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RESEARCH ARTICLE

THE DILEMMA OF DEMONETIZATION AND ITS IMPACT ON INDIAN ECONOMY.

Syed Haider Ali Zaidi¹, *Xin-Yu Wang², Pervaiz Iqbal³, Sardar Ahmad⁴, Saif UR Rehman⁵ and Muhammad Sajid⁶.

1. School of Management, China University of Mining and Technology, Xuzhou (221116), Jiangsu, P.R China.
2. University du Quebec a Montreal, Canada.

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Abstract

This article studies the background and impact of the recent demonetization initiative taken by the Indian Government. Upon the advice of Reserve Bank of India (RBI), Government of India demonetized all old bank notes of ₹1000 and ₹500 denominations and replaced them with new bank notes of ₹2,000 and 500 denominations. As per various statements by the government as well as commercial sources, the key motives of this policy were to counter the shadow economy and eradicate use of illicit and counterfeit cash being used in facilitation of the terrorism and illegal activities. The sudden nature of the policy announcement gave rise to various drastic problems e.g. prolonged cash shortages and public unrest that had a significant effect on small businesses, agriculture, and transportation, threatening the economic output. Simultaneously, it attracted heavy criticism from the opposition parties, prominent economists and international media. The move was widely commended by several prominent factions of the banking industry as well as international pundits. The policy was heavily criticized due to its poor planning and timing thus triggering protests, litigation, and strikes. As far as the economic impact of the policy is concerned, following the announcement, the indices of **NIFTY 50 stocks** and **BSE SENSEX** dropped by almost 6% along with various other economic factors which have been discussed later in detail. The move also affected India's GDP and industrial production. In this paper we will discuss the primary motives and benefits of this policy as well as its impact on the socio-economic scenario of India and her people along with recommendations for future.

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Introduction:-

This is not the first instance of India demonetizing her currency. In 1954, old banknotes of ₹1000 and ₹100 were replaced with fresh denominations of ₹1,000, ₹500 and ₹100 rupees following it with demonetization in 1978, of banknotes of ₹1,000, ₹500 and ₹100 rupees, to curb black and counterfeit currency. The Central Board of Direct Taxes, in 2012, stated that demonetization was not a best possible solution for tackling black economy since it existed in the form of properties, bullions and ornaments and therefore had recommended against demonetization (Indian Express, 2016). Income tax investigations confirmed that targeting cash will be an inappropriate strategy since only 6% of black money was kept in the form of cash (Hindustan Times, 2016). The currency notes amounting

Corresponding Author:- Xin-Yu Wang.

Address:- School of Management, China University of Mining and Technology, Xuzhou (221116), Jiangsu, P.R China.

to INR 17.77 trillion were in circulation at that time, of which INR 15.22 trillion (almost 86%) were 500 and 1,000 banknotes. (Indian Express, 2016)

On 8 November 2016, in a surprise move the Indian Government cancelled ₹500 old bank notes of ₹1000 and ₹500 denominations and replaced them with new bank notes of ₹2,000 and 500 denominations (The Hindu, 2016). This policy announcement invoked nationwide chaos and unrest as billions of bank notes were left worthless (India Today). The primary motive of demonetization, as highlighted by Economic Affairs Secretary, Shaktikanta Das and Governor RBI, Urjit Patel, was to prevent facilitation of terrorism through counterfeit currency. The rationale triggering this move was that the supply of all denominations had increased by 40% between 2011 and 2016 as compared to supply of ₹500 (76% increase) and ₹1,000 (109% increase) denominations, mainly due to counterfeiting (News 18, 2016). The decision taken almost 6 months earlier followed printing of new currency of ₹2,000 and ₹500 and was known to the RBI, some government factions, and national security agencies (The Daily Hindu, 2016).

The demonetization ordinance announced termination of government liability for the cancelled currency notes and imposition of financial penalty (five times of the currency note face value or ₹10,000, whichever is higher) for people transacting or found to be in possession of such bank notes afterwards (Hindustan Times, 2016). The ordinance also facilitated both resident and non-resident citizens to exchange old currency notes after December 30. Crematoriums, hospitals, railway and airline booking counters, Fuel stations, dairies and ration stores and were permitted to accept old ₹1,000 and ₹500 bank notes till December 2, 2017. (Ministry of Finance, 2016)

Out of total demonetized figure of INR 15.4 trillion, INR 14.97 trillion was deposited back into the banks (Times of India, 2016), contrary to government initial prediction of INR 5 trillion not returning to the banking system therefore government's move against black money was not that effective (The Indian Express, 2016). Here it is worth mentioning BJP had strongly opposed demonetization proposed by the then Congress government in 2014, stating that the general population will face great inconvenience due to lack of literacy and limited access to banking facilities (Huffington Post, 2016). Between June-September 2016, government had devised an **Income Declaration Scheme (IDS)**, which allowed the holders of black money to come clean by declaration of assets, payment of tax plus a penalty of 45% (First post, 2016).

