

PANEL DISCUSSION REPORTS
MYTHS & REALITIES OF
DEMONETIZATION

14th December 2016



Centre for Economy Development and Law



Centre for Economy Development and Law

PDS_CEDL 16/004

MYTHS AND REALITIES OF DEMONETIZATION

14th December

2016

The cancellation of legal tender character of Rs. 500 and Rs. 1000 denominations through a sudden announcement by the prime minister on November 8th, 2016 invited diverse and disparate responses which the Centre for Economy Development and Law attempts to accumulate with a critical perspective. The panelists and participants of the seminar bring into discussion various theoretical and practical implications of the demonetization policy.

PANEL DISCUSSION REPORT

RAPPORTEUR
AMEYA M. R.

PANEL MEMBERS

Dr. K. N. RAGHAVAN, IRS (Commissioner of Customs, Kochi)
DEEPTHI MARY MATHEW (Research Associate, Centre for Comparative Studies, CPPR)
Dr. N. R. BHANUMOORTHY (Professor, NIPFP, New Delhi)
P. R. DEVI PRASAD, IES (former Director, Fiscal Policy Institute, Bangalore)
Dr. MARTIN PATRICK (Chief Economist, CPPR)
JOMON K. GEORGE, FCA (founder and managing partner, JVR Associates, Kochi)

DISCLAIMER: The opinions expressed herein are those of the panel members, and do not necessarily reflect those of the Centre for Economy, Development and Law, or Government Law College Thrissur or any other persons or institutions affiliated with it. Any mention of trade names, commercial products or organisation and the inclusion of advertisements, if any, published in the report does not imply a guarantee or endorsement of any kind either by the centre or the college. All reasonable precaution was taken by the rapporteurs to verify the authenticity of data and information published there in the report. The ultimate responsibility for the use and interpretation of the same lies with the panel members. Publisher, Rapporteurs and the College shall not accept any liability whatsoever in respect of any claim for damages or otherwise therefrom.

Our Sincere Thanks



*for collaborating with us in organizing
the seminar.*

MYTHS AND REALITIES OF DEMONETIZATION

Touching the whole of the nation, over-the-night demonetization in India has dragged the peasant to president into daily life dilemmas and discussions. The decision to withdraw the legal tender status of the two higher denominations of 500 and 1000 with effect from November 8th, 2016, as announced by the Prime Minister Narendra Modi and being followed by a host of financial regulations pertaining to the most common transactions have triggered complex responses. This unprecedented situation is diversely viewed from inside and outside the country. In this backdrop, The Centre for Economy, Development and Law could not have missed the scope of a critical and scholarly analysis of the state of affairs. The seminar on “Myths and Realities of Demonetization” was organized in association with the Centre for Comparative Studies of the Centre for Public Policy Research (CPPR), Kochi, on 14th December 2016, from 4.30 pm to 7.30 pm at Bharath Tourist Home, Ernakulam.

The programme was launched by paying tribute to Dileep Padgaonkar, former editor at the Times of India, in memory of his earlier association with CPPR. Vinny Davis, Research Associate at CPPR, introduced the profile of the organizers and also the theme of the present of discussion. The seminar mainly intended to look into the following concerns:

- 1) Is demonetization the best way fight black money?
- 2) The theoretical aspects of demonetization
- 3) Impacts of demonetization on the Indian economy
- 4) Demonetization and the realistic scope of a cashless/digital economy
- 5) Demonetization and political economy

The seminar was moderated by Dr. K. N. Raghavan, IRS, Commissioner of Customs, Kochi. Following the welcome address by Lekshmi Nair, Centre Manager, the CPPR Centre for Comparative Studies, the seminar was initiated into its crux with the overview of the topic presented by Deepthi Mary Mathew, Research Associate of the centre. Ms. Deepthi began by stating that she is attempting to discuss the theoretical and philosophical aspects of

demonetization, its ground realities and practicalities, and not any political stand on the subject. Two main objectives were put forward behind the Prime Minister's move of demonetization: one was to curb terrorism financing and the other was to fight black money. In the case of terrorism financing, fake currency notes are a major security threat to the country. As per a study conducted by the Indian Statistical Institute, the total amount of fake currency amounts to 4 hundred crores, almost constant for the last four years. Various agencies of our country have been able to capture only one third of this fake currency notes. As the government has resorted to demonetization of the legal tender status of old 500 and 1000 currencies and issued new 500 and a higher denominated 2000 currencies, the question arises whether the government will be repeating the strategy time and again.

