



भारतीय प्रबंध संस्थान बेंगलूर  
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A report on

# Long-term Impact of Demonetization

under the guidance of

**Dr. Charan Singh**

*Visiting Faculty & former RBI Chair Professor (Dec '12 to Dec '16)*

Economics & Social Sciences

IIM Bangalore

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by

**Deep Zanzrukia (1611218)**

**Dnyanesh Katakdaunde (1611168)**

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## Abstract

This CCS report consists of outcome, analysis and impact of demonetization of Rs 500 and Rs 1000 notes announced on 8 November, 2016. The execution of this demonetization drive are studied and analyzed to verify its alignment with the stated objectives of the demonetization – Corruption (Black money), Counterfeit Notes (Funding Terrorism) and Digitalization (Less-cash economy). The review of literature published on demonetization, survey and analysis was focused on studying the impact across all stated objectives of demonetization on different sections on the economy. The scope of the research was limited only to latest demonetization and its impact on Indian economy. The scope of survey is limited to Bangalore City and its suburbs. The conclusions drawn from research study, analysis of secondary data and field survey of this project are compared to those from published literature. Contrary to the conclusions drawn on short term impact of demonetization, this report gives key outcomes and long-term impact of demonetization, researched not only as a separate measure but also along with other economic measures like RERA, GST and Digital India. Finally, the report gives recommendations on how the demonetization process could have been better executed for a higher impact on each of its several stated objectives.

## Long Term Impact of Demonetisation

### Section I: Demonetization

There are mainly two types of currencies in the world, commodity money and fiat money. The value of commodity money comes from the value of underlying commodity such as gold, silver and such other materials. The fiat money on the other hand is not backed by a real commodity but by a legal power of the issuing authority such as central bank of a country. In India, Reserve Bank of India (RBI) is vested with the authority of issuing fiat money and accepting is a legal tender. Demonetization means the currency tender is no longer backed by the recognised authority, in case of India, RBI.<sup>1</sup> However, all currency notes say “*I Promise to pay the bearer the sum of \_\_\_*” which is an implicit guarantee of the currency note being legal. So, even in demonetization, the issuing authority cannot withdraw its backing of the notes. It has to replace these notes with new notes that are acceptable in the economy.

### Objectives of demonetization

The primary objective of demonetization was to curb corruption & black money.<sup>2</sup> The objectives were then changed to fighting terrorism, curbing tax evasion, formalizing the economy<sup>3</sup> and thereby enable the dramatic growth of bank credit.<sup>4</sup> Later, the purpose of demonetization was revised to digitalization of the economy. The objectives of demonetization were apt but the assumptions made by the government behind these objectives were susceptible to challenge.

### Structure of this report

Our study and this report is divided into five sections including the introduction–

The first section gives the introduction and objectives of the demonetisation. Section II contains the literature review of demonetisation. Section III presents the cross-country experiences of demonetisation. Section IV gives the history of demonetisation in India and presents the findings of the survey done and its analysis for the impact of latest demonetisation. Section V give conclusion of our study and provides recommendations on demonetisation. These five sections are followed by annexures supporting our study and analysis.

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<sup>1</sup> Jayati Ghosh, C P Chandrasekhar and Prabhat Patnaik (2017), *Demonetization decoded: A critique for India’s currency experiment*. New York, NY: Routledge

<sup>2</sup> C Rammanohar Reddy (2017), *Demonetization and Black Money*, Hyderabad: Orient Blackswan Pvt Ltd

<sup>3</sup> India Development Update (May 2017), World Bank

<sup>4</sup> Jayati Ghosh, C P Chandrasekhar and Prabhat Patnaik (2017), *Demonetization decoded: A critique for India’s currency experiment*, New York, NY: Routledge

## Section II: Literature Review

There are three distinct concepts – black money, black economy and black cash. The black money is widely held in the forms of: (a) real-estate with declared value different from actual purchase/sale value (b) equity or investments in shell companies (c) “*benami*” holdings – investments in name of others; (d) commodities purchased through cash like – gold and silver (e) investment in foreign assets or foreign countries.<sup>5</sup> The black money was assumed to be held as cash ‘stock’ rather than as ‘flow’.<sup>6</sup> Thus, the government believed that ‘black money’ was held as piles of cash hidden away from the formal system. So, demonetization was believed to invalidate such cash held as black money. The transactions used to exchange cash need not be undeclared or illegal but the difference in declared value and actual value is what leads to generation of black money. Thus, there is not only constant generation of black money but also change of money from white to black and vice-versa.

- Black economy is estimated at 20-30% of GDP and for highest estimate of 75% of GDP, Rs 120 lakh crore black money is generated
- Rs 14.6 lakh crore exist in the form of Rs 500 and Rs 1000 notes. Even if 50% of all these notes comprise as black money, that would be merely Rs 7-8 lakh crore, that is, 7% of the total black income being generated
- Thus, cash as the only means of black money doesn’t justify the action of demonetization

### Counterfeit money and terrorism

It was believed that terrorism and counterfeit currency are strongly linked. It has been found that funding is only one part of terrorism, others being mobility, logistic bases and communications. Also, the extent of funding required for small terror options can be easily arranged through formal means without resorting to counterfeit notes. Even if this poorly reasoned objective is to be addressed, demonetization can address it only up to the extent till new counterfeit notes are produced. Reports of circulation of fake Rs 2000 notes in several cities surfaced shortly after new currency was circulated. This shows that generation of counterfeit notes takes short time. Demonetization is costly experiment and not an effective way of dealing with this problem.

- Amount of currency seized between 2012 and 2015 in fake notes was Rs 147 crore, that is, Rs 37 crore per year
- As per study by Indian Statistical Institute, fake currency was estimated at Rs 400 crore, that is, mere 0.022% of the total notes.<sup>6</sup> This is hardly significant to cause damage to MSMEs, retailers and millions of small vendors or to fund major terror operation

### Moving towards digital or cashless (less-cash) economy

Weeks after the announcement, cashless economy was stated as the primary motivation of demonetization. Public was encouraged to use alternative modes of payments such as credit/debit cards, mobile and internet banking and mobile wallets. This was used as a means

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<sup>5</sup> Economic Rationale of ‘Demonetization’, Economic & Political Weekly

<sup>6</sup> <http://economictimes.indiatimes.com/news/defence/secret-study-pegs-value-of-fake-notes-in-circulation-at-rs-400-crore/articleshow/55424455.cms>

to mitigate the short supply of new currency. December 17 onwards, government discounted petrol and diesel by 0.75 percent and waived of service tax on card transactions above Rs 2000. Suburban tickets purchased digitally got 0.5 percent discount whereas insurance policies got 8 to 10 percent discount.