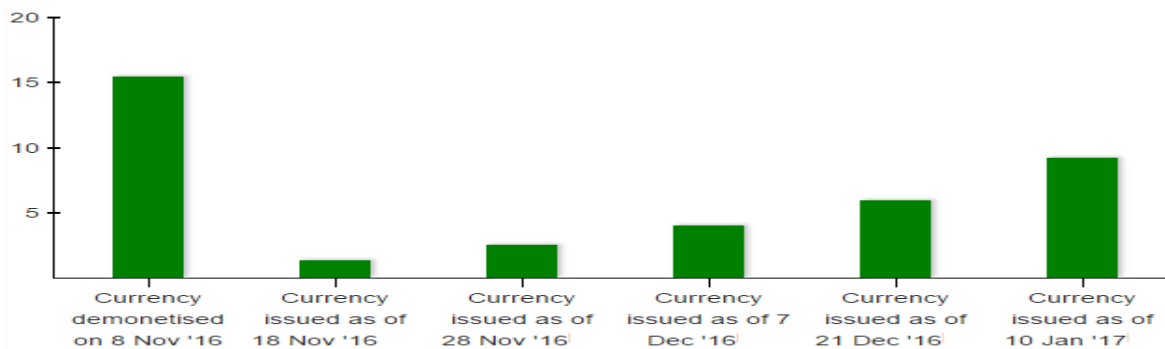


Figure 1:- Demonetization Fact & Figures (Source: Reserve Bank of India)

In this paper we will discuss the primary motives and benefits of this policy, its impact on the socio-economic scenario of India and her people along with recommendations for future.

Literature review:-

Historically, demonetization had been attempted either successfully or unsuccessfully by several countries. On a brief note, we will take a look at these countries as examples for future reference.

Demonetization – Success:-

United States of America:-

The very first demonetization was adopted by USA in 1969. Currently, \$ 100 is the biggest currency denomination in circulation, but in past, the Federal Reserve had also issued currency bills worth \$100,000, \$10,000, \$5,000 and \$1,000 issued in initial years of the United States. In 1946, the \$1,000 bill and other high value currency notes were cancelled and in 1969 recalled by Federal Reserve. (Speller Step, 2016)

United Kingdom:-

United Kingdom also demonetized its currency in 1971. UK replaced pence, shillings and pounds with decimal currency. Other currency notes remained unchanged but the 10 shilling note was replaced by 50 pence coin. 1968-1969 saw introduction of precise decimal coins equivalent to old currency (10, 2 and 1 shillings, 50, 10, 5 pence respectively) followed by introduction of non precise decimal coins (2p 2½p, 1p, equal to 4.8d, 2.4d and 2d (old pence) respectively) in 1971. In 1969, the largest and smallest non-decimal coins; the half crown and half penny were cancelled followed by withdrawal of other non-decimal coins with no precise equivalent in the new currency (3d, 1d) in 1971. (Speller Step, 2016)

Australia:-

From 1992 Australia started replacing the paper-based notes with polymer bank notes which were durable and counterfeit-resistant. Till 1996, the country's currency was completely transferred to polymer-based notes which were world's first long-lasting currency notes. This demonetization had no side-effects on the economy. (Speller Step, 2016)

European Union:-

The countries becoming members of European Union during its earlier years started cancelling their national currencies and using Euro from 2002. To ensure smooth transition to Euro, authorities first established currency exchange rates and cancelled old currencies following introduction of Euro. But old currencies remained in effect for some time for public convenience. (Speller Step, 2016)

Zimbabwe:-

Till 2015 Zimbabwe had a \$100,000,000,000,000 (1 trillion) currency note. In 2015, the government of Zimbabwe cancelled Zimbabwean currency to respond to the country's robust hyperinflation (recorded at 231,000,000%). The ensuing 3-month process expunged Zimbabwean currency from the financial system and South African Rand, Botswana Pula and US dollar were adopted as alternative legal tender for economic stability. (Speller Step, 2016)

Philippines:-

In 2015, the country replaced old currency notes (introduced 1985), with new ones (introduced 2010) to curb illicit and counterfeit currency and following it with demonetization of old currency effective January 2017. (Speller Step, 2016)

Pakistan:-

In the past, Pakistan had demonetized PKR 500 and PKR 5 currency. Pakistan replaced old design currency notes with new designs and started moving the old currency notes out of the system from 1st December 2016. Legal tender was issued a year and a half ago to facilitate the exchange of the old notes for newly designed ones. (Speller Step, 2016)

Demonetization – Failure:-**Ghana:-**

In 1982, to crack down on corruption and tax evasion and for mopping up excess liquidity, Ghana cancelled the 50 cedi currency note. The move reduced the peoples' belief in the banking system resulting in shifting of trend to foreign currency and physical assets thus encouraging flourishing of black currency market. Due to ensuing hardships, which included travelling long distances for currency exchange, currency notes worth millions were found abandoned after expiration of deadline. (Business Insider, 2016)

Nigeria:-

In 1984, military dictator Muhammadu Buhari formulated replaced old currency notes with newly issued banknotes within a limited period to crackdown on corruption. The move along with several others was targeted to fix the debt-burdened and inflation-ridden economy but was a complete failure as Buhari was ousted following a coup in 1985. (Business Insider, 2016)

Zaire:-

In early 1990s Zaire's Dictator Mobutu Sese introduced successive banknote reforms but was faced with increasing economic disruptions. In 1993, a plan was introduced to withdraw obsolescent currency from the system but resulted

in devaluation of national currency against US\$ and inflation uplift. Eventually In 1997, Mobutu was ousted as a result of civil war. (Business Insider, 2016)

Myanmar:-

In 1987, the military government of Myanmar cancelled almost 80 percent of currency in circulation. The move was directed at curbing the black market but caused economic unrest and triggered mass protests across the nation causing thousands of deaths as a result of government crackdown. (Business Insider, 2016)