Then Ms. Deepthi analysed the process of generation of black money, with examples. In her opinion corruption is a major source of black money, upon which the curbing impact of demonetization is not convincingly proved by any statistics hitherto. A more transparent system of governance will better fight black money, than demonetization. And she observed the gradual shift of the proclaimed objective of demonetization from the above two to a 'cash-less/digital economy'. Are our government departments equipped for a digital economy? The call for e-governance is a decade old in our country but still far from its optimal level. Ms. Deepthi repudiated the claim that the country is equipped for digital economy through Aadhar cards, Unified Payment Interfaces, Know Your Customer (KYC) norms and the like, by putting forth data of basic infrastructure required to carry the changes to the mass. Even now, the banking penetration in the country stands at 58.5%. The total number of ATMs is 18 per 10,000 of the population, the most of which are distributed in urban area. It is clear that the nationalisation of banks in 1969 has not met its aims. Another basic facility is internet connectivity, the average speed of which is mere 2 mbps in the country, far below the global average. She was keen to suggest that well executed policy decisions are the need of the hour. Ms. Deepthi also drew examples from other countries which adopted demonetization with similar objectives but were pushed into severe crises. She concluded by making a note on the unpredictability of the system we are living in where the real impact of demonetization is difficult to be quantified or assessed at this point of time.

Dr. N. R. Bhanumoorthy, Professor, National Institute of Public Finance and Policy, New Delhi, hilariously stated that one of the major changes occurred post-November 8th is a sudden increase in the number of economists as well as astrologers. He said he was a supporter of the policy of demonetization, considering the context of its announcement. India is one of the fastest growing economies in the world with a growth rate of 7.6%; but only 3-4% of the population pay income tax. This is a unique situation in the international scenario. He enumerated the mixed trends in Indian economy featured by call for reviving GDP growth rate, decline in inflation, almost zero current account deficit, low investments, and bad performance in the export sector, amid policy initiatives such as reintroduction of the income declaration scheme for government employees under the banner of anti-corruption campaign. In this backdrop, any attempt to analyse demonetization merely in terms of digits will be incomplete. Dr. Bhanumoorthy was able to perceive a sequence in the governmental decisions intended to enhance financial access and inclusion in the past fifteen years. He opined that the Goods and Services Tax will help prevent leakages in the taxation side while introduction of aadhar-based services will do the same in the public expenditure side. He agreed with Ms. Deepthi that still there is a very long way to go in the basic infrastructures as proved by his own study, though optimistic about the policy initiatives.

Beginning to question the mode of implementation of demonetization, Dr. Bhanumoorthy quoted a report that 182 rules have been changed since November 8th. These frequent changes without clear planning have caused misery. All the proclaimed objectives of the demonetization are sidelined by this time and the idea of a “less-cash economy” is driving the situation at present. Banks have been given a lot of confusing orders leading to a completely chaotic situation particularly in the sector which was supposed to be the backbone of the policy shift. He quoted the recent statement of RBI that, out of the 15 lakh crore rupees of currency to be demonetized, 12.4 lakh crore is returned from circulation when 20 days are yet remaining. What has happened to the black money? Even the Reserve Bank of India, to whom everybody will look for an answer under such circumstances, is left without a clue as to the future of the policy. On the other hand, Dr. Bhanumoorthy also noted the merits of a digital economy. In his view, currency creates black money. Hence the shift to digital payments will surely bring down illegal transactions as it reduces the role of middlemen. Quality employment can be another result of the same.

From his observations, Dr. Bhanumoorthy enlisted the qualities of the best public policy as follows:

- 1) Transparency
- 2) Timing
- 3) Predictability and
- 4) Credibility

Out of these four elements, he chose credibility to assess the policy of demonetization. He remarked that the banking statistics from September 16th to October end, provided by RBI, shows deposits worth 5.5 lakh crore rupees. But the rate of increase in deposit per month is mere 15,000 crore rupees. Even after considering influential factors such as the Seventh Pay Commission and income tax payments, the amount of deposit is still huge to be explained. After November 8th, the situation drastically changed so that even a 2000 rupee currency is scarce to draw. In conclusion he stated that demonetization is a good measure being implemented badly. He hoped that, more than controlling black money, this step will provide for a shift from currency to digital transactions which in turn can be prosperous to the country.

