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### Impact of demonetization on Indian economy

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#### Abstract

Countries across the globe watching India as a democratic country and is poised to become a leader of regions. In the global environment, India has multiple strengths of larger youth population, growing middle class people, increasing literacy level and improving technical knowledge among the work force which would address favorably any proactive change in the present setup. Moreover, demonetization, coupled with Digital India and Jan Dhan Yojana, is aimed at strengthening transparency in money transactions by curbing black money, corruption and financial crimes. Therefore, it is the best time to strike the chord of second financial reforms and new banking sector operations in tandem digital network so as to achieve remarkable economic development at a faster rate. In addition, a few immediate negative implications of demonetization are also seen in terms of minimum growth in GDP, losing job by wage earners in some industries and real estate sector which have affected the Indian economy to some extent. But, adopting good governance practices, providing sound infrastructure, congenial atmosphere to start business and ensuring trained workforce would have got positive long term impact on Indian economy. Further, total transparency in business operations through banking services would also increase tax revenue to the GDP ratio. Therefore, this paper will take up the issues relating to demonetization and its linkage to the implications of various sectors in Indian economy during pre and post demonetization periods discusses the experience and impact of demonetization on Indian economy.

**Keywords:** Demonetization, Financial Reforms, Income tax, Real Estate, GDP, GVA

#### Introduction

Indian economy is said to be a fast growing and also considered to be bright spot among other emerging markets in the world. In the global environment, India has multiple strengths of larger youth population, growing middle class people, increasing literacy level and improving technical knowledge among the work force which would address favorably any proactive change in the present setup. Moreover, demonetization, coupled with Digital India and Jan Dhan Yojana, is aimed at strengthening transparency in money transactions by curbing black money, corruption and financial crimes. As per the data released by the Central Statistics Office (CSO) the growth figures of many industries have showed downward trends from 7.6% to 7.1% for the financial year ending 2017 just before the quarter when the demonetization exercise is introduced. Several economists also viewed that the current and ongoing attempt to flush out black money would shave a good 2% of the GDP.

#### Issues

India is basically a cash transaction oriented economy in almost all business activities. It is true that any country which has a strong banking and financial system would have got the capacity to withstand any crisis arising out of financial dealings. In that order, Indian financial system is inherently strong and our banking system is also well structured to meet any financial endeavor.

The demonetization exercise which was suddenly introduced in India during the quarter (October – December, 2016) had affected the performance of many industries in the immediate next quarter (January-March, 2017) and on the other hand some other industries have positive implications. Therefore, this paper will take up the issues relating to demonetization and its linkage to the implications of various sectors in Indian economy during the financial year 2016-17 particularly pre and post demonetization periods and discusses the experience and impact of demonetization on Indian economy.

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## Review of Literature

CMA Jai Bansal (2017) reveals that GDP of Country slightly decreases as compare with the previous year but we cannot say it will be same in future also. This intervention is a one-time draining of this current stock of black money but unless the root causes of corruption are removed, corruption will continue. It is sort of like a dialysis, more of a short term cleaning up than a solution of the problem. It needs to be repeated periodically.

Dr. Partap Singh (2016)<sup>[2]</sup> researched on Impact of Demonetization on Indian Economy and concluded If the money disappears, as some hoarders would not like to be seen with their cash pile, the economy will not benefit. On the other hand if the money finds its way in the economy it could have a meaningful impact. However experiences from different countries shows that the move was one of the series that failed to fix a debt-burdened and inflation-ridden economy.

Sukanta Sarkar (2010) conducted a study on the parallel economy in India: Causes, impacts & government initiatives in which he focused on the existence of causes and impacts of black money in India. According to him, the main reason behind the generation of black money is the Indian Political System i.e. Indian govt. just focused on making committees rather than to implement it. So, he concluded that laws should be implemented properly to control black money in our economy.

## Objectives

1. To understand the implications of demonetization on various sectors.
2. To analyze the impact of demonetization on Indian economy.