Soviet Union:-

In January 1991 Mikhail Gorbachev government cancelled circulation of 50 & 100 ruble bills (about 1/3 of the money in circulation) to take on the black economy and shoring up the ruble value. The reform reduced confidence of people in the government and thus was unsuccessful in controlling inflation. Economic collapse, political infighting followed by a coup attempt destroyed Gorbachev influence, finally leading to the fall of USSR in 1992. Learning lessons from this debacle, Russia's 1998 redenomination of the ruble was smoother as compared to the previous attempt. (Business Insider, 2016)

North Korea:-

In 2010, to target black markets and tighten economic control, Dictator Kim Jong-II initiated economic reforms to demonetize the old currency. The move was marked by severe food shortages due to poor harvest. This along with surging rice prices created public unrest prompting an unusual apology from Kim and his execution of the finance minister. (Business Insider, 2016)

Venezuela:-

Venezuela is the latest country to have tried demonetization with the same motives as India's initiative but the decision turned out to be a catastrophic one. As per an economic decree issued by Venezuelan President Nicolas Maduro on December 11, 2016, the country's largest banknote, 100 Bolivar bill, was declared illegal within 72 hours. Soon after demonetization, the country was hit by protests and chaos and currency shortage at banks and ATMs and approaching Christmas holiday. Ensuing two days of unrest including one death, Maduro temporarily postponed the decision until 2 January 2017. This was seen as an attempt towards implementation of digital economy but since almost 40% of Venezuelans have no access to banking facilities, the initiative was deemed a complete failure. (The Logical Indian, 2016)

Support of Indian demonetization:-

Nationally, the decision was highly appreciated by various factions of the Indian banking industry as well as various reputable businessmen stating that the move will be highly effective in curbing shadow economy as well as promoting e-commerce (Indian Express, 2016). In a statement, Federal Finance minister, Arun Jaitley said that demonetization would cleanse the national economic system and would increase revenue base and size of economy. He further added that demonetization coupled with upcoming Goods and Services Tax (GST) is an endeavor for transforming the life style and spending habits of general population (Daily News Analysis, 2016). The move was also welcomed by current opposition party, Indian National Congress, but at the same time remained skeptical to after effects of the decision (India.com News Desk, 2016).

The International community was optimistic regarding demonetization as a valiant effort towards eradicating corruption. International Monetary Fund (IMF) highly commended demonetization initiative to fight corruption (Business Standard, 2016). The move was also praised by the Chinese media factions against corruption and black money (The Hindu, 2016). Vice-President of European Commission and Former Prime Minister of Finland, Jyrki Katainen greeted the demonetization move and emphasized on increasing transparency to further strengthening the Indian economy (Economic Times, 2016). In his article, BBC Correspondent Justin Rowlett, commended the move for its success and secrecy and further discussed the motives behind demonetization (BBC, 2016). Forbes correspondent, Tim Worstall, termed demonetization as a welcoming macro-economic effect (Forbes, 2016). Swedish Minister of Enterprise, Mikael Damberg lauded demonetization as a daring decision (The Hindu, 2016). The Independent published an article comparing Modi to Lee Kuan Yew, Former Prime Minister of Singapore and architect of modern Singapore, in eradicating corruption in India (The Independent, 2016).

A Member of Pakistan Senate, Senator Osman Saifullah Khan submitted a resolution, which was endorsed by majority of lawmakers, calling for cancellation of 5,000 and 1,000 currency notes to tackle black economy and

corruption quoted the recent Indian demonetization example (Daily Dawn, 2016). The submission of resolution coincides with gradual shifting of Pakistan's population to cash economy and government's ill-conceived taxation policies. The resolution said that demonetization will compel the masses to use banking channels, reduce illicit money flows and shrink the size of undocumented economy in Pakistan. The withdrawal should take place within three to five years in order to purge markets of the notes. He emphasized on taking up of this issue with Ministry of Finance and the Central Bank however the move was ruled out by the Ministry of Finance stating that it will adversely affect the business prospects (Daily Dawn, 2016).

Criticism of Indian demonetization:-

Talking of national criticism, Ex-Prime Minister Manmohan Singh said that demonetization will badly affect small and medium enterprises, the agriculture sector as well the GDP which can decline by about 3 per cent due to demonetization. At the same time he asked the Prime Minister to quote examples of countries where the people were not allowed to withdraw their money after depositing in the banks. He also criticized the issuance of notifications by the banks on daily basis citing the poor reflection on Reserve Bank of India Ministry of Finance and Prime Minister's Office. Restraining cooperative banks from dealing in cash has caused major to the people associated with the agriculture sector (The Hindu, 2016). In his closing comments, Singh referred to demonetization as legalized plunder and organized loot of the common people (Economic Times, 2016)

Indian economist and Nobel Laureate Amartya Sen harshly criticized the demonetization and called it tyrannical and despotic (The Hindu, 2016). Chief Economist and Former Senior Vice-President of World Bank, Kaushik Basu, stated that demonetization has more potential damages than benefits (New York Times, 2016). Former Chairman Planning Commission of India and Chief Statistician RBI, Pronab Sen declared demonetization as a hollow move due to its failure in achieving the designated goals of tackling fake currency and black economy (Live Mint, 2016). A former professor of economics at the Jawaharlal Nehru University, Delhi, Prabhat Patnaik, called the move witless and anti-people. He also criticized the idea of black money being thought as a hoard of cash, stating what minimal effect it would have in eliminating black activities (The Citizen, 2016). In his article in Business Standard, renowned economist and journalist, T. N. Ninan said that execution of demonetization has been ill-timed and ill-devised (Business Standard, 2016).

