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A CRITICAL STUDY OF THE EFFECTS OF CURRENCY DEMONETISATION ON INDIAN ECONOMY


ABSTRACT OF PH.D. THESIS




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Abstract

Just about a week after India celebrated Deepawali and the very day, on which the Americans elected Donald Trump as their president, the Indian Government suddenly withdrew the high denomination banknotes in circulation on November 8, 2016. A myopic view of the situation highlights the initial confusion, chaos and inconvenience caused to the public for exchanging/depositing their Rs. 500/Rs. 1,000 banknotes. Also, a large part of the country's population, both rich and poor alike was stripped off the ability to interact economically, since 86 per cent of the currency in circulation was rendered as an illegal tender. Though demonetisation was implemented amidst an otherwise stable macroeconomic environment, the Policy resulted in a marked decline in the availability of cash which was being utilised in routine, day-to-day transactions across the nation.

The objective to demonetise the high-denomination currency notes was Government's pre-determined move to "eliminate counterfeit currency, terror funded activities, corruption and black money" from the Indian economy. The need was felt more so as the currency notes of higher denominations (i.e, Rs. 500 and Rs. 1,000) had been widely used by miscreants to create socio-political instability and economic destabilisation within the country.


Demonetisation was implemented to interrupt the circulation of bogus and forged notes which would restrict any kind of support/cash assistance to the anti-social elements and further upset the black/parallel economy. The existence of this parallel economy has been a serious economic matter for a long time now. The Government thus endeavoured to execute a series of steps to uncover the black money and thereby the demonetisation policy was executed on November 8, 2016.


The primary purpose of the study is to assess the benefits and implications of the high-denomination currency demonetisation policy of November 2016. The analysis has been divided into two Phases. The first phase quantitatively assesses the impact of demonetisation on the major economic variables and the growth of aggregate deposits of the Indian Public Sector Banks. The study further assesses the extent to which the changes in the key economic variables can be attributed to the changes in the banknotes in circulation at the time of demonetisation and a few quarters later. It also examines the extent to which changes in the deposits of public sector banks can be attributed to the changes in the banknotes in circulation.

The second phase of the study qualitatively analyses the impact of demonetisation on the elimination of black money from the Indian economy. A comprehensive analysis of the problem at hand revealed various aspects of the deep-rooted problem of black money in the Indian economy. Since there are various studies/reports originating from both Government and non-Government sources there is a varied point of view on this issue. The researcher has thus attempted to derive a consensus on the issue of elimination of black money after demonetisation was implemented.

The findings revealed that demonetisation temporarily disrupted activities in most of the sectors of Indian economy due to a decline in demand. It even led to a short-term decline in the economic growth however, it recovered from the same, by the next Financial Year.

The study observes that demonetisation shall have long-term benefits as the base has been set for an increase in the "tax compliances, financial inclusion, greater funds in the Government exchequer, more lending in the economy, reduced cost of transactions, increase in digital modes of payments". These shall also provide a basis for a higher GDP growth and help in bringing the unorganised economy in the formal economic set-up. These reforms will further have an impact on the operations of black economy as well as the formalisation of the overall Indian economy, which will create a trail of transactions making it easier to track them. This shall widen the scope of the "white economy" as the money will move through the formal banking/financial system.


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