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Research paper on Impact of Demonetization 2016 on Indian Economy

Abstract

The paper focuses about the shift of demonetization taken by Central Government of India on 8th November, 2016 with regards to its reasons and effects on different sectors in India. The sectors cover Micro Businesses, E-Wallet businesses, online retail stores and so on. The paper is based on secondary data collected from different newspapers and online sources, mentioned in references.

Keywords: demonetization, reasons of demonetization, sectors in India

Introduction

Demonetization is the action of discontinuing a currency unit of its status as legal kind. It is a process of removing a currency from use or movement of money in a country. Demonetization is an act where the old unit of currency gets replaced with a new currency unit. It can also be considered as withdrawal of a specific currency from market.

Objective

The objective of the paper is to identify the impact of demonetization adopted in 2016 on Indian economy

Methodology

This paper is based on secondary data collected from various articles, websites and research papers.

The birth of a paper currency in India

Before starting the discussion about demonetization, the history of paper currency should be considered first. Till the 18th century, silver and gold coins were used for transactions in India. But since European trading companies developed their banks in the region, such as the Bank of Hindostan in Calcutta, they started issuing the first versions of Indian paper currencies which were initially just text-based. As British companies started improving their control on what were then Bengal, Bombay, and Madras, they founded presidency banks.

However, only after the Paper Currency Act of 1861 the British colonial government really got involved in producing money, establishing the paper currency as we know it today. Money was now to be issued by the state alone, not by banks.

Demonetization in India before November, 2016.

The first instance was in 1946 and the second in 1978 when an ordinance was promulgated to phase out notes with denomination of Rs 1,000, Rs 5,000 and Rs 10,000, but the same denomination's currencies were reintroduced again in 1978. In 1978, Demonitisation was proposed by Janata Party government. The objective behind all the acts of demonetization happened in past and happened recently is common reduction of black money, corruption and removal of fake currency.

Demonetization- November, 2016

Prime Minister of India Shri Narendra Modi announced the demonetization on 8 November. In the announcement, Mr. Modi declared that use of all Rs500 and Rs1000 banknotes of the Mahatma Gandhi Series would be invalid past midnight, and announced the issuance of new Rs500 and Rs2000 banknotes

of the Mahatma Gandhi New Series in exchange for the old banknotes. The major reasons behind this move were controlling black money, controlling fake currency and controlling corruption.

Reasons of Demonetization

According to The Reserve Bank of India, there were mainly three reasons to take the said initiatives which are like:

- 1) To address black money in the economy.
- 2) To control the cash circulation in the country relevant to corruption
- 3) To remove fake currency and dodgy funds used by terror groups to fund terrorism in India.

Effects of Demonetization

Demonetization had created various impacts on the economy. Most of the sectors where transactions are done on cash basis were affected highly. Somewhere it was boom where in other sectors temporary slowdown was found. For the research paper researcher has considered various sectors where there has been vital impact according to researcher.

1 Temporary Liquidity shortage: It was the time when people were standing in long queue to exchange the money. The highly used denomination currency is Rs.500. People were not getting that money currency. There was a shortage of the currency which was clearly observed.

2 Time of Currency Shortage: reports suggested that all printing presses could print 2000 million units of RS 500 notes by the end of year. Nearly 16000 million Rs 500 notes were in circulation as on end March 2016. Some portions of this were bridged by the new Rs 2000 notes. Towards end of March approximately 10000 million units were printed and replaced. All these suggested that currency crunch was going to be continued in our economy for the next four months.

3Loss for population using currency: Most of the poor section of society uses cash for their livelihood. They depend most of the time on cash basis transactions as such they receive wages in daily basis in cash. Due to shortage of cash it was assumed that companies will try to lower down cash expenses and may reduce their labor cost. Because of shortage of cash poor section of society including labors and workers will not get enough wage and payment.

4 Consumption affected: Consumption was adversely affected because of the liquidity problems and because of consumption the entire cycle was disturbed temporarily.

5 Predicted Loss of Growth: India wants to be fastest growing economy but because of liquidity position there was a doubt on growth position of India. Because of liquidity crisis GDP and income figures also were at risk.

6 Effect on bank deposits and interest rate: For short run deposits with banks were hiked as people deposited their money to convert their old currency into new one but once when the new currency supply in the economy was full-fledged once again people had withdrawn their money from the banks because it was the money they deposited to convert in to new currency. This was the amount deposited by people which they were using for liquidity not for investment. Interest rates were predicted to be reduced only for short to medium run but not for long run.

7 Effect on black money: The problem of black money had been addressed but only to limited extent because only few portion of black money is held in cash and rest other portion of black money is held in the assets and properties. The extent of addressing black money depended on the amount of black money held in the form of cash. However this measure had created huge awareness among the public and citizens of the country to address the issue of black money.

8 Effect on fake currencies: The major effect of this measure had been on fake currency as its circulation has been evaluated after this exercise.

Conclusion

Demonetization is considered with some advantages and disadvantages in various sectors in short run but in long run it definitely will have positive impact in controlling black money and fake money. Apart from positive benefits it created some inconvenience to poor sections of the society. In short run also we could easily identify its impact on the economy, from the above discussion it is clear that the decision taken will have far reaching impact on the economy.

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Sachin Abda

Assistant Professor

Sanskars Institute of Management and IT

Bhuj

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