Impact of Demonetisation on different sectors of India's economy

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Abstract

The demonetization had an immediate impact on the state of the Indian economy. In this paper, an attempt has been made to examine the impact of demonetization on the liquidity, agricultural, manufacturing sectors of India. The demonetization policy is seen as a financial reform in the country but this decision is fraught with its own merits and demerits. This study will also help us to know about what is demonetisation and examines the positive and negative impact of note ban decision taken by Indian government. This study is based on secondary data, which is collected from newspapers, magazines, internet, some useful books related to topic etc.

Keywords: Demonetisation, Liquidity, Agriculture sector, Manufacturing sector

Introduction

The word demonetization has become much popular than a household name since the old notes of Rs.500 and Rs.1000 were pulled out of circulation. While as per dictionary demonetisation means "ending something that is no longer the legal tender of a country". In the economics demonetisation means the circulation of a specific currency unit is stopped, followed by the withdrawal of old banknotes or coins. The process of demonetisation is opposite to remonetisation, where the legal status is restored. In other words, it is the process that involves a change of national currency, where old currency is replaced with new currency. If we looked at the history of India it is not a new concept. Demonetisation has been implemented twice – 1946 and 1978 in the past to combat tax evasion and curb black money. Firstly in 1946, the currency note of Rs.1000 and Rs.10, 000 were removed from circulation. Secondly in 1978, the currency notes of Rs.1000, Rs.5000 and Rs.10, 000 were out from circulation. The ban really did not have much impact on the Indian economy, due to two reasons- the first one is the currency notes of such higher domination was not accessible to the common people. Another reason is that in 1978 the value of demonetisation was only 0.1 per cent of GDP. The decision of Indian government on November 8, 2016 to cancel the legal tender of Rs.500 and Rs.1000 notes, which had more impact on the different sectors of the Indian economy (Hari, 2017).

Review of Literature

Jadhoa et.all (2017), analysed the impact of demonetization on the different sectors of the India. Demonetization is the act of stripping a currency unit of status as legal tender. It is also used to tackle the problem of corruption and black money in the economy. Agriculture sector is principal means of rural households of their livelihood. Many of farm households are illiterate they cannot afford major change in the market due to the traditional working and business practices farmers already suffering the problem of the natural calamities, market fluctuations and exploitation from money lenders. Farm households were suffered a setback due to nationwide cash crunch and a collapse in the demand for rabbi crops and vegetables in the markets. Agriculture was affected through the input-output channels, moreover price and output feedback effects. Marketing, Sale, transport, and distribution of ready produce to wholesale centres is dominantly cash-dependent. Interruptions in the supply chains feedback to farmers as sales fall, rising wastage of perishables, decrease in revenues that exhibits trade dues instead of cash in hand and when credited into bank accounts with restricted access affect the sector

Mali (2016), made an attempt to examine the positive and negative effects of demonetization on the different sectors such as Micro Businesses, E-Wallet businesses, online retail stores and so on. The study is based upon the secondary data. Demonetization created effect on different sectors in different manners resulting into boom for some sectors like E-Wallet businesses and somewhere resulting into temporary slowdown like micro businesses like vegetable vendors or some small seasonal businesses, where most of the transactions are on cash basis. Indian Micro Small and Medium Enterprises (MSME) sector contributes considerable share in India's GDP. But amongst all the three, medium sized enterprises have share of around one per cent and they generally use online mode for their payment and receipts. But Small and Micro, especially micro businesses faced lot of problems as most of the transactions take place on cash basis, because many people are not that educated. So the move demonetization has hampered micro businesses in a bad manner resulted into slowdown in micro enterprise sector.

Demonetization put a great impact on the economy growth rate. The study shows that that rupee is devalued, loans rate are declining, investors are not ready to invest their money in different derivations, and the market is declining day by day due to unavailability of cash. The most affected class is middle and lower level class. They are unable to get the money from their own account after spending long hours waiting in a queue. Savings are decreasing and bankers are not getting deposits. It causes unstable condition in the economy (Hari, 2017).

Former Reserve Bank of India governor Raghuram Rajan (2017), had revealed that he did not favour demonetisation as he was felt the short term economic costs associated with such a disruptive decision would outweigh any longer term benefits from it. He, however, reiterated that the move to cancel 87.5 per cent of the currency value was "not a good idea". He also expressed concern that a lot of people probably lost their jobs due to demonetisation but that has not been counted well as it would be mostly in the informal sector. He said most estimates of the cost of demonetisation vary between 1.5-2 per cent of the GDP.