Chairman of HDFC, Deepak Parekh initially was highly supportive of demonetization but later changed his stance saying that the move had caused financial uncertainty and derailed the economy (Financial Express, 2016). Initially, demonetization move was appreciated, but the execution of the move was highly criticized since it caused hardships to common people (Bloomberg Quint, 2016).

Internationally, Steve Forbes stated the move as shocking, sick and dissipated calling it a massive theft of people's property by a democratically elected government at the same time ignoring the pretense of due diligence process (Forbes, 2017). Nobel laureate Paul Krugman, while speaking at the Hindustan Times Leadership Summit, said that it is too early to forecast the benefits of demonetization and allied costs (Hindustan Times, 2016). The demonetization also attracted sharp criticism from international media, e.g. New York Times, about atrocious planning of demonetization and its incapability in combating black money (Indian Express, 2017). The Guardian stated that Modi has brought havoc to India in the form of demonetization (Times of India, 2016). Bhaskar Chakravorti said that the phenomenon is a case study in poor policy and execution (Harvard Business Review, 2016)

Short term impact:-

Demonetization affected the following sectors:

Human trafficking:-

Nobel laureate Kailash Satyarthi and other activists against human trafficking said that post demonetization, sex trafficking, exploitation of children and corruption has been significantly reduced and has acted as major obstacles for human traffickers (First Post, 2016). However, after two months, he indicated that due to lack of concrete steps, human traffickers are using Rs. 2,000 currency notes and expressed disappointment (Economic Times, 2017).

Fundamentalist groups:-

Armed separatist groups notably Maoist and Naxalites had been badly affected by demonetization. According to police sources, post demonetization, the number of surrendering separatists has increased manifold because the

money stashed by these organizations over the years is left virtually with no value thus hampering their activities country-wide. The move has also crippled separatists financing through money laundering (Times of India, 2016).

Income tax raids:-

Under instructions of PM Office and Finance Ministry, all revenue intelligence agencies (Income Tax, Enforcement Directorate and Central Bureau of Investigation) are tracking demonetized currency notes movement and have initiated a clean-up operation against hawala operators, jewelers and forex traders (The Economic Times, 2016). PMO receives information about black money and passes it on to various law enforcement agencies to probe and act against financial crimes like disproportionate assets, money laundering and corruption (India TV News, 2016). The agencies were also instructed to strictly act against various evasion attempts through gold purchases (Hindustan Times, 2016), donation at religious places (First Post, 2016), multiple bank transactions (The Indian Express, 2016), railway bookings (Times of India, 2016), municipal and local tax payments (Hindustan Times, 2016) and back dated accounting (The Economic Times, 2016).

Cash seizures:-

Post-demonetization new bank notes worth ₹24 billion were seized countrywide (Hindustan Times, 2016). The media highlighted that people with powerful connections amassed new currency in millions, thus making the demonetization exercise futile (Indian Express, 2016). In order to ease out the cash shortage, seized notes would soon be brought into the mainstream as announced by the government. Until the adjudication of cases by judiciary, the agencies were instructed to hold seized cash as evidence in their strong rooms, later depositing it into the Consolidated Fund of India (Times of India, 2016).

Cash shortages:-

Post demonetization people were faced with severe cash shortage. People had to wait in endless queues outside banks and ATMs to exchange old notes, which was affecting their everyday lives. Although the daily withdrawal limit was set at ₹2000 still ATMs across the country were either running out of cash instantly or were completely out of order. Instances of sporadic violence were reported nationwide but without any grievous injuries. (Indian Express, 2016)

Deaths:-

There were several instances of deaths due to people queuing for hours for exchanging demonetized banknotes as well as non availability of medical facilities due to hospitals refusal to accept old currency. Post demonetization, media has reported over a 100 deaths. (Daily News Analysis, 2016)

Stock market performance:-

Demonetization initiative coincided with the US presidential elections, causing critical drop in the stock market index with NIFTY 50 plunging by over 541 points and BSE SENSEX crashing 1,689 points. NIFTY 50 index also reached a record low of 8100 points (The Hindu, 2016).

Transportation halt:-

Demonetization also affected the transport sector as approx. 400,000 truck drivers were faced with severe cash scarcity, and majority of them were stranded on major highways across India (Daily News Analysis, 2016). Due to drivers inability to access the new currency notes and refusal of toll plaza operators to accept old banknotes, government announced nationwide suspension of toll collections on all national highways till the stabilization of situation (Business Standard, 2016).

Banking:-

During the initial time period, ₹3 trillion old banknotes were deposited and about ₹500 billion were withdrawn from the banking system with the banks handing about 180 million transactions. Till November 27, banks reported exchange (₹339.48 billion) and deposits (₹8.11 trillion) and withdrawal (₹2.16 trillion) of demonetized banknotes (Indian Express, 2016).

Business:-

Demonetization also had a significant impact on business. Nation-wide sales recorded a drop of 40% and E-commerce companies witnessing cash on delivery orders decline by 30% (The Indian Express, 2016). But demonetization was hailed as a catalyst to enhance digital payments as it is expected to cut down costs leading to a

decrease in COD returns (Tech Circle, 2016). An increase of 108% in debit card transactions and 60% in credit card transactions was also reported. According to Pine Labs, the demand for POS machines, electronic payment options (PayUMoney, Instamojo Payment Gateway and PayTM,) doubled after the decision (The Economic Times, 2016).

