Rural sales have been hit more.

❖ CONSUMER DURABLES: SLUMP SALE

IMPACT: Negative

The market for white/brown goods still operates 80% on cash, thereby affecting volumes. Makers of durable goods are launching new schemes to tempt consumers to go cashless. Some of them are also extending discount offers and promotions such as waiver of processing fees and installment schemes with delayed start of payments.

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❖ ORGANISED RETAIL: SELLING NON-CASH

IMPACT: Positive

The sector is a clear beneficiary of demonetisation as consumers flock to large stores which accept non-cash payments. The nature of purchases at modern retail stores has changed. Consumers are stocking and purchasing more of daily needs and essentials such as fruits, vegetables and staples such as sugar and flour.

❖ AIRLINES: FLYING ON ONE ENGINE

IMPACT: Negative

There has been a significant impact on inbound travel. Some airlines have seen bookings go down by about 16% in the week after demonetisation compared to the one before that. Discretionary travel has been the worst hit. Poor sales have forced all airlines to bring forward their airfare sales—usually reserved for the low season starting January. International traffic to West Asia and South-East Asia, especially by traders and low-wage workers, has been hit. Business jet operators say several charter flights have been cancelled as payments are often made in cash.

❖ AUTOMOBILES: SKIDDING OFF TRACK

IMPACT: Negative

Demand has been hit. Most firms expect to see a decline in sales. In two-wheelers, where transactions are through cash, sales have taken a massive hit. Hero Moto Corp Ltd, for instance, sold 480,000 units in November, down from a monthly average of 600,000 units.

❖ TOURISM: THE ROAD LESS TRAVELLED

IMPACT: Mixed

The most difficult period of demonetisation sits squarely in the busiest season for the tourism industry. There was a slump in hotels and associated services bookings in the first week after the currency withdrawal. However, the premium hotel segment has not seen any impact as bookings are mostly done in advance and online. So the hit has mostly been confined to the unorganized sector.

❖ INFRASTRUCTURE: CORE IMPACT

IMPACT: Negative for now, positive in long term

Power demand and road traffic have been hit. Road companies faced short-term cash flow problems because they weren't able to collect tolls, but things are limping back to normalcy. Wage payment to labour can be an issue for some time, which can impact execution in the short term.

❖ PHARMA: TEMPORARY DOSE

IMPACT: Negative for now, neutral over the long term

Pharmaceutical product sales likely fell 8-10% month-on-month in November with sales of medicines for acute diseases feeling the adverse impact of demonetisation due to lower patient turnout, although retail sales of medicines for chronic diseases rose in the first fortnight, as patients stocked up medicines by using old notes at pharmacies, which were among the few outlets accepting old banknotes. Off take from wholesalers and stock a list was sluggish and companies have extended the credit period by 7-21 days.

VIII. CONCLUSION

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When an economy is suffering from cancer, the only way to deal with it is painful doses of chemotherapy. With intense follow-up and awareness campaigns, the government can have people on its side even during their continuing hardship. The Government has tried something different to make the country better place to live in. The decisions may cause a lot of pain but in the future periods it will benefit a lot. The biggest hurdle in India is the lack of State capacity. But the government and the RBI are taking steps to make life easier for people and should flood the Banks and ATMs with new notes without delay so that panic is removed. The Govt. and RBI are working on it to make life normal as it was earlier.

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