Impact of demonetisation on the different sectors

Agricultural sector

Agriculture is referred as the backbone of Indian economy as it contributes about 17% to the total GDP. In India more than 60 per cent of the population is directly or indirectly depend on the agricultural or agricultural activities. Cash is the primary mode of transaction in agriculture sector. The farmers struggled a lot at the time of demonetisation because the saving habits as well the payment mode of farmers were only on cash. 70% of the farmers market their products through farm markets or they may be street vendors where cashless transaction is impossible. The farmers who owned limited acres had not keep lump sum in bank accounts largely due to fact of low income and no knowledge about the digital transaction, which had a large impact on the farmers at the time of demonetisation. Demonetization has affected every Indian, but it has hit the agricultural sector the hardest. Because, farmers cannot buy seeds, fertilizers and other things required for their winter crops. As results, wheat outcome was decreased in northern India. Fruit and vegetable farmers were also badly hit. They need cash on daily basis to purchase inputs like pesticides, fertilizers and hired labour for harvest and also to transport and sell at urban centres. Lack of cash with farmers leading to less-than optimal use of inputs resulted in lower yields, reduced sales, higher wastage and lower price realization. In the scenario of demonetisation of currency, most of the transaction going on credit basis. The input dealers (seed, fertilizer and pesticide dealers) are increasing prices by 20-30% of the normal price as the transactions were on credit basis. In product market also big traders and commission agents are offering credit to farmers at much higher interest (reaching 36% for just a month) than in normal conditions. The cash crunch caused by demonetisation affected farmers badly who were not acquainted with cashless transactions (Sumathy and Savitha, 2016).

Manufacturing Sector

Demonetization of high-value currency notes in November hit the manufacturing sector as indicated by a private sector survey. The Nikkei India Manufacturing Purchasing Managers' Index (PMI) fell to 49.6 in December, the first time it hit below the 50-mark in 2016, from 52.3 in November. A reading below 50 implies contraction while one above 50 indicates expansion. Companies saw new work and output dip for the first time in 2016. In turn, quantities of purchases were scaled back and employment lowered (Dr. preethi, 2017).

According to Geeta Rani (2016), the production for some industries has been impacted by the non-availability of select raw materials (e.g., agriculture- commodities). Industries had cut down production to adjust for the unanticipated rigger levels of unsold finished goods across the supply chain. Supply chains had further getting affected by the cash crunch faced by transportation vendors. Traders and distributors were unable to pick up stock because of the liquidity crunch.

There was a decline in trade and manufacturing output as industries were knocking by the hard cash crisis. The Purchasing Managers' Index (PMI) fell to 46.7 in November from 54.5 in October, recording its sharpest reduction in three years. A reading above 50 indicates growth and a reading below shows contraction. This indicates a slowdown in both, manufacturing and services industries. The PMI report showed also showed that the reduction in inflation in November was due to shortage in money supply. The growth in eight core sectors such as cement, steel and refinery products, which constitute 38% of the Index of Industrial Production (IIP), was only to 4.9 percent in November as compared with 6.6 percent in October (Siddiqui et.al, 2017).

Liquidity

Demonetization technically is a liquidity shock; a sudden stop in terms of currency availability. It creates a situation where lack of currencies jams consumption, investment, production, employment etc. In this context, the exercise may produce following short term/long term, consumption, investment and growth impacts on Indian economy. The intensity of demonetization effects clearly depends upon the duration of the liquidity shocks. Notes in circulation as of November 4, 2016 was Rs.17,742 billion i.e., 13 per cent of GDP and the value of Rs.500 and Rs.1,000 notes in circulation was Rs.15,347 billion which was about 86.5 per cent of notes in circulation i.e., 11 per cent of GDP (Hari, 2017). The demonetization move along with the imposition of withdrawal limits resulted in severe contraction in money supply and reduced the usage of these notes and thus negatively impacted the liquidity.

Conclusion:

The demonetization move has created chaos in every strata of the society whether upper, middle or lower. This is because, India is cash based economy and demonetization temporarily decreased the liquidity position. Decreased liquidity leads to less demand which in turn results in low productivity causing a slowdown in consumer market. Without adequate and proper planning, the demonetization-driven cash crunch has rendered Indian economy paralyzed at least for short duration. It has affected the informal sector where cashless transactions are minimal. Informal sector includes like agriculture, workers in construction, local transport, community services and small workshops like shoe makes and garment makers, rural populations and the urban poor and middle class.

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