Mr. P. R. Devi Prasad, IES, former Director of the Fiscal Policy Institute, Bangalore, joined the seminar through a skype call. He extensively discussed the theoretical aspects of demonetization. He presumed that the new policy is an attempt to shift from a vicious circle of “kala-dhan” we are in. In the present economy there is this situation where bad money chases away good money – “in black” is the demand. Demonetization in this context is to be analysed from multiple points of view – political, economic, social, and constitutional/institutional. It is to be studied conceptually as well. He noted the definition of a Good Economy Government that which is expected to help all the people to earn their incomes and protect value of all of it. This will probably bring every one under the tax-paying system. Use of technology can enhance the process. Mr. Devi Prasad discussed how gold is a potential “fund money”. In the world, 17.5% of gold is official reserve excluding India; India’s private reserves are 9.7-16.1%, and above-ground stocks amount to 66.1%.

The terms “black money”, “fake currency”, and “cashless/digital economy” are in communication since November 8th, among which the first two came down in frequency of use while the third one went up by the end of the month. This clearly notes the shift of focus of the demonetization over the days. He further discussed opinions and demands arising from different sides of society. From common people to RBI officials, the policy has rendered mixed responses, mostly in confusion and uncertainty. Mr. Devi Prasad noted that currency of denomination 500 has been 47.8% of the total currency in circulation and denomination 1000, of 38.6%. Costs and benefits of the policy decision of demonetization can be comprehensively analysed only after a period of time when its impacts are clear in the economy.

The Chief Economist at CPPR Dr. Martin Patrick took over the dais by questioning the very terminology, “demonetization”. Withdrawal of currency from circulation and replacing it with new ones is normally called “demonetization”. This is not exactly what has happened in India. 1000 rupee notes are withdrawn permanently. This can be a variant of/a partial demonetization. Analyzing the historical evidences of success of demonetization elsewhere, we don’t have a happy note, he said. Soviet Union, Nigeria, Zimbabwe, Australia, the United States of America etc. had practiced demonetization earlier. In the USA, the policy shift brought about some positive changes in the corrupt economy whereas in Soviet Union it led to the fall of the country itself. We are awaiting news from Nigeria on its transformation into cashless economy. These mixed experiences from all over the world assure no success but only unpredictability in Indian situation, he underlined.

Another point Dr. Martin Patrick put forth for contemplation was the theoretical backing of demonetization. Modern Monetary Theory is the best framework within which demonetization can be decoded. This theory argues that modern economies are working with fiat/paper currencies and the withdrawal of money will affect only the people, not the government. He asserted that this is a bold and welcome move but at the same time, conceptually flawed. To effectively put black money in chains, the government should be withdrawing all the higher denominations and circulate more of lower denominations as practiced in USA. Drawbacks in implementation have furthered sufferings of the lot. Demonetization is considered as a powerful tool to address the black economy. On scrutinizing the ethical or logical side of demonetization, there are different schools of

thought. One school argues that the current policy is part and parcel of globalization strategies and hence to be rejected outright. Another school holds the opinion that demonetization is conceptually good and it can be followed once the problems in the implementation level are rectified. Dr. Martin Patrick is of the opinion that the government should have done a lot of homework before stepping into demonetization, including printing of more 500 denomination currency and an additional denomination of 200. At the bare minimum, the functioning status of the 2 lakh ATMs in the country were to be ensured and more ATMs to be provided in the rural areas. In an assertive note, he added that the central government should have taken the cooperative and charitable institutions into faith in the process instead of totally neglecting them. Having agreements and disagreements with the rest of the panel, he reinstated mixed responses and the need to wait for a period of almost six months to get clear statistics substantiating the impact of demonetization on Indian economy. 97% of the population are the sufferers and the rest 3% are culprits rather than beneficiaries of poor implementation of a good initiative. It is favourable that the negative impacts of demonetization are contained in 3-5 months; but under the present situation it is probable to extend up to 8-12 months. His observation is that, if this continues above one year, our GDP will definitely come down by 1-2%. With the suggestion that the implementation side has to be looked into seriously and the government has to take stringent measures to overcome the current issues, Dr. Martin Patrick concluded his words.