Drop in industrial output:-

The industrial output was also affected due to decrease in money supply (The Hindu, 2016). The Purchasing Managers' Index (PMI) recorded its greatest reduction in three years falling from 54.5 (October) to 46.7 (November) thus indicating a contraction in both, manufacturing and service sectors (Business Standard, 2016). The Index of Industrial Production (IIP) also fell from 6.6% in October to 4.9% in November (Huffington Post, 2017).

Forecast of GDP Growth:-

International economists forecasted a reduction in growth rate of India's GDP due to demonetization (Financial Express, 2016). India's GDP in 2016 is estimated to be US\$2.25 trillion; thus 1 per cent reduction in growth rate represents a shortfall of US\$22.5 billion for the economy (International Monetary Fund, 2016). According to Societe Generale, India's quarterly GDP growth rates would drop below 7% for an entire year at a stretch for the first time since June 2011 (CNBC, 2017).

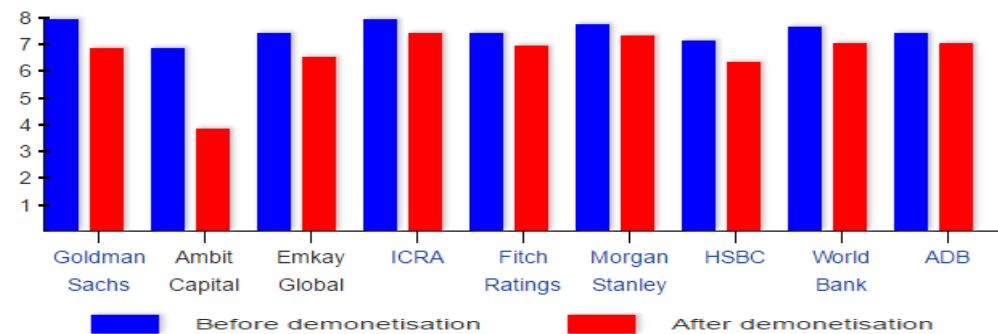


Figure 2:- Forecast of GDP Growth by International Economists (Bloomberg)

Long term impact:-

General Impact:-

Demonetization had a significant impact on the Indian economy with substantial impact on certain key industries and sectors. It caused a significant decline to short term liquidity although gradual relief is expected with the introduction/circulation of the new currency notes. It has also significantly increased bank deposits as well as bank deposit base thus enabling banks to reduce higher lending costs of funds (Kumar and Kumar, 2016). Since peoples' interest has shifted to from unproductive physical asset-based savings to interest-bearing financial assets, the financial savings are also expected to increase thus improving the banks' liquidity position which can be leveraged for increased lending (Deepak and Bhagyashree, 2017)

Decreasing liquidity has encouraged, use of alternative payment methods, such as online transactions, e-wallets, debit and credit card and e-banking thus facilitating creation of an efficient cashless infrastructure (Makhopadhyay, 2016). Reduced liquidity has also affected economic spending and consumption trends due to decline in the availability of disposable income (Deepak and Bhagyashree, 2017). These trends, coupled with certain industry-specific issues are expected to decrease India's GDP growth by around 50 base points for fiscal year ending March 2017 with a further decrease of 30 base points predicted for fiscal year ending March 2018 and 2019 according financial forecasting by Goldman Sachs and Ambit Capital. It is also predicted that India's credit ratings are unlikely to improve for the next two years. However, India's current sovereign credit rating of **BBB-** is expected to hold in the long term (Deepak and Bhagyashree, 2017).

Real estate:-

Historically, the real estate sector in India has been a significant source for informal funding. Since the demonetization is expected to reduce the informal funding sources, it is expected to adversely affect the real estate sector. Due to expectancy and encouragement of long term and transparent real estate pricing due to these measures, decrease in liquidity will significantly deteriorate the demand for resale properties. Due to involvement of large cash volumes, luxury real estate transactions usually use funding from informal sources instead of bank financing (Kumar

and Kumar, 2016). So post-demonetization, luxury property rates are expected to fall due to lack of purchasers with considerable liquidity. These measures will also adversely affect investors in projects with insufficient audit and KYC funding procedures (Chatterjee and Banerji, 2016).

The real estate investors, who intend to invest in new projects, could also be affected by decline in resale property rates (Deepak and Bhagyashree, 2017). In absence of informal funding, this will not only affect the primary market as it will be challenging to find funding for new projects, but will also affect industries associated with the real estate, infrastructure and construction sectors, especially steel and cement industries (Gupta, 2017). However due to surging bank deposits, growing stability in banking operations and resultant lower cost of funds; the real estate market is expected to become stable. However demonetization is not expected to directly affect large institutionalized real estate developers; since the infrastructure development projects are partially-funded by government (Kumar and Kumar, 2017). The unorganized and middle tier real estate developers are expected to rely heavily on institutional investors for funding projects. A more transparent pricing structure and anticipated stability in the medium and long run will interest these institutional investors to invest in the real estate sector. (Deepak and Bhagyashree, 2017)

Legislation measures:-

Demonetization coupled with other government initiatives (formulations and implementation of various legislations) like **RERDA** Act, 2016 (Mullick, Wadhvani, 2016) and **BTPA** Act, 1988 is expected to have long term positive impact on real estate sector. To ensure registration of all real estate projects, Real Estate Regulatory Authority (**RERA**) has been established as a regulator for commercial and residential and real estate transactions. RERA requires developers to maintain a significant portion of funds in a dedicated account to ensure proper allocation/usage of earmarked project funds. Likewise, the BTPA prohibits and subjects property transactions to criminal penalties and confiscations, undertaken on behalf of a third party beneficiary (Ministry of Law and Justice, 2016).

