

DEMONETISATION NOVEMBER 2016 - A FIASCO!

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ABSTRACT

Demonetisation as a blunt instrument of economic policy was used by various countries of the world in the past. It was also implemented by the Government of India in the past. Prime Minister Narendra Modi announced on 8th November, 2016 the Government of India's decision to cancel the high denomination currency of 500 rupees & 1000 rupees as the legal tender with effect from 9th November, 2016. The demonetization of currency was motivated, as per the press release issued by the Government of India to eliminate black money 'which casts a long shadow of parallel economy on our real economy' and to curb counterfeit currency, which is used to finance terrorism and drugs and as a conduit for money laundering. The Government also said that in place of the delegalized currency notes, it will introduce two notes in the denomination of 500 rupees and 2000 rupees, which will be distinctly different from the outgoing notes in size, design, colour and look. However, the key point to the issue was whether procedure followed for the process of demonetization of the high denomination which is 86% of the money in circulation was planned out and modalities properly decided to tackle the implementation of this decision. Also, whether it served the intended purpose for which it was implemented. The main source of data is secondary, journal articles and conference papers related to demonetization in general and information regarding the current demonetization policy announced on 8th November, 2016 in particular are considered. Here an attempt has been made to scrutinize the reason for the failure on the part of the Government to properly implement the Policy and the hardship caused to the public in general.

Keywords: Black Money, Cashless Economy, Counterfeit Currency, Demonetisation, Economic Policy, Remonetisation, Planning

Introduction:

Demonetisation is the withdrawal of a particular form of currency from circulation. Remonetization is a form of payment which is restored as legal tender.

The main reasons for use of Demonetisation as a tool of economic policy was to

- combat black money
- combat corruption
- combat counterfeit notes
- combat terrorism
- discourage a cash system

History of Demonetisation:

The policy of demonetization dates back to 1873 where in United States there was a general revision of the laws relating to the Mint of the United States. In abolishing the right of holders of silver bullion to have their metal struck into fully legal tender dollar coins, it ended bimetalism in the United States, placing the nation firmly on the gold standard. It led to economic depression in the country and silver was remonetised as a legal tender in 1878.

In the year 2002 when EURO was introduced the nations of the European Monetary Union adopted the euro. However to switch to the euro, the authorities first fixed exchange rates for the various national currencies into euros. When the euro was introduced the old national currencies was demonetized. However, the old currencies remained convertible into euros for a while so that a smooth transition through demonetization was assured.

In the year 2015 Zimbabwean government demonetized the Zimbabwe dollar to combat hyper inflation. It was around 3 month's process when Zimbabwe dollar was totally removed and US Dollar as the country's legal tender was introduced to stabilize the economy.

In India in the year 1978 during the period when Morarji Desai was the Prime Minister Rs.1,000, Rs. 5,000 & Rs.10,000 notes were demonetized especially to curb the black money. At that time Rs.1,000 & other higher denomination notes were impossible to be possessed.

Objectives of the study:

- To review the objective of Demonetisation
- To critically analyse the implementation of the policy and whether it served the intended purpose.

Research Methodology:

The present study is related to the Demonetisation policy declared on 8th November, 2016. The study is based on secondary data collected from various websites, books, newspapers & information regarding the policy of demonetization.

Unearthing Black Money:

“Cash Money”, “Black Money” & “Corruption Money” are different. All the cash money may not be black money or corruption money. All the Black money may not be Corruption money. And all the Corruption money may not be Cash money.

In terms of value, the annual report of Reserve Bank of India (RBI) of 31st March, 2016 stated that total bank notes in circulation valued to 16.42 lakh crore (US\$240 billion) of which nearly 86% (around ₹14.18 lakh crore (US\$210 billion)) were ₹500 and ₹1,000 banknotes.

Table 1: Rs. 500 & Rs. 1000 Banknotes in Circulation

Rs. 500 & Rs. 1000 Banknotes in Circulation						
Denomination (Rs.)	Volume (Crore Pieces)			Value (Rs. Lakh Crore)		
	Mar-14	Mar-15	Mar-16	Mar-14	Mar-15	Mar-16
500	1141	1313	1571	5.7	6.6	7.9
(% Share)	14.7	15.7	17.4	44.4	45.9	47.8
1000	508	56.1	633	5.1	5.6	6.3
(% Share)	6.6	6.7	7.0	39.6	39.3	38.5
500 & 1000 together	1649	1874	2203	10.8	12.2	14.2
(% Share)	21.3	22.4	24.4	84.1	85.2	86.4
Total of all notes	7733	8358	9027	12.8	14.3	16.4

Source: RBI – 4th February, 2017.

On the assumption that 75 percent of this money is returned to the banking system (either through cash exchange or deposit into accounts), about Rs. 10.5 lakh crore will return to the banking system, while the balance Rs. 3.5 lakh crore will be windfall gain and can be transferred to Reserve account.

However, in fact as per the current position disclosed by the government and RBI around 14 lakh crore rupees have been returned in the form of 1000 & 500 rupee notes. The government is left out with hardly any gap and the main objective of demonetization was not achieved.

Combating corruption:

The demonetization opened a new door for corruption. Many people started exchanging the old 500 & 1000 rupee notes with the new currency for a commission. Even the bank officials played an important role in this exchange with the exchange rate as high as 30%.

