



Peer Reviewed Referred  
and UGC Listed Journal  
(Journal No. 40776)

ISSN 2277 - 5730  
AN INTERNATIONAL MULTIDISCIPLINARY  
QUARTERLY RESEARCH JOURNAL

# AJANTA

**Ajanta  
Prakashan**

Volume-VIII, Issue-I  
January - March - 2019  
English Part - II

IMPACT FACTOR/  
INDEXING 2018 - 5.5  
[www.sjifactor.com](http://www.sjifactor.com)



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ज्ञान-विज्ञान विमुक्तये

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**Ajanta Prakashan**

Aurangabad. (M.S.)

## 27. Demonetization: Impact on Indian Economy

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### Abstract

Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization refers therefore; to the process of deciding that certain coins and banknotes can no longer exchanged goods and services. It occurs whenever there is a change of national currency. The current form of money is pulled from circulation and retired, often to be replaced with new notes or coins. Sometimes a country completely replaces the old currency with new currency.

In India it was announced on 8<sup>th</sup> November 2016 that the Rs.500 and Rs. 1000 banknotes would cease to qualify as valid tender from 9<sup>th</sup> November 2016 onwards. The currency unit that has been demonetized is with drawn from circulation. During the implementation of this policy, the currency unit that has lost its status a legal tender is deposited with the banks or other authorized financial institution and replaced with units that still legal tender status.

### Objectives

- 1) To study the objectives of Demonetization.
- 2) To study the impact of Demonetization on Indian Economy.

### Research Methodology

This paper is specially based on secondary data, the data accumulated from different sources like internet, Economic Journals, Research papers and Economic References.

### Objectives of Demonetization Process in India Highlighted by BJP Government

Demonetization is an important weapon applied by the Prime Minister which has been called as a surgical strike against black money. The objectives of demonetization in India are;

- 1) To curb the menace of fake currencies.
- 2) To wipe out unaccounted and tax evaded money in such a high value notes.
- 3) To prevent use of high demonetization notes for terror financing.

### Historical Background of Demonetization process in India

The First Demonetization happened in India in January 1946. Rupees 1000, Rupees 5000 and Rupees 1000 notes were taken out of circulation. All these three higher demonetization banks notes were reintroduced in 1954 after that in 1978 all were again demonetized. The current demonetization in third row on 8 November 2016, the total bank notes in circulation in India was rupees 17.77 trillion (US \$ 260 Billion) in term of value, the annual report of RBI 31<sup>st</sup> march 2016 stated that total banknotes in circulation valued to rupees 16.42 trillion (US \$ 240 billion) which nearly 86% around rupees 14:18 trillion (US \$ 210) were rupees 500 and rupees 1000 bank notes, they were taken out of circulation from 2016.

### Positive Effects of Demonetization

1. **Black Money :** At one stroke the Prime Minister has choked the supply of black money stacked inside the country. Of the Rs. 17 lakh crore of total currency in circulation in the country, black money is estimated at mind-boggling Rs. 3 lakh crore, Black money is nothing but a punder of the nation. Black money operators run a parallel economy which shakes the very foundation of the Indian economy. With Modi's demonetization move, all domestic black money will either be deposited into the banks with heavy penalty or be simply destroyed.
2. **Economy :** Demonetisation will have a huge resultant effect on the Indian economy. The clean-up of illegal cash will help turn around the economy. First, it will bring more borrowings to the exchequer, improve inflation outlook and increase India's gross domestic product (GDP). Second, it will revive investment opportunities and give a fillip to infrastructure and the manufacturing sector. Third, it will help reduce interest rates and lower income tax rate.
3. **Note Bank Politics :** In the run up to the crucial assembly elections in Uttar Pradesh, Punjab, Goa and Uttarkhand, Prime Minister Modi's demonetization announcement has come as a shock and awe for the political parties and politicians for whom black money is a lifeline. The pulling out of the old Rs. 500 and Rs.1,000 currency notes will help make the election process clean and transparent. But it has brought tough times for the political parties and politicians who believe in the idea of purchasing votes in exchange for notes.

is used to purchase arms and ammunition, food and medicine and daily essentials, apart from distributing it among the ranks and the cadre.

- **The Negative Effects of Demonetization**

The scarcity of cash due to demonetization led to chaos and most people holding old banknotes faced difficulties exchanging them due to endless lines outside banks and ATMs across India, which became a daily routine for millions of people waiting to deposit or exchange the < 500 to < 1000 banknotes since 9 November.