As per World Bank 2015 report, only 53 percent of the adult population in India had bank accounts and many of them being dormant. Though, 25 crore new bank accounts have been opened under *Jan Dhan Yojna*, many of these accounts have been dormant since they were created. Still, around 80 percent of women either do not have bank accounts or have a joint account with a male member of the family. Debit card holders and users are even lesser than the account holders and still lesser were the outlets which accepted the debit cards. As on December 2016, there were estimated 700 million debit card holders but only 700,000 outlets which accepted them.<sup>7</sup>

- Fewer than 50% of families have access to banks
- More than 60% of our economy comprises of informal sector, which is cash dependent
- India has one of the highest cash to GDP ratios in the world at 12% compared to global average of 4% and estimated 78% of transactions in India are in cash

## **Execution of the experiment**

### Announcement

The demonetization of November 2016 was planned as a covert and confidential initiative. This nature of execution was to get maximum impact on the objectives of demonetization. Also, the Prime Minister made the announcement on national broadcast at 20:15 IST. The time was chosen such that all banks and financial institutes were closed at the time of announcement. Further, old notes were allowed to be exchanged only up to 31 December 2016 that too with a limit of value which can be exchanged. Thus, the announcement created panic in the society.

### Pre-announcement preparation

Due to confidential nature of the initiative, the pre-announcement preparations were kept minimum so as to not reveal any information. According to RBI, 22 billion notes of Rs 500 and Rs 1000 were in circulation while the total capacity of printing machines was 23 billion notes per year. Thus, the shortage was evident even before the announcement. Further, the design of new notes was changed to a different size. This meant, the ATMs were required to be re-calibrated for new notes. However, no ATMs were calibrated for new notes before announcement. Distribution of new currency notes across geographies wasn't planned as some regions got more of new currency notes as compared to others. There were no guidelines and planning on what was to be done with the old notes received by the banks except that the notes were sent to RBI.

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<sup>7</sup> Jayati Ghosh, C P Chandrasekhar and Prabhat Patnaik (2017), *Demonetization decoded: A critique for India's currency experiment*. New York, NY: Routledge

### Post-announcement actions

The announcement of demonetization was made at night when banks were closed. The banks were closed for next two days. The number of new notes of Rs 500 and Rs 2000 printed were much less than demonetized old notes of Rs 500 and Rs 1000. The size of new notes was also different from the old notes which required ATMs to be re-calibrated.

The exchange of old notes was limited to one time transaction of Rs 4000 per person. This limit was then revised to Rs 4500 and then to Rs 2000. However, owing to suspicion that one person might be depositing multiple times as a proxy for someone else, government issued orders to put inedible ink on fingers of depositors. The over-the-counter exchange was stopped abruptly effective 25 November. The old notes were allowed to be deposited only into bank accounts. Withdrawal of new notes from customers own accounts was allowed with daily and weekly limits. These withdrawal limits were frequently changed. Daily withdrawal from ATMs was limited to first Rs 4000, then Rs 2000 and then Rs 2500 till March, post which the limit was withdrawn.

Exceptions were made where old currency notes were still accepted. This included use of old notes in hospitals, clinics, petrol, CNG & gas stations, payment of public utilities and toll booths, transactions with government offices, schools and colleges. All these exemptions were first allowed up to 14 November, then 24 November, then 15 December. However, some of these deadlines were brought forward. Deadline for accepting old notes at petrol pumps was brought forward from 15 December to 2 December with one day's notice.

### Immediate outcomes of the experiment

Sudden announcement of demonetization create panic in the society. Bankers and business owners reopened their offices to decide on further actions. Banks were closed for two days over the weekend so as to prepare themselves for the outcome. When banks reopened, people lined up at banks for getting cash. Recalibration of ATMs for new notes took time limit leaving withdrawal from banks as the only option to get cash. Even after recalibration, ATMs ran dry within few hours after reloading due to long queue and limited number of new notes available.

Small retailers and businessmen working mostly on cash suffered due to lack of cash. Overall demand of goods and services decreased as people started postponing their purchases. Informal sector, comprising 60% of our economy, is dependent on cash transactions. Thus, major impact on economy was anticipated due to this exercise. Several analysts estimated that maximum Rs 13 lakh crore of currency out of Rs 15.4 lakh crore in circulation would return to banks leaving at least Rs 2.4 lakh crore of black money outside the system.<sup>8</sup> However, by December 2016, only Rs 75000 crore remained out of the formal banking system.<sup>9</sup> This showed that the initiative had no major impact on black money as anticipated by the government.

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<sup>8</sup> <http://www.thehindu.com/business/Industry/%E2%80%98At-least-Rs.2.5-lakh-crore-won%E2%80%99t-return-to-banking-system%E2%80%99/article16760047.ece>

<sup>9</sup> <http://indianexpress.com/article/business/economy/demonetization-black-money-cash-crunch-rs-14-lakh-crore-in-old-notes-are-back-only-rs-75000-crore-out-rbi4465542/>

### Section III: Demonetization: Cross-country Experience

#### European Union<sup>10</sup>

Nations of the European Monetary Union demonetised their respective currencies to shift to euro while joining European Union. The authorities fixed the exchange rates of different currencies to euro. Domicile nations' currencies were demonetised when euro was introduced. The demonetization was smoothly carried out overall long time-period until all currencies were replaced by euro.

#### United States<sup>11</sup>

In 1969 US went for demonetization of all notes above \$100. This was done as higher denomination notes weren't required due to arrival of better bank transfer technologies. Sufficient time period was provided to exchange the old notes and Federal Reserve Bank destroyed them as and when they were received.