Automobile:-

Demonetization will also affect cash transactions in Indian automobile sector, particularly for motorbikes, used vehicles, auto ancillary and secondary automobiles (Chatterjee and Banerji, 2016). Due to reduced liquidity, potential customers are deemed to face more challenges in selling older vehicles due to indirect effects of demonetization on OEMs. Various two-wheeler and used vehicle markets in tier 2 and tier 3 cities/towns and semi-urban and rural regions are largely driven by cash, so they will be particularly affected by these measures (Deepak and Bhagyashree, 2017). To counter these effects, OEMs and auto component suppliers will continue periodic monitoring of inventory. In order to offer schemes for cashless purchases and zero down payments, automobile dealers will look to find financing initiatives through banks and other financial institutions (Mukhopadhyay, 2016).

Manufacturing:-

Since 2014, the government had been striving hard to revive India's manufacturing sector and increase it from 16% (2015) of the GDP, to 25% (2025). But seemingly this sector has been immensely affected by demonetization. The Purchasing Managers' Index (PMI) which is manufacturing sector's economic indicator linked with tracking inventory levels, new orders, supplier deliveries, production and employment environment was recorded at 54.4 (October) but post demonetization dropped to 52.3 (November) which indicates an economic contraction (Kumar and Kumar, 2016). This PMI indicates that demonetization had caused immense problems to manufacturers as growth of new work; purchasing activity and production were hampered by cash scarcity which is expected to continue through December (Deepak and Bhagyashree, 2017). Since PMI doesn't account for various factors (e.g. higher inventory due to low volume of sales), therefore it can be assumed that the PMI for November will understate the disruption in activity hence causing PMI for December to drop further. However some experts believe that in spite of these disruptions, performance of manufacturing sector had been better than expected and instead of an outright downturn, the sector has remained in expansion mode (Gupta, 2017).

Services:-

The services sector has been among the sectors worst affected by demonetization. Trade, hotels, communication, restaurants, transport, real estate, finance, and insurance all come under the services accounting for a healthy 60% of India's GDP (Rani, 2016). The Nikkei/Markit Services PMI, which measures prices and inventories of service sector companies, sales and employment, for the first time since June 2015, dropped from 54.5 (October) to 46.7 (November) marked the biggest one month drop since November 2008 (Kumar and Kumar 2016). This was

attributed to decline in new business thus leading to a solid reduction in activity and increase in work backlogs but only marginal increase in employment. Yet panelists are anticipating a pickup in activity which will cause the sector to rebound quickly (Rani, 2016).

Consumer spending:-

Private consumption expenditures contribute 60% to GDP of India. Interestingly, the consumer sector, which previously was showing good growth rate, post demonetization was the lowest performing area post suggesting drastic effect to consumption, the solitary growth driver (Rani, 2016). India's countryside economy was the main driving force behind the India's consumption boom (2007-2012) but due to being over dependent on cash transactions has seen sluggish demand and based on current scenario, its recovery can take months (Tripathi, 2016). This will have a domino effect on purchasing power of the farmers who will be facing even more problems (Tripathi, 2016). The consumer spending for next two quarters is likely to be affected and its restoration will take considerable time. However, due to ease in inflation, RBI could bring down key lending rates. (Deepak and Bhagyashree, 2017)

Agriculture:-

The agriculture sector contributes 15% to Indian GDP but grew by a meager 0.2% (2014) and 1.2% (2015). Before demonetization, agriculture sector was expected to show excellent performance because of good rainy season with the growth rate expected at approx 4% in the current fiscal but has suffered a major setback post demonetization. *Agriculture sector predominantly depend on cash, for procuring tools, seeds and fertilizers, payment of laborers salaries and sale/transportation/distribution of agricultural products to Markets* (Tripathi, 2016). *Majority of farmers use services of the cooperative banks for their banking needs and since RBI has restricted the cooperative banks from exchanging old notes, this action will bring more problems to the agricultural sector and farmers.* Currently kharif (monsoon) crops are being harvested which will be followed by preparation of land for sowing Rabi crops (harvested in March). Despite of a good harvest, post demonetization scenario is making it difficult for farmers to sale produce in the markets therefore proportionate improvement in rural demand is highly unlikely (Tripathi, 2016).

Foreign direct investment:-

The confidence of investors has also been jittery which, in turn has also affected the demonetization. Centre for Monitoring Indian Economy (CMIE) which is a think tank for tracking economics and business reported that post demonetization the SENSEX has decreased by around 5% (Forbes, 2016). The foreign portfolio investors (FPIs) withdrew INR 370 million from capital markets in November as compared to INR 121 million in October (RBI sources). This was attributed to possibility of increasing of interest rate by the Federal Reserve and uncertainty looming over relationship between US and emerging countries post Donald Trump victory coupled with post demonetization scenario and imposition of GST by the Indian government on corporate earnings & economic growth. (Kumar and Kumar, 2016)

Business:-

The critics argue that the demonetization has dealt a mighty blow to economic activity due to its unsuspected and sudden nature. The pros and cons of the policy will be continuously debated but the public opinion suggests that while intentions surrounding demonetization might be good but it has caused unwarranted suffering to masses in India. Due to the fact that the banned currency accounted for 86% of the total circulation, economists are relating the pain and suffering of the common people to removing 86% of blood from someone's body (Wharton Knowledge, 2017).

