

## DEMONETIZATION AND ITS EFFECT ON BANKING SECTOR

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### ABSTRACT

Everyone is aware of the government's demonetization strategy, which involves outlawing the Rs. 500 and Rs. 1000 notes. It makes sense that it would harm small businesses, real estate, the transportation industry, and the manufacturing of consumer durables. In addition to these industries, it would have a significant impact on company operations in rural regions because most transactions there are cash-based. The businesses where strict cash transactions are conducted would be impacted by the ban on Rs. 500 and Rs. 1000 currency notes. Although demonetization may impact liquidity, it is a short-term measure to combat inflation, black money, corruption, and crime, deter a cash-dependent economy, and facilitate commerce. The government's decision to outlaw the Rs. 500 and Rs. 1000 notes has had an impact on practically every sector of the economy. Its impact on the banking industry is considerable since banks serve as a hub for distributing money that is legal tender to meet all societal demands. Banks are the main winners of demonetization. It forced the banks to accept deposits without charging fees for promotions and significantly improved the banks' liquidity condition. The literature on post-demonetization is what was used to create the current study. It illustrated how demonetization affected the banking industry. Due to its complex effects on all facets of the economy, demonetization—the abrupt and broad removal of a nation's currency notes from circulation—has been a topic of heated controversy and discussion. This abstract explores how demonetization has affected the banking industry, a vital part of every country's financial infrastructure. The research looks at the issue of India's 2016 demonetization, in which high-denomination currency notes were rendered useless, notably the Rs. 500 and Rs. 1,000 notes. The main goals were to combat black money, and counterfeit money, and to advance digital commerce. After demonetization, the banking industry underwent considerable changes and faced several difficulties. This paper aims to discuss the effects of demonetization in the banking sector.

**Keywords:** Demonetization, Banking Law, Banking Sector, Note Ban.

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## INTRODUCTION

After demonetisation a behaviour change has come to India.. for the first time after independence, the corrupt are feeling the heat<sup>1</sup> this was the statement made by PM Narendra Modi after the demonetisation was announced in India. There was a note ban on 100 and 500 rupees notes and they had to exchange it from the bank and collect the new notes from the government. According to the government, the exercise's primary goal was to reduce "black money," which includes unreported income that was not subject to taxes, money obtained via corruption, the sale of illegal items, money obtained through unlawful operations including human trafficking, and counterfeit money. It was declared on November 8<sup>th</sup>, 2016 the PM's address to the nation declared demonetisation which ceased to be out of the hands of people. The demonetisation affected a lot of people they started worrying about their money further which shook the nation. All the people who had black money suffered a lot and they lost so much of the money. In this paper, I aim to discuss the legal implications of demonetisation and also the effect and impact on the banking sector of India.

## OBJECTIONS OF STUDY

The paper aims to discuss the legal implications and the effect of demonetization on the banking sector. The meaning, outcomes the challenges of demonisation also shall be briefly discussed.

## RESEARCH PROBLEM

The topic is about understanding demonisation and its effect on the country and the banking sector of India.

## RESEARCH QUESTIONS

What is demonetization? How did demonetization affect the banking sector? After demonetization was there a failure of banks in India?

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<sup>1</sup> Statement made by PM of India, Narendra Modi

## RESEARCH METHODOLOGY

The methodology adopted for the work is the doctrinal method. The research will be based on demonisation in India and its effects on the banking sector.

## LITERATURE REVIEW

In a journal article titled “The Great Indian Demonetization<sup>2</sup>” which is written by Amartya Lahiri<sup>3</sup>. This is published by the American Economic Association. This journal article talks about the incident that happened on November 8<sup>th</sup>, 2016. 86% of India's money in circulation was demonetized. Disaggregated data indicates that the demonetization process did result in a significant loss of production and jobs. The output costs, nevertheless, seem to have been transient. The article in detail emphasis the whole process of demonization and its effects on the Indian citizen. It is a very insightful article. Disaggregated data shows that there was a notable loss of output and employment as a result of the demonetization process. However, the output costs appear to have been temporary. The essay goes into great detail on the demonization process and how it affects Indian citizens. This essay is perceptive.