#### Zimbabwe<sup>12</sup>

Plagued by hyperinflation, Zimbabwe replaced its currency Zimbabwe dollar with US dollar in 2015. This was done in a short span of time. This hurt the wealth owners as compensation provided towards their holding of Zimbabwe dollar was too low. The demonetization had great effect on country's economy as exports became costly in US dollars.

#### Myanmar<sup>4</sup>

Myanmarese kyat was demonetised thrice to curb black market and smuggling. During demonetization of 1987, old notes were not exchanged with new notes resulting into severe economic problems in the country.

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<sup>10</sup> <http://www.economaldives.net/2016/11/demonetization-in-maldives-india-and.html>

<sup>11</sup> <https://mostlyeconomics.wordpress.com/2016/12/16/demonetization-in-us-on-14-july-1969-how-relevant-is-it-for-comparing-with-indias-demonetization-in-2016/>

<sup>12</sup> <https://qz.com/845803/demonetization-zimbabwe-myanmar-and-ussr-have-been-there-done-that-and-screwed-themselves-over/>

## Section IV: Survey findings

### History of Demonetization in India

The demonetization of 8 November 2016 is not the first currency ban of India. Demonetization has been implemented twice in the past – 1946 and 1978

#### Currency ban of 1946<sup>13</sup>

In 1946, the currency notes of Rs 1000 and Rs 10,000 were demonetised and removed from circulation. These higher denomination notes were not accessible to common people at that time. So, the currency ban did not have much impact on the common people and the Indian economy. However, these notes were re-introduced in 1954 along with new Rs 5000 note.

#### Currency ban of 1978<sup>5</sup>

In 1978, the then Prime Minister of India, Morarji Desai, demonetised Rs 1000, Rs 5000 and Rs 10,000 notes and removed them from circulation. This action was kept confidential. This was done to check the black money generation in the country. The higher denomination notes weren't easily accessible to most common people. So, the impact of currency ban on common people was limited.

#### Demonetization of November 2016

On 8 November 2016, at 20:15 IST, Prime Minister of India announced demonetization of Rs 500 and Rs 1000 notes in a television broadcast. He described how this move will help to capture the 'black money'. The Rs 500 and Rs 1000 notes constituted 86%<sup>14</sup> of the currency in circulation and was used by most common people of the country. This currency ban was also kept confidential and banks were closed for 2 days after announcement. So, this currency ban had a high impact on common people.

### Survey

As a part of this project we interviewed 80 people from Jeweler community, Bankers, Real Estate (Builders), Workers in Weaver colony & regular consumers. Below are our findings from the survey on demonetization & its long-term impact on them

#### Bankers

All bankers were worried about following rules and managing their branches when demonetization was announced. They worried about increasing workload, managing staff and deciding on the action plan for next few days.

Cash management became the main issue. However, all banks achieved their annual cash deposit targets due to demonetization which resulted in increase in cash deposits by more than

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<sup>13</sup> <http://www.freepressjournal.in/featured-blog/indias-history-with-demonetization-from-1946-to-2016/988212>

<sup>14</sup> [http://www.business-standard.com/article/economy-policy/86-of-currency-by-value-in-india-are-of-rs-500-rs-1-000-denominations-116110801416\\_1.html](http://www.business-standard.com/article/economy-policy/86-of-currency-by-value-in-india-are-of-rs-500-rs-1-000-denominations-116110801416_1.html)



100%. In one case, the daily deposits saw a decrease rather than increase. This was due to widespread fear among public that they'll lose their money if they deposited it into banks.

In all cases, cash was provided less frequently and only at 60-70% of value as compared to pre-demonetization values. However, two branches were found to be cash positive due to higher cash reserve and smaller customer base. These branches also gave out cash to other branches. This was contrary to our assumption that all branches were cash negative. Operation and situation was found to normalize from around mid-January 2017 for all branches.

All banks saw increase in digital transaction by 50-60% and it has stayed that way. In one case, it was found to increase by 500%. This was due to the fact that the branch was recently setup and had digitalized mainly during the period leading up to demonetisation. Owing to operational challenges and problems faced by bankers, they're less keen to support another demonetization. However, if it is properly planned and sufficient time and resources are provided, bankers will support another demonetization.

Some people went to bank branches for banking activities other than cash withdrawal or deposit. However, people lined up outside branch didn't allow them to go inside thus halting other banking operations.

#### Jewelers

The demand for gold didn't change much and showed only slight increase. This disproves our assumption that people turned to buying gold to utilize their cash after demonetization. Also, the forms of gold sold after demonetization were same as that before demonetization.

Mode of payment by customers changed with more customers opting for digital payments like online banking, credit card and debit card payments. Purchase of gold by jewelers wasn't affected. There were no restrictions on sale or purchase of gold. Also, jewelers bought gold by paying through cheque. The jewelers faced challenge of depositing their excess cash by showing relevant documents of purchase and sale.

#### Retailers

Retailers of non-durable goods experienced decreased demand for both essential good and non-essential goods. They managed inventory by purchasing on credit. They didn't lay-off workers working in retail stores. The situation hasn't turned normal for such retailers and they see these conditions will continue due to implementation of GST.

Retailers of durable goods also saw slight decrease in demand of the goods. Customers approached them with old notes but such customers weren't entertained. The situation turned normal for such retailer's mid-January onwards. They too didn't layoff any workers.

#### Weaver Colony

Weavers operated on small budget and credit mode. So demonetization didn't impact much on them. They managed their purchase using credit for large purchase and paying cash for smaller purchases.

Their sales were impacted as they weren't able to collect cash payments. In some cases, the workers left the job and went to their native places for 1 to 2 months only to come back and work again. They use digital payment only in few cases and still largely rely on cash, cheque and credit for their business.

Weavers find more problem with implementation of GST rather than demonetization. The weaver's union is opposing GST and has not registered for it. The availability of water and power remains the main problem for weavers rather than cash.

### Consumers

Approximately 83% of the people said that Demonetization was undertaken to curb black money and avoid corruption. 52% of people also said that to check counterfeit money and increase digitization was also an objective of demonetization. Very few consumers (2.2%) said that demonetization was undertaken due to political purpose. Approximately 50% people said they were happy for such a bold move. 30% people said they were shocked when they heard the news and some of them thought that this is fake news. Remaining people said either this move was not required or they were not impacted at all.