The Income tax department has identified 18 lakh people with suspicious deposits. These people will have to reply within 10 days otherwise action will be initiated against them. The Income tax department through its "Operation Clean Money/Swachh Dhan Abhiyan" programming software is trying to analyse the data and take appropriate action against the erring people. In the current budget the government also proposed to empower officers of the rank of joint director, the deputy director or assistant director to call for information for the purpose of inquiry or proceeding without seeking prior approval of higher authorities. Earlier, such powers were only with officials of the rank of the principal director or director or the principal commissioner or commissioner. This will open up more scope for corruption.

Combat counterfeit notes:

Within a short period of the new 2000 rupee notes being printed there were incidents where counterfeit notes of the same were in circulation. The pressure on the bank officials during the period of demonetization did not give sufficient time to check the counterfeit notes. The bank officials claimed that the 500 & 1000 rupee notes has to be destroyed and hence did not took sufficient care to check the counterfeit notes. Moreover there are incidents where the bank officials were exchanging the old notes with the new notes on commission basis & did not allow the same to be checked properly. As a result the counterfeit notes which were in circulation entered the banking system.

Combat terrorism:

The terrorist use the counterfeit notes only once and then it enters into the circulation. Hence extinguishing one time counterfeit notes does not serve the purpose. Moreover the terrorist activities have other options to be financed by way of using gold, dollars, diamonds, drugs & other than Indian currency.

Within a week of demonetization, in the forests near Baramulla a policeman was killed by the terrorists. On 19th November, United Liberation Front for Asom (Independence) carried out an attack on an army convoy in Assam's Tinsukia district. Three soldiers lost their lives in an attack carried out with the help of IEDs, mortar propelled grenades and automatic rifles. ULFA killed a civilian three days earlier at the same location in another terror attack. On 22 November 2016 Pakistani terrorists alongside 'Border Action Team' ambushed soldiers of 57 Rashtriya Rifles in Kupwara district. Three Indian soldiers lost their lives as body of one of them was inhumanly mutilated. 29th November when terrorists attacked Indian soldiers at Nagrota. Seven Indian soldiers including two Major rank officers were killed.

All these incidents once again proves that there is no impact of demonetization on terrorism as wrongly claimed by the Government.

Discourage a cash system:

The government was not prepared to go for "Cashless system" for the time being but as a face saving had to announce for the Cashless system. However, there were terms like "Less Cash" & "digital system" being coined from time to time. The financial and technological infrastructure especially in rural area is bad. As per the Pew Research Centre report just 22% of Indians use the internet "at least occasionally" and only 17 percent have a Smartphone. 11 % of consumers were using a debit card in 2015, while most retailers don't accept cards.

In 2014, there were 18 ATMs and 13 commercial bank branches per 100,000 adults — in comparison, the number in Brazil was 129 and 47 respectively. According to a December 2015 Reserve Bank of India report on "financial inclusion in India", each rural and semi-urban bank branch serves 12,863 people compared with an urban and metropolitan branch which serves just 5,351 people.

Table 2: Data of Cashless Transactions

POS(Point of Sale) terminals installed by various Bank branches	1.44 million
No. of ATM across India	200000
No. of Debit Card transactions	881 million transactions
No. of cash transactions through Debit Card at ATM	92% around 811 million transactions

Source: As per the RBI data July, 2016

Table No. 2 highlights that Indian economy is not prepared to go Cash less as of now.

Conclusion:

To sum up the process of demonetization did not achieve the intended purpose of combating the black money, corruption, terrorism, counterfeit notes. The Government was not clear in its demonetization policy implementation. RBI has periodically changed the rules on cash deposits and withdrawals through notifications. This on the one hand was making way for black money conversion & on the other hand was sending confusing signals to the general public. The banks were not ready for the process of demonetization policy for absorbing the 86% of the Issued currency. There were not enough notes for exchange. The ATMs did not have provision to hold the new printed 2000 rupee note & had to be recalibrated which took a long time. As a result the common man had to wait in long queue to exchange &/or deposit the so called "tender money". This money in most of the case was the hard earned money and on which the legitimate tax had been paid. Also the economy has been hit. The livelihoods of the poor which depends on cash for their day to day expenditure were affected. The well off who had the black money resorted to ways to convert their black money which were in 500 & 1000 rupee notes to the new notes or other

forms like gold, real estate. The government took a turn by misguiding the people to resort to “cashless economy” without there being any preparation to shift to this form of economy.

Recommendations:

- The government should have properly planned out the procedure of implementation and should have assessed the impact of the demonetization. There should have been sufficient notes in circulation for exchange.
- The government should have come out with an amnesty scheme for declaring the black money which should have wide acceptability by the people as against the two recent schemes of “ITDS-2016 (Income tax disclosure scheme)” & “Prime Minister Garib Kalyan Yojana” which did not have wide acceptability.
- The government should increase the tax base and reduce the tax rates so that more people pay their tax dues.
- Moreover, the government should introduce the infrastructure facility in the form of roads, railways, etc so that people willing pay their tax dues.
- Internet facilities should be made available on a mass scale at a cheaper price to enable to shift to Cashless system. Strict action to be taken against those who perpetrate online frauds.
- The government should avoid “divisive” policy & should focus on “non discriminative” policy of development so that the people do not resort to terrorism.

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