ATMs were running out of cash after a few hours of being functional and around half the ATMs in the country were non-functional.

As of 18 December 2016, there were still long queues at banks and ATMs.

1. **Deaths :** Several people were reported to have died from standing in queues for hours to exchange their old banknotes.

Deaths were also attributed to lack of medical help due to refusal of old banknotes by hospitals.

2. **Stock Market Crash :** As a combined effect of demonetization and US presidential election, the stock market indices dropped to an around six-month low in the week following the announcement. The day after the demonetization announcement, BSE SENSEX crashed nearly 1,689 points and NIFTY 50 plunged by over 541 points.

By the end of the intraday trading section on 15 November 2016, the BSE SENSEX index was lower by 565 points and the NIFTY 50 index was below 8100 intraday.

3. **Transportation Halts :** After the demonetization was announced, about 800,000 truck drivers were affected with scarcity of cash, with around 400,000 trucks stranded at major highways across India were reported.

While major highway toll junctions on the Gujarat and Delhi-Mumbai highways also saw long queues as toll plaza operators refused the old banknotes.

4. **Agriculture :** Transactions in the Indian agriculture sector are heavily dependent on cash and were adversely affected by the demonetization of < 500 and < 1,000 banknotes.

Due to scarcity of the new banknotes, many farmers have insufficient cash to purchase seeds, fertilizers and pesticides needed for the plantation of Rabi crops usually sown around mid-November.

5. **Banking :** A State Bank India branch remained open at night and a long queue of people waited outside the ATM to withdraw money.

In the first four days after the announcement of the step, about < 3 trillion (US\$45 billion) in the form of old < 500 and < 1,000 banknotes had been deposited in the banking system and about < 500 billion (US\$ 7.4 billion) had been dispensed via withdrawals from bank accounts, ATMs as well as exchanges over the bank counters. Within these four days, the banking system has handled about 180

Between November 10 and November 27, banks reported exchange and deposits of demonetized banknotes worth < 8.45 trillion (US\$130 billion) (exchange of <339.48 billion (US\$5.0 billion) and deposits of < 8.11 trillion (US\$120 billion). During this period, an amount of < 2.16 lakhcrore (US\$32 billion) had been withdrawn by people from their accounts.

6. **Business :** By the second week after demonetization of < 500 and < 1,000 banknotes, cigarette sales across India witnessed a fall of 30-40%, while E-commerce companies saw up to a 30% decline in cash on delivery (COD) orders. Several e-commerce companies hailed the demonetization decision as an impetus to an increase in digital payments. They believe that it would lead to a decline in COD returns which is expected to cut down their costs. The demand for point of sales(POS) or card swipe machines has increased. E-payment options like PayTM and PayUMoney has also seen a rise.

7. **Income Tax Raids and Cash Seizures :** The Finance Ministry instructed all revenue intelligence agencies to join the crackdown on forex traders, hawala operators and jewelers beside tracking movement of demonetized currency notes.

Huge amounts of cash in the form of new notes were seized all over the country after the demonetization.

As of December 2016, over 4 crore in new banknotes of < 2000 were seized from four persons in Bangalore, < 33 lakh in < 2000 notes were recovered from Manish Sharma, an expelled BJP leader in West Bangal and < 1.5 crore was seized in Goa.

### Conclusion

Demonestation process is like a two faces of a coin because one side it will benefit the nation and other side it's going to create some temporary and long term problems.

### **Benefits of the Nation**

1. Possible to stop counterfeit currency using for the terrorism activity.
2. Black Money : by demonestation of currency suddenly it will take out illegally stored money from the holders.
3. Transparency : Moving towards digital economy may bring the transparency in the system.
4. Easy Monitoring : Digital payment easy to monitor cash flow.
5. Less chance of avoiding the taxes.
6. Transparency in the system will bring more invest from the foreign countries.

### **Drawbacks of Demonestation**

1. Losses to small vendors trade because of cash crunch (violation of article 19 of the Indian constitution)
2. Many people died because some hospitals not accepted old money and rejected treat them.
3. Repeatedly changes in the rules and misleading to the people.
4. Many people do not have bank accounts in rural areas and hilly areas.
5. Lots of daily basis labours removed from the work.

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