India Brand Equity Foundation, in its report, mentioned that barring some glitches of demonetization, overall 2016 has been a good one for the Indian economy. The GDP growth rate was maintained above 7% and the foreign direct investment also jumped by 30%. Government initiatives program like "Make in India" have also been highly successful with prominent MNCs (Panasonic, Pepsi etc) establishing manufacturing facilities in India (New Indian Express). Post demonetization there has been a reduction in investment activity, but it can be viewed as a positive outcome instead of a worrisome contraction. Let us hope that demonetization proves to be a wild card for Indian economy although the prospective outcomes are still unclear. It is optimistic to say that the negative impact of demonetization on GDP and other economic activity will be temporary and with permanent long term benefits such as promotion of E-commerce (Mehta, Patel and Mehta, 2016)

The demonetization was unanticipated and it caught the masses unaware). The government defended the decision stating that making it public beforehand would have defeated its primary purpose. But economists argue that there was absolutely no need for secrecy quoting examples of countries (European Union, Britain etc) who did demonetization in the past but did it with a prior warning with the intent to reduce the inconvenience to the public (Business Standard, 2016). Instead of all this secrecy surrounding demonetization, the government could have monitored suspicious transactions, just as it is doing now (Deepak and Bhagyashree, 2017). In another case economists argue that demonetization was not a good idea in the first place because if the government wanted to promote a cashless or less cash economy then replacing a high value currency note (Rs. 1000) with a currency note of even higher value (Rs. 2,000) does not make any sense (Deepak and Bhagyashree, 2017).

In another twist, government demonetization strategy has shifted from countering the black economy to promoting E-commerce. Several measures like offering discounts on making digital payments for purchasing petrol (0.75%) and railway tickets (0.5%) have been introduced (Mehta, Patel and Mehta, 2016). Saying, that in India cash is the king will not be wrong since 98% of consumer transactions are cash-based compared to China (90%), Japan (86%), USA (55%) and UK (48%) (Bloomberg Quint, 2016). All these attempts and measures are aimed to make India the world first cashless economy albeit while causing a lot of misery to common people by rendering them incapable of utilizing their own money thus bringing life to a standstill, especially in rural India. Due to limits on ATM withdrawals (₹2,000 per day), depositing the money into a bank account will further compound the problems (Deepak and Bhagyashree, 2017).

It is difficult to ascertain the comprehensive long term impact of these measures at this stage, but we can expect that the overall economy will ultimately benefit following decrease in unaccounted cash transactions, elimination of counterfeit currency notes hence facilitate increased tax collections and transparency in determining transaction costs which is also likely to attract foreign investors, at the same time expected to improve the fiscal deficit of India (Chatterjee and Banerji, 2016). Before demonetization India was growing at a rate of over 7% per annum, but post demonetization impact was rather immediate and quandary. Growth forecast figures by Goldman Sachs (6.8%), Mumbai-based Ambit Capital (3.5%) and Deutsche Bank (6.5%) are some notable stats for the current fiscal with expectancy of adverse effect of demonetization initiative on present and next quarters With the looming possibility of RBI reducing interest rates, the GDP growth is forecasted to reach 7.5% for 2018 fiscal year (Kumar and Kumar, 2016) (Mukhopadhyay, 2016).

Regardless of slow imminent sector growth and setbacks to the Indian economy, economists are optimistic of an eventual recovery next year. Temporary socio-economic dislocation is being regarded as a major step in strengthening India's formal economy and, subject to a significant uplift in private consumption expenditure threshold, achieving over 7% growth in Indian GDP until next year (Business Standard, 2016).

Future prospects:-

Demonetization was meant to bring the cash holdings of people in to the banking system in the process rendering the cash that didn't utterly worthless hence eradicating black money, terrorism and the informal economy (Huffington Post). At first glance the idea looks effective and easy to implement. But this was happening not in a developed economy, where things are planned beforehand and well communicated before implementation, but in India and one can easily doubt the ability of the government to pull off such a massive initiative (Deepak and Bhagyashree, 2017). Demonetization initiative was accused of weakening political opposition thus making Modi administration appear stronger and to bringing misery to the general masses while elite class stashed their black money in Swiss accounts with absolutely no detection or accountability. The government can be given benefit of the doubt but that too raises questions not about intent but about the implementation of the demonetization initiative (Mitali and Jayanta, 2016).

The government issued various directives essential to this policy's success e.g. issuance of National ID cards (Adhaar cards), access to bank accounts, adequate staffing in the banks and availability of new currency in the ATMs. According to UIDAI (Unique Identification Authority of India), great efforts have been made to issue NICs and hence by 2015, 93% of the adults had NIC cards (UIDAI sources, 2017). Another initiative taken by Indian government, called the Prime Minister's People Money Scheme (Pradhan Mantri Jan-Dhan Yojana) was launched in 2014 which is under the administrative control of the Financial Services Department, Finance of Ministry (Press Information Bureau, 2016). The primary objective of this program was to ensure across the board access of core banking services (remittance, savings & deposit accounts credit, pension and insurance) to general public (Reuters, 2014). Till date, over 270 million accounts have been opened with deposits exceeding ₹665 billion (Government of India sources, 2017). But keeping in view the population of India which is a robust 1.3 billion, these measures are

inadequate and much more efforts are required for effective policy implementation. Bringing bank account penetration from 35% (2011) to 53% (2014) is commendable effort but almost 50% population is still without access to banking facilities and 300 million people still without the Adhaar card (Kumar and Kumar, 2016).