Major problem faced by consumers was long queue formed at banks and ATMs. Also most of the time there was no cash in ATM. 70% consumers faced this problem. Very few consumers were faced information unavailability or no support at banks and ATMs. At other places like petrol pump and money lenders, people didn't face any problem apart from not having proper information. For very few consumers demonetization affected buying decision of durable goods. One possible reason for no impact was use of digital transaction. Most of the people use debit and credit cards to buy durable goods hence no such impact was observed. Also there was no change in buying decision for essential goods. But there was considerable decrease in buying decision for non-essential goods.

Approximately 94% people said that conditions have been normalized now and 98% people said that their consumption pattern has turned normal. Close to 20% consumers said that from November 2016 itself their consumption pattern turned normal and around 27% people said their consumption pattern turned to normal from December 2016 and January 2017. Moreover, around 54% consumers said that change in consumption is permanent and remaining said that it is a temporary change.

Almost 83% started or increased using digital medium for transactions. Debit card and digital wallet were the preferred medium for digital transaction as 63% and 68% consumers opted for it respectively. 40% consumers preferred online banking. 100% consumers, who were using / started using digital medium says that they will continue to use digital medium for transaction. For the people who didn't use digital medium for transaction, availability of enough cash was main factor for not opting digital medium. Close to 90% people didn't turn to money lenders for cash exchanging.

Around 44% consumers used petrol pump as a way to exchange banned notes. 35% used agent, family or friend contact to exchange notes. Also 11% opted for investment for converting banned notes. Around 57% consumers said they will support to government if there is another instance of demonetization on some prior conditions. These conditions are demonetization activity has to be planned and enough notes needs to be made available to people, genuine people don't have to suffer, no transactions limit at ATMs, checks at banks for checking fraudulent instances.

### Analysis of our study and findings

On 8<sup>th</sup> November 2016, PM Narendra Modi announced that “after midnight of 8<sup>th</sup> November, Rs 500 and Rs 1000 notes will no longer be valid”. This announcement came as a shock to all Indians as these were the currencies in which most of the cash was held. Many people especially people in rural India had life-long saving in the form of Rs 500 & Rs 1000. For those people it was like end of the road situation. Demonetization is not a new activity for India but the way it was announced and volume of notes were banned in the process was different. That was the main reason people panicked and spent available cash wherever possible. This was one of the immediate impact Demonetization had on Indian Economy. There were many such immediate impacts along with long lasting impacts on Indian Economy. Some of the sectors like manufacturing, banking, real estate sector were impacted severely. The short term and long term impact on various affected sectors are as below –

### Short Term Impact

#### Impact on Manufacturing Sector

- Demonetization created a cash crunch for at least 2 months. This cash crunch reduced the demand as consumers delayed consumptions of non- essential goods and durable goods. Thus the demand for non-essential and durable goods fell sharply<sup>15</sup>
- As the demand reduced, manufacturing sector produced less goods thus the regular cash flow was impacted severely
- Reduction in cash flow due to lower output coupled with cash crunch due to demonetization, manufacturers had to resort to credit system for managing day to day to operations<sup>16</sup>
- Due to lower demand, many manufacturers had to lay off some of the workforce as they couldn't pay daily/monthly wages
- On the other hand there was no decrease in demand for essential goods. People used various means like using credit system, digital mediums for buying essential goods<sup>17</sup>

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<sup>15</sup> <https://www.magzter.com/article/Technology/industrial-business-MART/Demonetization-Impact-on-Manufacturing>

<sup>16</sup> <http://www.thehindu.com/business/Economy/Demonetisation-hits-manufacturing-sector/article16979062.ece>

<sup>17</sup> <http://blogs.timesofindia.indiatimes.com/minorityview/impact-of-demonetisation-on-industrial-growth-more-severe-than-anticipated/>

### Impact on Real Estate Sector

- Before demonetization, many of the buyers used part cash and part digital medium for buying / renting houses, but due to cash crunch created by demonetization, people delayed buying/renting houses<sup>18</sup>
- Many of people who used to invest in real estate sector stopped investing in new housing projects
- Builders stopped introducing new projects or suspended ongoing project. Also Real estate sector also saw layoffs being carried out.
- As real estate sector is majorly unorganised sector, builders faced problems for giving daily wages due to unavailability of hence many labours left the job and returned to their hometown

### Impact on Banking and Financial Sectors

- Next after demonetization was announced, SENSEX fell by more than 1500 points. Nifty too suffered loss of 700 points as investors took demonetization announcement negatively<sup>19</sup>
- Banking sector which was forefront for the carrying out demonetization activity had to work extended hours. This condition remained the same till end of December.
- During first 2 weeks after demonetization enough notes were not available. Hence banks couldn't give demanded cash to account holders. Due to this there were many altercations between bank employees and people<sup>20</sup>
- Money deposited in banks increased significantly along with new account openings
- Many loan holders repaid the loan using banned notes before the timeline hence banks lost revenue which they could have earned in the form of interest
- In rural areas, bank employees had to first educate people about demonetization apart from carrying out day to day activities

### Impact on Jeweller Community<sup>21</sup>

- Just after demonetization announcement, many people rushed to gold shops to buy gold by giving up old notes thus just after demonetization announcement gold demand increased considerably
- But within 1 week this demand was neutralized as many jewellers refused to accept old notes as they were also facing problems while exchanging old notes with new ones
- Some jewellers also came under scanner of government and received notice from Income tax department. Due to this many of the jewellers stopped accepting cash in exchange of gold

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<sup>18</sup> <http://www.morningstar.in/posts/39098/impact-of-demonetization-on-real-estate.aspx>

<sup>19</sup> <https://financetapmi.wordpress.com/2017/03/09/effects-of-demonetization-on-the-financial-sectors-of-india/>

<sup>20</sup> <http://www.iosrjournals.org/iosr-jbm/papers/Conf.17021-2017/4.%2020-22.pdf>

<sup>21</sup> [http://www.indiainfo.com/article/news-top-story/how-demonetization-will-impact-jewellers-and-jewellery-industry-116111100375\\_1.html](http://www.indiainfo.com/article/news-top-story/how-demonetization-will-impact-jewellers-and-jewellery-industry-116111100375_1.html)