## Methodology

The present study is diagnostic and analytical as well and secondary data were used for the purpose of analysis. Main source of data has been collected from the Central Statistics Office (CSO) and supporting information is taken from the facts released by Reserve Bank of India (RBI) and different websites relating to it. The collected data were analyzed with paired sample t - test and regression analysis so as to understand the immediate effect and to measure its impact on Indian economy.

## Implications of demonetization

On referencing various information from the leading financial dailies, the consensus view among many economists is that while there would be indeed a noticeable slowdown in the economy for a “quarter or two”, most of them seem to agree that growth would indeed bounce back and the Indian economy would regain its momentum as well as turnaround with a renewed sense of vigour due to higher tax revenues. It is a fact that, as per the recent estimates by some economists, nearly 90% of the total cash in circulation has come back into the banking system and hence, the stated purpose of the Demonetization exercise which was to “extinguish” black money and enable the RBI to lower its liabilities thereby providing the government with a huge dividend seems to have been belied.

In addition, there are some who now argue that the Indian Banking System is now “flush with cash” and this has enabled the government to “nudge” the RBI to cut rates as well as to allow banks to pass on the benefit of ample liquidity to consumers by lowering lending rates. On the other hand, with more taxes being collected due to higher deposits in banks that can be taxable as well as increased compliance due to greater scrutiny and oversight by the Income Tax Department, the government too might be tempted to announce lower rates for taxes and other aspects of what are known as fiscal measures. In this context, it is worth remembering that fiscal stimulus which is by lowering taxes and providing more incentives to consumers as well as producers by boosting supply can be complemented and supplemented by the monetary stimulus which is by boosting demand for goods and services by lowering lending rates thereby putting more money in the hands of consumers.

It is ensured that the demonetization exercise would drastically affect the corrupt practices and People who are holding black money in cash would not be able to exchange much as they would be in a fear of getting prosecuted by the authorities. Further, enemies of the country who are involved in counterfeit currency and terrorism would not be able to continue it further.

As per CRISIL there will be a direct positive impact on government's tax revenue collections, its ability to spend on infrastructure investments and resultant impact on growth. Since government investments will increase and there will be a positive impact on the GDP in the long run. Higher income tax collections arising from better compliance would offer scope to reduce tax rates over long term, which would increase disposable income. This can give a positive impact on consumption demand in long term.

Initially, it is very difficult to create cashless society as more than 50 percent of Indian population is not well versed with card transactions. Also for these initial months, it will be very difficult to make in cash transactions of a higher amount. The liquidity squeeze caused by demonetization will be negative across sectors with high level of cash transactions. Real estate, jewelry, retailing, restaurants, logistics, consumer durables and luxury brands, cements and some segments in retail/SME lending space will be facing short term instability.

## Impact of Demonetization on Indian Economy

Statistical analyses have been done and measured the impact of demonetization and results have been arrived at the end.

## Analysis & Discussion

The impact of demonetization on Indian economic growth has been widely outraged. According to the government's latest growth estimates, the pace of growth will be impacted by slow growth in the manufacturing and mining sectors and also in the traditional retail sector. The study ensures that some of the industries have been affected unfavorably in term of poor performance and on the other hand some other industries have been benefited in term of growth prospects.

**Table 1:** Quarterly Data of Gross Value Added on Various Sectors in India

Sectors / Year	2016-17 (Rupees Billion)	
	H1	H2
Agriculture, Forestry and Fishing	7000.06	9961.67
Mining & Quarrying	1518.53	1786.33
Manufacturing	10078.78	10120.5
Electricity, Gas, Water Supply & Other Utility	1218.68	1187.23
Construction	4471.11	4475.57
Trade, Hotels, Transport, Communication and Services Related to Broadcasting	10200.22	11239.34
Financial, Real Estate and Professional Services	13676.84	10619.54
Public Administration, Defence and Other Services	6855.46	7444.56
Total Gross Value Added at Basic Price	55019.67	56834.72

Source: Central Statistics Office (CSO)

Note: H1 include Quarter 1 + Quarter 2 (April to June & July to September respectively), H2 include Quarter 3 + Quarter 4 (October to December & January to March respectively).