Another article titled “ Impact of demonetisation on Indian Economy: A critical study<sup>4</sup>” was written by H Kushwaha, A Kumar, and Z Abbas and published by the International Journal of Management Studies. This article talks about the post implications of demonetisation in India and its effect of the same. They have painted a very clear picture and close to the reality of how the situation of India was at that very exact moment. A lot of different perspectives are spoken about in this article. This article discusses the consequences and aftermath of demonetisation in India. They have depicted a very accurate and realistic depiction of how India's condition was at that precise time. This article discusses many diverse points of view.

In a paper written by Charan Singh, the title of the paper is “India <sup>5</sup>Since Demonetisation<sup>6</sup>.” Corruption and tax evasion are obstacles to economic growth. India is a developing nation with significant infrastructure needs that will require significant development spending. Resources

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<sup>2</sup> JOURNAL OF ECONOMIC PERSPECTIVES  
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<sup>3</sup> Lahiri, Amartya. 2020. "The Great Indian Demonetization." *Journal of Economic Perspectives*, 34 (1): 55-74.

<sup>4</sup> Kushwaha, H., Kumar, A., & Abbas, Z. (2018). Impact of demonetisation on Indian economy: A critical study. *International Journal of Management Studies*, 2(7), 25-31.

<sup>5</sup> Singh, C. (2018). India since demonetisation. IIM Bangalore Research Paper, (567).

<sup>6</sup> IIM Bangalore Research Paper No. 567

that are not debt-related are urgently and continuously needed to provide a break from the enormous interest load that is now in place. A step towards achieving an honest tax system, more tax revenue, and less reliance on borrowing is demonetization. They have depicted a very accurate and realistic depiction of how India's condition was at that precise time. This article discusses many diverse points of view. This has a very good insight into how it was in India post-demonetisation.

In a journal article titled “A Study on Demonetisation and Its Impact on Indian Economy<sup>7</sup>” which is written by Mandala, Gangu Naidu; Mohanty, Anoop. This article talks about the aftereffects of the impact on the Indian economy. They have detailly spoken about the same in the whole paper. it has affected the economy's rate of development. It has an impact on the shopping habits of customers, other members of the public family, and Internet businesses. We see that India has a great deal of problems as a result of this behaviour. Therefore, it becomes crucial to assess how demonetization affects both the economy and the general public. Nevertheless, the PM highlights the importance of online commerce and developments.

In another article named “Demonetisation and the Rule of Law<sup>8</sup>” which is written by AP Kumar. Here they talk about the connection of law and this incident. This article talks about the aftereffects of the impact on the Indian economy. Resources that are not debt-related are urgently and continuously needed to provide a break from the enormous interest load that is now in place. They have painted a very clear picture and close to the reality of how the situation of India was at that very exact moment. A lot of different perspectives are spoken about in this article.

## **DISCUSSION AND ANALYSIS**

It was declared on November 8th, 2016 the PM's address to the nation declared demonetisation which ceased to be out of the hands of people. The demonetisation affected a lot of people they started worrying about their money further which shook the nation. All the people who had black money suffered a lot and they lost so much of the money. The process of removing a currency unit's legal tender status is known as demonetization. It is often carried out when the country's currency is changed, swapping out the old unit for the new one. The phrase has, however, recently come to be more frequently linked with abrupt, unexpected declarations by

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<sup>7</sup> Mandala, G. N., & Mohanty, A. (2019). A study on demonetisation and its impact on Indian economy. *Journal of Computational and Theoretical Nanoscience*, 16(5-6), 2377-2380.

<sup>8</sup> Kumar, A. P. (2016). Demonetisation and the Rule of Law. *Economic and Political Weekly*, 19-21.

governments to nullify the current currency, generally to combat corruption, black money, and counterfeit money. Due to its complex effects on all facets of the economy, demonetization—the abrupt and broad removal of a nation's currency notes from circulation—has been a topic of heated controversy and discussion.