- Also some of the jewellers faced problems in gold procurement from gold suppliers / distributors
- Government put certain restriction of providing PAN number for gold purchases of 2 lacs and above
- Most of the jewellers started using POS machine and demanded digital transaction from their customers which helped in digitization of economy

#### Impact on Agriculture<sup>22</sup>

- As cash was the primary medium of transaction in agriculture, agriculture sector had very severe short term impact
- As Rural Cooperative banks were barred from exchange-deposit of demonetized notes, farmers suffered most as many farmers uses rural cooperatives banks for banking operations
- Many farmers had to sell their *kharif* harvest at lower price or at credit system due to cash crunch as demonetization was done when farmers harvest in *Kharif* season
- Similarly many farmers couldn't buy seeds for *Rubi* season sowing as no one was accepting demonetized notes
- Due to disruption created by cash crunch and lower demand, whole supply chain which was used by farmers to bring their products to market broke down, which resulted in lower price for output (sometimes less than cost incurred to produce them) and higher wastage of perishable goods

#### Impact on Consumers

- Demonetization had major impact on consumers as 86% of the currency was invalidated by government
- There was cash crunch, huge line at banks, non-functioning of ATMs and daily new update about demonetization which made consumers life miserable during the first 2 weeks of the demonetization<sup>23</sup>
- People in rural area were affected most as they were the last ones to receive new currency notes
- Due to lack of the formal education many people feared that if they put money in the bank government will confiscate that money as a black money and they will lose their life-long savings
- Thus in place of going to banks for exchanging old notes, rural people resorted to going to money lenders. Money lenders charged 25-40% for exchanging old notes with new ones
- In urban areas situation wasn't different. People had to stand long hours in a queue just to get notes replaced. Many times they had to return empty handed as not enough new notes available

<sup>22</sup> <http://www.livemint.com/Opinion/B1vFTOgwqHjdM5nkmg2CxJ/Demonetization-The-impact-on-agriculture.html>

<sup>23</sup> <http://www.allresearchjournal.com/archives/2016/vol2issue12/PartF/2-12-71-172.pdf>

- Consumers delayed the consumptions of non- essential goods and durable goods. Also for essential goods consumers started using digital wallets, credit/ debit cards and credit system. Thus one of the objective of demonetization – digitization received major push<sup>24</sup>
- After first two weeks of demonetization, conditions started to normalize. But normalization was mostly due to the acceptance of consequences of demonetization by people. People cooperated with government agencies and government agencies also put in additional effort to smoothen the process of demonetization

## Long Term Impact

### Impact on Manufacturing Sector<sup>25</sup>

- Manufacturing sector started to normalise by March 2017 and currently more or less it has been normalized completely
- There is enough liquidity in system now and demand has returned to its normal level hence many of the workers which were removed from jobs have been hired again
- Workers who left jobs voluntarily and went to their hometowns have to return to urban areas and have found new jobs
- Mostly unorganized before demonetization, manufacturing sector is now migrating towards organized sector as they embrace digital medium like use of banking system for paying wages, using net banking or debit/credit card for major transactions etc.

### Impact on Real Estate Sector<sup>26</sup>

- Though real estate sector predominantly deals in cash, the predicted severe impact on real estate has proved to be wrong. Condition is returning to its normal level. Especially for established players in major tier 1 & 2 cities, prices have already been stabilized and demand for new & houses is also increasing
- Land transaction which have historically been dealt in cash has taken a major hit & correction of up to 20-30% could be seen. Thus lower cost of land in emerging areas like Tier 3 cities will lead to lower cost of housing projects<sup>27</sup>
- Demonetization coupled with Real Estate Regulation Act (RERA), has brought some transparency in Real estate sector which is historically known as one of the prominent sources of generation of black money
- Increase in demand has resulted in new employment opportunities and thus the people who were laid off during demonetization have found new jobs

24 <http://www.allresearchjournal.com/archives/2017/vol3issue3/Part1/3-3-95-206.pdf>

25 <http://taxreturnwala.com/impact-currency-demonetization/>

26 <http://www.mirrornow.in/expert-views/focus/demonetisation-immediate-and-long-term-impact-real-estate/35069>

27 <http://www.moneycontrol.com/news/business/personal-finance-business/demonetisation-dissectingimpactreal-estate-sector--921129.html>

Impact on Banking and Financial Sectors<sup>28</sup>

- Demonetization though had negative short term impact on banking & financial impacts but its positive effects are now seen as both financial markets & banking system have been normalized. SENSEX & NIFTY have crossed their highest peak point in recent time
- Banking sector which was forefront for the carrying out demonetization activity had to work extended hours. This condition remained the same till end of December
- As some amount of black money which was hidden from formal economy has entered into system, liquidity has increased which has resulted in lower inflation
- Increased deposit amount has resulted in lower interest rate. Due to this many private sector companies have taken up investment opportunities recently & this trend is expected to continue in future
- Demonetization has given a push to digitization which is evident from the increased usage of net banking, use of debit / credit card, use of online wallets. Many banks have seen increased in online / digital transaction by more than 20-30%

Impact on Jeweller Community<sup>29</sup>

- Demand for gold even after 9 months of demonetization haven't returned to its normal level as people are still shying away from investing in gold.
- Most of the sales happening now is through digital medium. Due to this cost of buying gold has increased
- But on the other side demonetization exercise should also expand the tax base and the positive impact on public finances could generate a more benign and gold-supportive policy approach by government

Impact on Agriculture<sup>30</sup>

- Agriculture sector returned to its normal state once the cash flow was normalized. Majorly all agricultural related operations normalized by end of March 2017.
- Government took various measures such as providing chemicals, pesticides, seeds on a credit system which nullified negative impact of demonetization up to some amount
- Farmers also adopted digital medium to do major transactions thus lowering the impact of cash crunch and helping push towards digitization<sup>31</sup>

Impact on Consumers<sup>32</sup>

- As the consumers got used to demonetization activity its impact started to reduce and it was reduced to negligible level by March 2017

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28 <http://www.businesstoday.in/current/economy-politics/demonetisation-long-term-and-the-short-term-impact/story/241439.html>