The next session was handled by Jomon K. George, FCA, founder and managing partner of JVR Associates, Kochi. He presented an auditor's perspective of the theme of discussion. Beginning with a conceptual analysis, he moved on to link demonetization with the previous steps of the government. The introduction of schemes such as Jan Dhan Yojana intended to bring rural India into the formal banking sector saw 25.82 crore account openings of which 23% still maintain zero balance. 64,000 crore rupees is disclosed under the Income Disclosure Scheme, which is yet a miniscule portion of the real figure. He remembered it from popular discussions that 'corruption runs in our DNA'. Demand for "favours" which every individual faces while in need of some government service and large amount of unaccounted transactions flowing beneath the financial system are menace to the economy. The complex tax structure in our country, which is difficult to understand and comply, has a role to play in this. To exemplify, Mr. Jomon picked and shared one of his experiences of auditing in North India where he met with a jewelry group who account for only 8% of their

actual turn over, through manipulation of accounts. When the 92% of money is distributed into the system, it becomes black money. Understating considerations is another source of black money, he pointed out. We have high instances of stamp duty especially in real estate/immovable property transactions. In villages it is below 10% but in metro cities it amounts up to 24%. It is a well known secret that any purchase of land will contain an amount of illegal money. He observed that, now, the restrictions on withdrawal of money from banks will adversely affect the white money in the deal. The Indian experiment of demonetization in 1978 by the then Prime Minister Morarji Desai was failure in his opinion; black economy has grown by 5% since then. Mr. Jomon detailed how black money can be made white through bank accounts outside the national boundary and also transactions from multiple accounts. Agreeing with the statement of Kerala Finance Minister Thomas Isaac that 'black money is not kept in sacs', he argued that demonetization is not going to be effective in controlling real estate transactions. He dismantled the common fear about possession of gold in the light of recent regulations; unless there is wide search and seizure, deposits in gold are not going to be affected much. He then accused that cooperative institutes are working under totally unregulated environment - there is no external auditing system - though he himself let space for criticism of the work of Chartered Accountants. They cannot expect immunity. In his comparative analysis, the black economy in India is of value of 30 trillion, i.e. 20% of GDP, while the Asian average stands at 25-26%, African statistics at 40%, and the Latin American, even worse up to 45%.

Jomon K. George also commented on the difficulties being faced in daily life situations due to the delay in lower denominations percolating down in the economy. He critically examined the negative short term impacts of demonetization upon business, agriculture sector, particularly perishables, retail sellers, travel and tourism, real estate etc. According to him, "remonetization" is the challenge awaiting. The cost of the whole demonetization process is around 1.32 lakh crores of rupees. If the amount is not returned to the government, the whole of effort will prove to be in vein. However, there is the long term hope of banking system swollen with all the money deposited and loans repaid in order to get rid of black money. Lending rates will be brought down as a result, which may probably put back the GDP and growth rates already down by around 0.4%. Mr. Jomon further presented with details of printing currency of 2000 and 500 denominations, expected at present capacity of the country, which requires a minimum of 295 and maximum of 461 days. And the shift to

digital economy is a dream of long road from 3% to 90%, easier for the urban population to catch up with. Even while lauding the bold move of the Prime Minister Narendra Modi, Mr. Jomon reminded of the chances of failure which can powerfully pull down the economy at a time when the whole of the world is looking up to India. Untimely, not planned properly, and very poorly executed are the final words Jomon K. George chose to describe demonetization.

The seminar witnessed a highly participative discussion session thereafter. Audience from different walks of life raised their questions and concerns. They were mainly centred on enquiring scope of interest-free banking in India, questioning the claims of advantage of digital payment methods that cause baseless intermediary charges, the relationship between Foreign Direct Investment (FDI) and black money, sustenance of the grass-root level cooperative societies being crucified under the recent financial regulations, and probable political objectives of the sudden move of demonetization. Students, academicians, scholars, economists, administrators, bureaucrats, members of cooperative bodies, businessmen, and others utilised the platform of discussion utmost. Dr. K. N. Raghavan appropriately moderated the session so as to let every voice heard and answered by the panelists. The perspectives projected at the venue have been reflective of the kaleidoscopic responses to demonetization at national and international spaces.

The seminar was concluded with Hormis Tharakan, IPS, presenting mementos to the panelists and moderator. Abhilash Gopinath, Assistant Professor, Govt. Law College, Thrissur, and Director of CED&L, proposed vote of thanks, referring to the legal and procedural aspects of demonetization to be brought under the purview of further discussions.