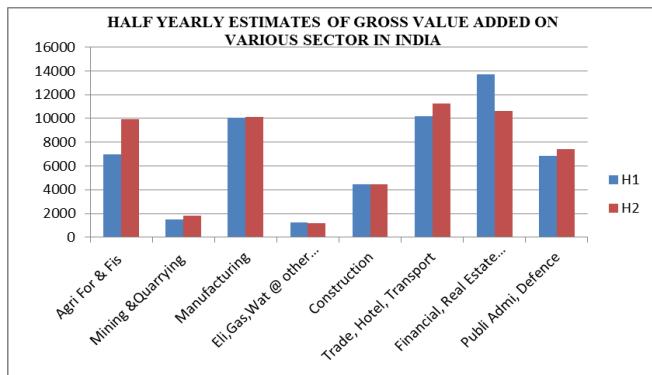
**Chart 1**

Table 1 depicts four quarterly data converted into half year of gross value added on various sector in India specifically, Agriculture, Forestry and Fishing, Mining & Quarrying,

Trade, Hotel, transport, and Public administration, Defense showed increasing trend comparing to previous half year thus there is a highly positive impact of agriculture on gross value added. Manufacturing, Construction, Electricity, Gas, Water supply and other utility shows, that there is no significant change on impact of demonetization. However, Financial, Real Estate and Professional Services showed decreasing trend as compared to previous six months. So there is a negative impact on Financial, Real Estate and Professional Services.

Though there are changes in various sectors of Indian economy, but these are not significantly impacted Indian economy. The following analysis has proved the hypothesis:

**H<sub>0</sub>:** There is no significant difference between impact of demonetization on pre and post period

**Table 2:** Paired Samples t –Test

	Paired Differences				t	df	Sig. (2-tailed)	
	Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
				Lower				
Pair 1 H1 –H2	-113.625	828.106	292.780	-805.939	578.689	-.388	7	.709

Source: Computed Data

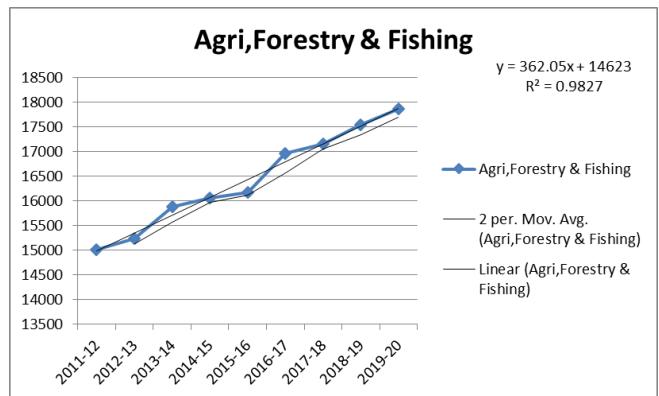
Note: H1 include Quarter 1 + Quarter 2 (April to June & July to September respectively), H2 include Quarter 3 + Quarter 4 (October to December & January to March respectively).

The above table shows the paired sample t – test of Gross Value Added for H1 and H2 of major contributing sectors on Indian Economy. The paired difference shows that there is no significant difference between the samples and the mean value is -113.625. The significance value is greater than the p-value 0.05(0.709), hence the null hypothesis is accepted. It proved that there is no Significant difference between Half yearly 1 and Half yearly 2.

**Table 3:** Trend and Forecasting GVA Value of Agriculture, Forestry and Fishing

Year	Trend Value
2011-12	15018.16
2012-13	15243.98
2013-14	15882.36
2014-15	16061.40
2015-16	16172.08
2016-17	16961.73
2017-18	17158.07
2018-19	17538.53

Source: Computed Data from CSO's All four quarters in each year.