29 [http://www.business-standard.com/article/economy-policy/note-ban-to-benefit-jewellery-sector-in-long-run-jewellery-industry-117011701115\\_1.html](http://www.business-standard.com/article/economy-policy/note-ban-to-benefit-jewellery-sector-in-long-run-jewellery-industry-117011701115_1.html)

30 <http://www.iosrjournals.org/iosr-jhss/papers/Conf.DAGCBEDE/Volume-1/10.%2035-38.pdf>

31 <http://www.thehindubusinessline.com/economy/agri-business/demonetisation-will-benefit-farmers-in-the-long-run/article9418356.ece>

32 [http://www.indiawest.com/news/india/no-long-term-impact-to-indian-economy-from-demonetization-u/article\\_96341e74-dcf1-11e6-9035-9f1347a3bee9.html](http://www.indiawest.com/news/india/no-long-term-impact-to-indian-economy-from-demonetization-u/article_96341e74-dcf1-11e6-9035-9f1347a3bee9.html)

- Consumption pattern has also returned to normal and consumers have started to buy durable goods which they delayed during first few weeks of demonetization
- Banks emphasizing on use of ATMs reduced the long queues at bank. As enough cash was made available by government (RBI) through ATMs daily visit to bank for getting cash was reduced lowering the pressure on banking system
- Once the rural people were informed about objectives of the demonetization, they also embraced the situation & helped government organization in smooth functioning of demonetization activity



## Section V: Conclusion and Recommendations

### **The Big question: Was Demonetization successful?**

When demonetization was announced, government stated three objectives for undertaking demonetization. These objectives were

1. Curbing black money and corruption
2. Counterfeit fake currency & cross border terrorism
3. Transforming cash based economy to digital economy

Success of demonetization is dependent on till what level government was able to achieve these three mentioned objectives. Following section analyses the demonetization impact through these mentioned objectives

#### Impact on Black money & Corruption

- Initially government was able to curb generation of new black money as many people were caught by surprise due to sudden move by government but after 1 month or so people found loopholes in system and converted black money to white using various means such as opening new account using names of family members, house-keeping staff, etc and depositing money in their account.
- This was evident by the amount of money which had entered in formal system by December 2016. Government was hoping that 12-15% of total available currency will not entered into formal system but by December 2016, 97% of the total currency had entered into formal system.
- As proportion in which people keep undisclosed income in cash is very less, government's motive of curbing black money was always going to be a failure
- People also found new means by which they could perform corruption like accepting various goods in place of cash, getting unnecessary favours, etc.
- As demonetization was a one-time activity it is not enough to curb whole of black money & corruption. Sustained and long term efforts are required by government to achieve the objective of curbing black money & eradicating corruption from system.
- Thus we believe that though demonetization was a bold and necessary move from government it alone can't be sufficient for curbing black money. Also given the lapses in implementation of demonetization & loop holes which people exploited we believe that demonetization was neither a success nor a failure as far as first objective is concerned.

#### Impact on Counterfeit fake currency & cross border terrorism

- Sudden implementation of invalidation Rs 500 & 1000 notes had a positive impact on Counterfeit fake currency & cross border terrorism
- After 8<sup>th</sup> November there was a significant reduction in cross border terrorism
- Also government claimed that presence of fake currency in system had reduced after demonetization but no significant proof was provided to support this argument

- But as time passed by cross border terrorism started to initiate again as newly introduced currency started to get available in abundance. Also within 2 months there were reports of fake notes of Rs 2000 being circulated in the system
- Thus we believe that demonetization succeeded in short term but in long term it was not successful. Thus government has to introduce other strict measures to achieve the mentioned objective

#### Impact on digitization of economy-

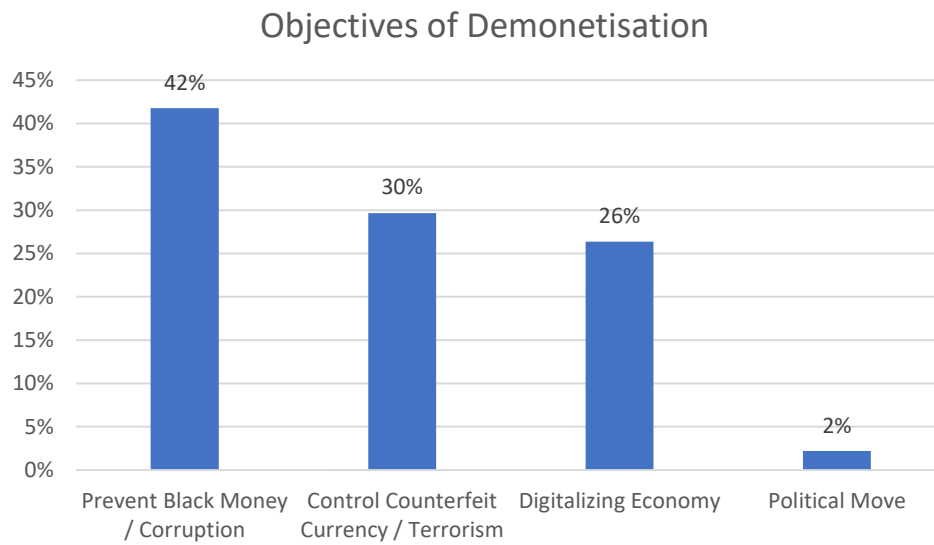
- As 86% of the currency was invalidated by government, people had to accept other means for exchanging goods. As credit system was not efficient people had to accept digital modes of transaction
- Once people started using digital modes for transaction they came to know about its simplicity of usage & its benefit people reduced usage of cash even after it was available & did more transaction using digital medium
- Looking at the success of digital wallets, many banks launched their own application for doing banking transaction. This also helped in reducing no of people going to banks & thus the pressure on banking system
- Government also announced some favorable policies such as no limit on number of times cash is withdrawn from ATMs, zero % transaction charge on online transaction etc
- Also launch of *Reliance Jio* which provided free internet across the country enabled easy of doing digital transaction
- Many banks have seen up to 20-30% increase in digital transaction. Digital wallets have seen increase of at least 200% in no of active as well as new users
- Average amount of transaction through digital wallet post demonetization has been increased by 20% showing the greater level of acceptance of digital wallet by people
- Thus, from all these impacts, it is evident that demonetization was successful in respect to giving digital push to an economy. But this one time alone is not going to be sufficient for sustaining the increased acceptance of digital modes of transaction
- Thus, we believe that demonetization was successful for digitizing the economy, more sustained efforts are required from the government