This abstract explores how demonetization has affected the banking industry, a vital part of every country's financial infrastructure. First off, while the banking industry received fewer incentives than anticipated, demonetization prompted more Indians to open bank accounts. Before the enactment of this policy, only 50% of Indians had bank accounts, and 10% had access to bank credit. As a result, the country's banking industry had grown out of proportion to its standing as an international economy. This has to do with the people's way of life and the underground economy in addition to the obvious reasons of India's widening income disparity, traditional farming methods, and inadequate infrastructure. For the rural Indians, bank accounts used to be something novel. The demonetization process accelerated India's shift from cash to digital commerce. On November 27, 2016, Modi made a nationwide call to action for people to learn about the E-economy. This included learning about the various applications for banking on mobile devices, how to do business without cash, and how to utilise bank accounts and e-banking. Several initiatives were also implemented under the Indian government's "Go Cashless, Go Digital" slogan, including encouraging people to open bank accounts, providing access to credit and debit cards, and electronic payment, and waiving applicable banking fees for transactions.

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But this isn't always the case. Even though demonetization helped spur the advancement of financial technology in India, the country's fragile financial system would take time to stabilise. Even while some individuals are going back to using cash, demonetization has greatly boosted e-payments, according to Vijay Sharma, the creator of Paytm, the largest payment network in India. E-wallets are now well-known in India. Economic development is fuelled by the expansion of electronic payments. Payment systems were discovered by Xiaodan Gao, Mingzhi Wang, and Na Zhang to stabilise the real economy by mitigating negative short-term consequences. Over time, as electronic payments become more widespread, the financial system will see more liquidation, which will increase economic activity efficiency and transparency while tightening taxation.

Some significant changes occurred in the fiancé sectors which are:-

### **Increase In Bank Deposits**

When consumers rush to deposit their old currency notes in their bank accounts to protect their money, demonetization usually increases bank deposits. The banking industry may benefit from this deposit inflow.

### **Increase In Digital Transactions**

People are compelled to use digital transactions as a result of the abrupt lack of real cash. The banking industry may benefit from this as it promotes the use of digital payment methods, which raises consumer demand for banking services.

### **Enhanced Scrutiny And Compliance**

Following demonetization, there is frequently a greater emphasis on keeping track of transactions and keeping an eye out for any questionable activity. This might result in banks having to comply with stricter regulations, which would raise the administrative load and expenses.

### **Impact On Non-Performing Assets (Npas)**

Because of the unexpected increase in deposits and increased transparency, the banking industry may get a brief respite from NPAs. Long-term effects on non-performing assets (NPAs) are contingent upon the state of the economy as a whole and the degree to which demonetization has succeeded in reducing criminal activity.

Interest rates may decline as a result of banks having greater liquidity as a result of the unexpected rise in deposits. While this could help borrowers, it might also affect banks' bottom lines.

### **Difficulties In Managing Liquidity**

Banks may have difficulties in controlling the unexpected spike in deposits and making sure that the system remains liquid. The financial system needs to handle the additional liquidity, which calls for efficient planning and execution.

### **Technical Upgradation**

Banks may need to make investments in infrastructure and technology to improve their digital banking services to meet the growing demand for digital transactions. Better client experiences and developments in the banking industry may result from this.

It is important to remember that depending on the particular setting, the extent of demonetization, and the efficiency of the policy's execution, the effects of demonetization on the banking industry might differ.

### **CONCLUSION**

To sum up, demonetization affected the banking industry in both good and negative ways. Although it resulted in a spike in digital transactions and a rise in liquidity, it also revealed operational flaws and sparked concerns about the banking system's capacity to adequately service all facets of society. Future studies should examine the long-term impacts of demonetization on the banking sector, accounting for changing consumer preferences and financial industry technical developments.

The study's main conclusions and consequences are outlined in the closing part, which also highlights the necessity of executing demonetization laws with a balanced approach to minimise negative impacts on the banking industry. eliminating fake banknotes worth four billion rupees and preventing their entry into circulation in India. It also promoted mobile payments and raised the quantity and value of debit and credit cards used at the point of sale. It emphasises how important it is to have a strong regulatory framework to protect the banking industry's efficiency and stability in the face of economic fluctuations. By providing them with funding outlets and lowering their financing costs, the demonetization programme did not, in the long run, improve financial services for India's poor. The government's original objectives of anti-counterfeiting and anti-black money were also not met by the programme. On the other hand, the demonetization programme eventually led to the use of electronic payments.



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