Informal economy:-

The concept of the informal economy requires considering two aspects;

- i) Informal economy is desirable or not?
- ii) Is it possible to avoid informal economy in India?

Informal economy is formed of the various elements; the black market which involves the dealing of questionable and illegal goods, but also common people like low wage workers, farmers and local rural economies therefore the resultant transactions in cash are not meant to escape undetected rather than being used as means of exchange by those without access to banking services. Because informal setting is without any regulations, so is best suited to their livelihood (Gajjar, 2016). Countless people use cash transactions to conceal their wealth and tax evasion but countless other people do so because they are habitual users of cash or due to poverty and lack of easy access to banking facilities. In this connection, authorities have arrested numerous business men and corrupt officials involved in hoarding cash. Thus demonetization is having a disproportionate impact on the lives of the middle and lower classes and resulting disruption has led the people to call the policy a disaster and in some other terms criminal justice. Queuing outside the banks for hours and being deprived of liquidity needed for wages and purchases is really a poor sight. Although the government wants to use recovered black money to help the public but intentionally or otherwise they are bearing the biggest cost of this initiative (Gupta, 2017).

As discussed above major aim of the government was bringing the informal economy into the tax net (Business Standard, 2016). Income tax is paid by a meager 5% of Indian workers with just 15% of the economy falling inside the tax net and tax-to-GDP ratio of 17% (only 5% lower than comparable countries). This answers the question about the desirability of the informal economy. However, answering the second question about eradication of informal economy in India, is very difficult since it provides employment for 94% of India's labor force nation-wide and has different reasons for not being a part of the government tax net (Deepak and Bhagyashree, 2017). Secondly, instead of being isolated, it is interlinked with formal economy and any action against one will automatically cripple the other. This policy presents a serious question to ending of informal economy and its repercussions like the loss of livelihood for millions and decline in GDP growth (Kumar and Kumar, 2016)

Corruption:-

Corruption has a deep connection with the bureaucratic affairs especially in Asia (Deepak and Bhagyashree, 2017). This aspect even though is humiliating, callous and frustrating thing to admit, but nevertheless is a fact. India is a big Asian economy and presence of massive corruption is what is preventing it to progress to another level. One aspect of demonetization implies that inspite of all the disruptions and problems it had caused, it will be a great step forward in combating and eradicating corruption from the country. But at first glance it is uncertain how this policy will eradicate corruption (Gupta, 2017).

Economists say that demonetization may help to eliminate some hidden wealth today but in absence of concrete steps and changes to institutional culture fostering it, the black economy will be regenerated (Mitali and Jayanta, 2016). Several economists have started a debate over following two approaches:

- i) Whether the policy will work?
- ii) Whether it's worth the cost of implementation?

It's difficult and too early to answer these questions because it is easier said than done to distinguish between intention and implementation of the policy and that too in background of an underfunded/corrupt government and a diverse sprawling population (Gajjar, 2016). It is not easy to realize government ambition of cashless economy in presence of sheer number of people who are living hand to mouth (Mukhopadhyay, 2016). India is an emerging and with future potential and we are living in a digital world that is accelerating at a great pace and everyone wants to be a part of it. But at the same time we cannot ignore the India's real picture. The gains of demonetization are not associated with intentions and aspirations but with the implementation of the policy and capability of government to deliver on its promises. The point that really brings this discussion to a conclusion is that it is need of the day to avoid implementation errors and problems that can lead to failure of this move e.g. cancellation of old notes instead of stopping printing of new/high value currency and the crucial unaffected traits of Indian financial system e.g. peoples' acceptance of corruption as normal business practice. (Mukhopadhyay, 2016)

Recommendations & Conclusion:-

- i) As discussed above, since major portion of black money is not kept in cash form but is converted into assets or deposited in overseas banks therefore for demonetization to work perfectly there should be no loop holes for the elite and influential people.
- ii) The government should take concrete steps to counter the underlying factors and structural problems that facilitate corruption. Government should devise and enforce severe punishment with respect to bribes, as it is the only way of preventing the people from committing the crime. This is a common observation that the people more susceptible to bribes are overworked and underpaid government officials. So their remuneration structure must be revised to facilitate satisfactory life style parameters.
- iii) The fact is that only the uniform distribution of wealth will reduce black money, corruption, and encourage transition to cash-less economy with no shortcut to the implementation

The primary motive of demonetization is to safeguard and facilitate the general public but at the same time it's aimed to scrutinize and prevent money laundering through real estate sector, NGOs and educational institutions by ensuring routing of all their transactions through the financial system and not otherwise. This policy is not for people with limited cash resources but instead is for people who have immense cash resources and tend to evade the national economy. Therefore, necessity for the implementation of demonetization cannot be denied.

Almost 4 months have passed since demonetization was announced by the government and if we observe, the conditions prevailing in India are much more streamlined now than they were at the beginning. Now the problems of cash running out in the ATMs and long queues in front of them are no more. The people are shifting their stance to online shopping which is much more convenient option compared to former cash based approach, thus giving a massive boost to E-commerce (Mehta, Patel and Mehta, 2016). Hence, it can be said that the short term objectives of demonetization have been achieved. Now it's time to look ahead and see the distant future. Since India is one of the most diverse and highly populated countries in the world so it is very difficult to implement a scheme in a perfect manner. In spite of all the inconveniences caused and unfavorable situations, the prime minister of India deserves the public praise for making some bold decisions for future of India by taking actions against some long standing national problems like corruption, shadow economy and terrorism.

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