#### **Recommendations**

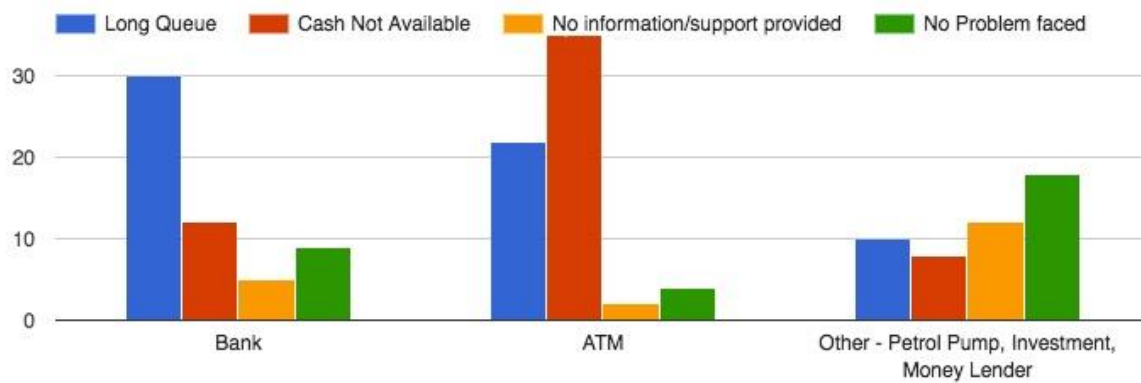
The demonetisation isn't the only measure to curb black money and corruption. Regulations that target root cause, that is, transactions leading to generation of black money and not the cash output should be made. GST and RERA are few such measures. Infrastructure required for digitalization of economy is not in place. That needs to be developed first. After that, a planned demonetisation can be undertaken with sufficient time for exchange of notes and clearly defined rules. That can result in higher level of digitalization. Total percentage of counterfeit notes in circulation is too small and doesn't warrant a drastic measure to resolve it. Educating people and strict checking mechanisms should be employed.

Thus, if another demonetisation is required, it should be properly planned and executed. Also, it should be supported with other initiatives to achieve the stated objectives.

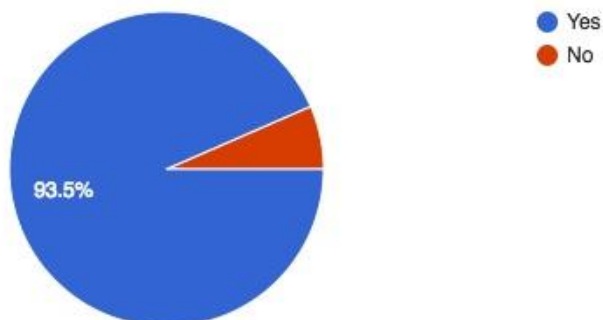
**Annexure-1: Perceived objectives of demonetization by public**



**Annexure-2: Difficulties faced due to demonetization**



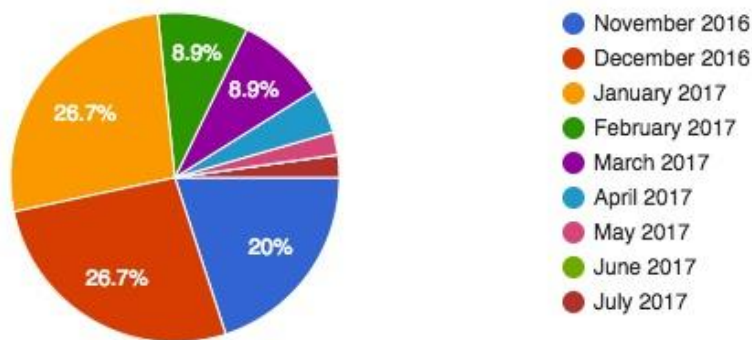
**Annexure-3: Perception on Financial Conditions been normalized**



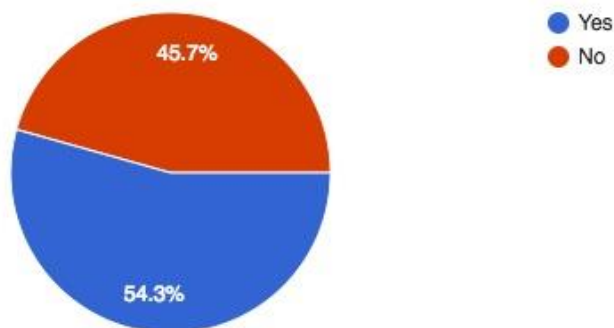
**Annexure-4: Has consumption turned normal**



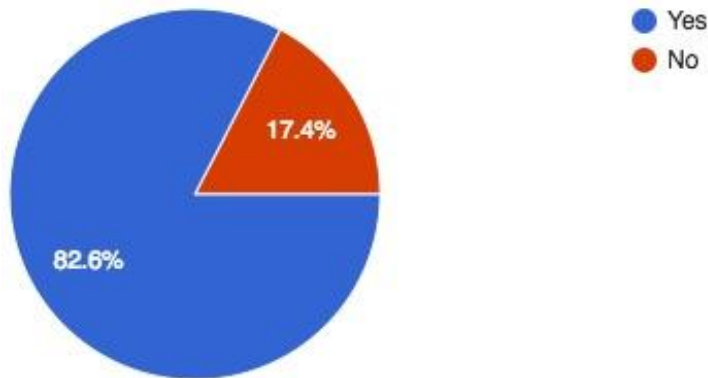
**Annexure-5: Period when consumption turned normal**