**Chart 2**

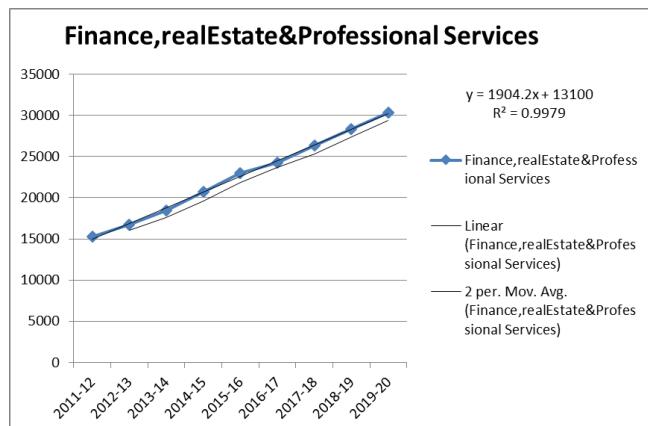
The above table and chart shows the trend forecasting of GVA Value of Agriculture, Forestry and Fishing from 2012-2016. It is inferred from Table 3 that the trend value of Agriculture, Forestry and Fishing ranges between Rs. 15018.16 and Rs. 16172.08 during the study period. It is concluded that there is increasing trend of Agriculture,

Forestry and Fishing. The forecasting of the Agriculture, Forestry and Fishing for the year 2017 will be Rs. 16961.73 which is showing an increasing trend 17538.53 for the year 2019. The R<sup>2</sup> value is 0.982 and the slope value for the Agriculture, Forestry and Fishing is 362.0 and the intercept value is 14623.

**Table 4:** Trend and Forecasting GVA Value of Banking, Financial, Real estate and Professional Services

Year	Trend Value
2011-12	15306.91
2012-13	16755.93
2013-14	18440.71
2014-15	20755.50
2015-16	22987.97
2016-17	24296.38
2017-18	26353.06
2018-19	28376.77

**Source:** Computed Data from CSO's All four quarters in each year



**Chart 3**

The above table and chart shows the trend forecasting of GVA Value of Banking, Financial, Real estate and Professional Services from 2012-2016. It is inferred from Table 4 that the trend value of Banking, Financial, Real estate and Professional Services ranges between Rs. 15306.91 and Rs. 22987.97 during the study period. It is concluded that there is increasing trend of Banking, Financial, Real estate and Professional Services. The forecasting of the Banking, Financial, Real estate and Professional Services for the year 2017 will be Rs. 24296.38 which is showing an increasing trend 28376.77 for the year 2019. The R<sup>2</sup> value is 0.997 and the slope value for the Agriculture, Forestry and Fishing is 1904 and the intercept value is 13100.

**Table 6:** Regression analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.926a	.857	.833	894.221	1.986

**Source:** Computed data

**Note: a)** Predictors: (Constant), H2. B) Dependent variable: H1

The above table confirms that the impact of demonetization on Indian economy is 85.7% as the r<sup>2</sup> value depicts. It is clearly noted that the effect of demonetization has been widely outraged.

## Conclusion

The present study showed the impact of Demonetization on different sectors of Indian economy. The gross value added of India is slightly decreasing as compared to the previous years, but during the current financial year the half yearly data are in increasing trend. As per the t-test analysis the positive effect of demonetization between the pre and post period has no significant difference in short term and through the regression analysis it is confirmed that there is a positive impact during the long term period. Agriculture sector typically sees high cash transactions and therefore near-term impact could be seen till liquidity is infused in the rural areas. As farmers face a temporary shortage of cash in hand, it could lead to a delay in payment which in turn would hurt the related companies in the short term. The real estate sector has been affected in a short term period negatively, whereas this sector will be escalating to a positive growth in the forth coming years. This intervention is a one-time draining of this current stock of black money but unless the root causes of corruption has been removed. It is sort of like a dialysis, more of a short term cleaning up than a solution of the problem. It needs to be repeated periodically.

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