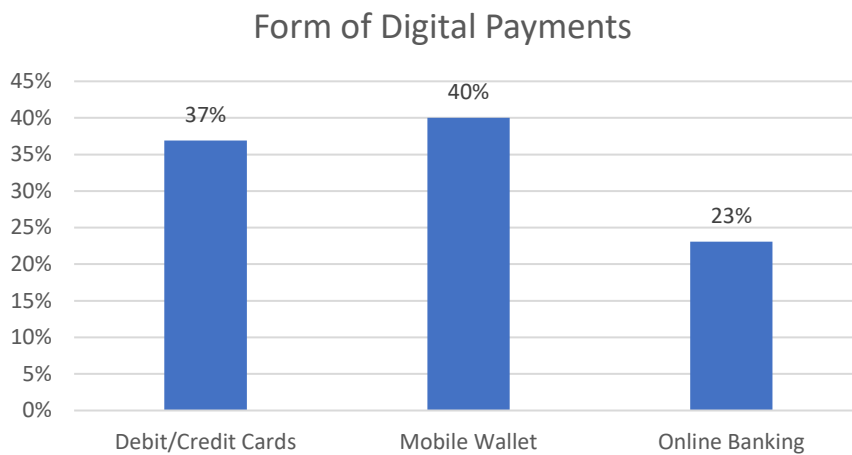
**Annexure-6: Is the consumption change permanent?**



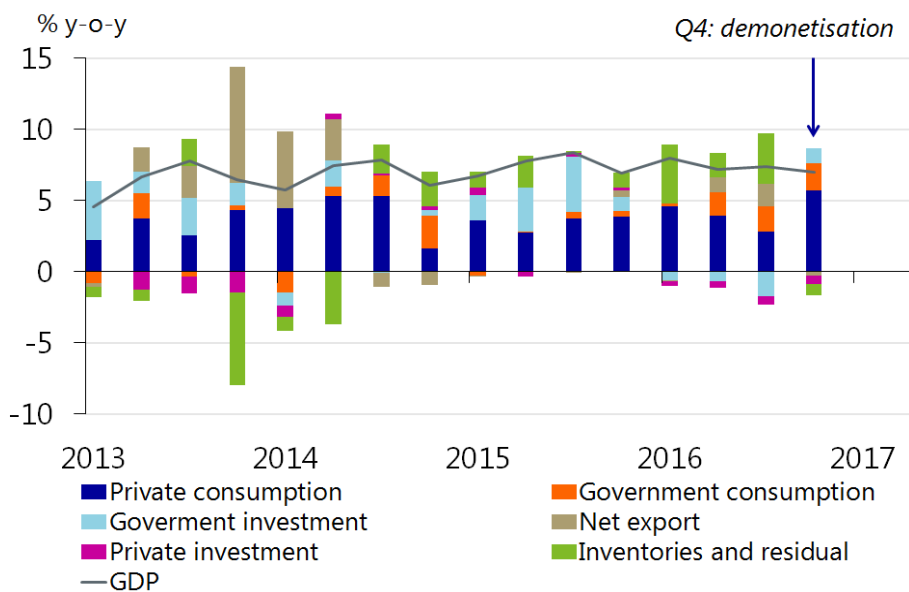
**Annexure-7: Percentage of people started / increased use of digital payments**



**Annexure-8: Forms of digital payments used**



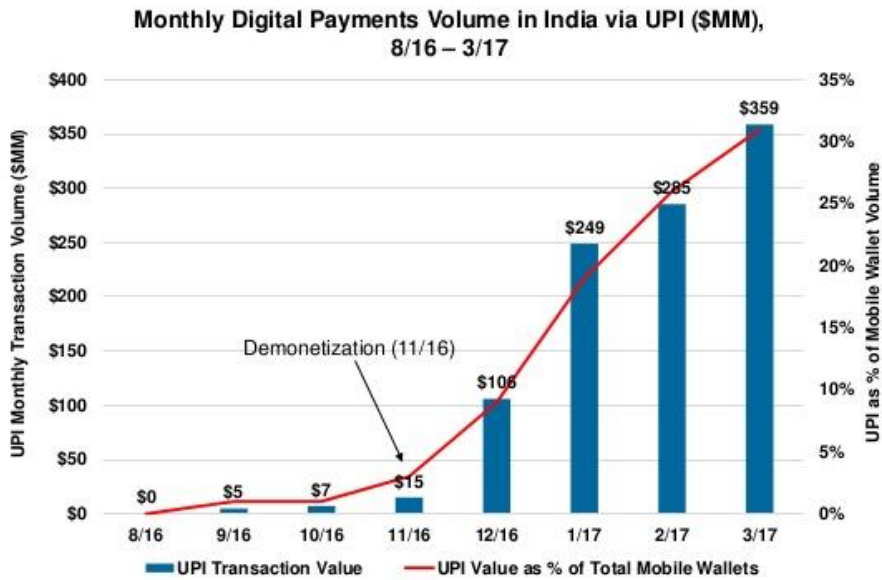
**Annexure-9: GDP comparison during Pre & Post Demonetization Period**



**Annexure-10: Digital Transaction Comparison Pre & Post Demonetization**

a) UPI Transactions

...India Payments = UPI (Universal Payments Interface)...  
Rapidly Enabling Bank-to-Bank Mobile Money Transfers

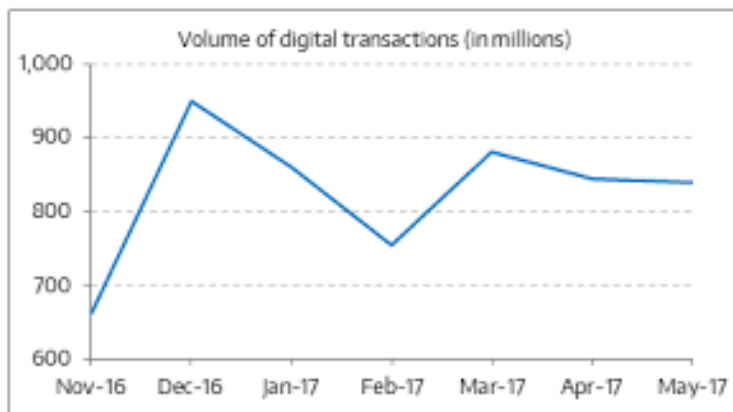


**KLEINER PERKINS**

Source: Reserve Bank of India, Monthly Bulletin (Payments and Settlement Systems)

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b) Number of Digital Transaction



Source: Reserve Bank of India

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