

BLACK HOLE OF SILENCE ON DEMONETIZATION

Two years on, why do we still not ask about the people and economic activities that were severely disrupted by this 'surgical strike'?

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There is one "surgical strike" from two years ago that will not be celebrated this year: the 8 November 2016 demonetization of ₹500 and ₹1,000 currency notes. Two years on, the economy and its institutions continue to experience the negative after-effects of the process and the events surrounding demonetization. For instance, the central government is now brazenly able to put pressure on the Reserve Bank of India (RBI) and its governor, Urjit Patel, to hand over its surpluses only because two years ago the same RBI under the same governor did not demur on the demonetization of 2016.

Since there is always an official fog of rationalisation spread around demonetization, it is important to remember what the objectives were as laid down in that late evening speech on 8 November 2016 of Prime Minister Narendra Modi and the gazette notification later that same day. The prime minister outlined three sets of objectives, (i) "to break the back" of corruption and black money, (ii) to end the circulation of fake currency and (iii) to end terrorist financing. The gazette notification outlined the same three objectives but did not mention corruption.

GIFT WRAPPING NOTE BAN

The BJP-led NDA government, which places so much importance on packaging, had to suitably wrap demonetization in a manner that would sell. It was therefore not surprising that ending fake currency circulation and terrorism financing were tagged along with the main objective of rooting out black money. These two objectives were drawn up at a time when a fervour against "anti-nationals" had been cultivated. By themselves, neither objective made much sense.

There was indeed a spike of fake high denomination notes (HDNs) of ₹500 and ₹1,000 detected during the surrender of notes in late 2016. This was to be expected since ultimately nearly all the HDNs in circulation returned to the banking system and were then processed by the RBI. But since the new series of currency notes did not have any additional unique security features, the counterfeit presses were soon in operation: a small number of fake notes of the new ₹2,000 were detected in the last few months of 2016-17 itself and a much larger number (almost 18,000 pieces) in the next year, 2017-18. So much for demonetization ending the spread of counterfeit currency.

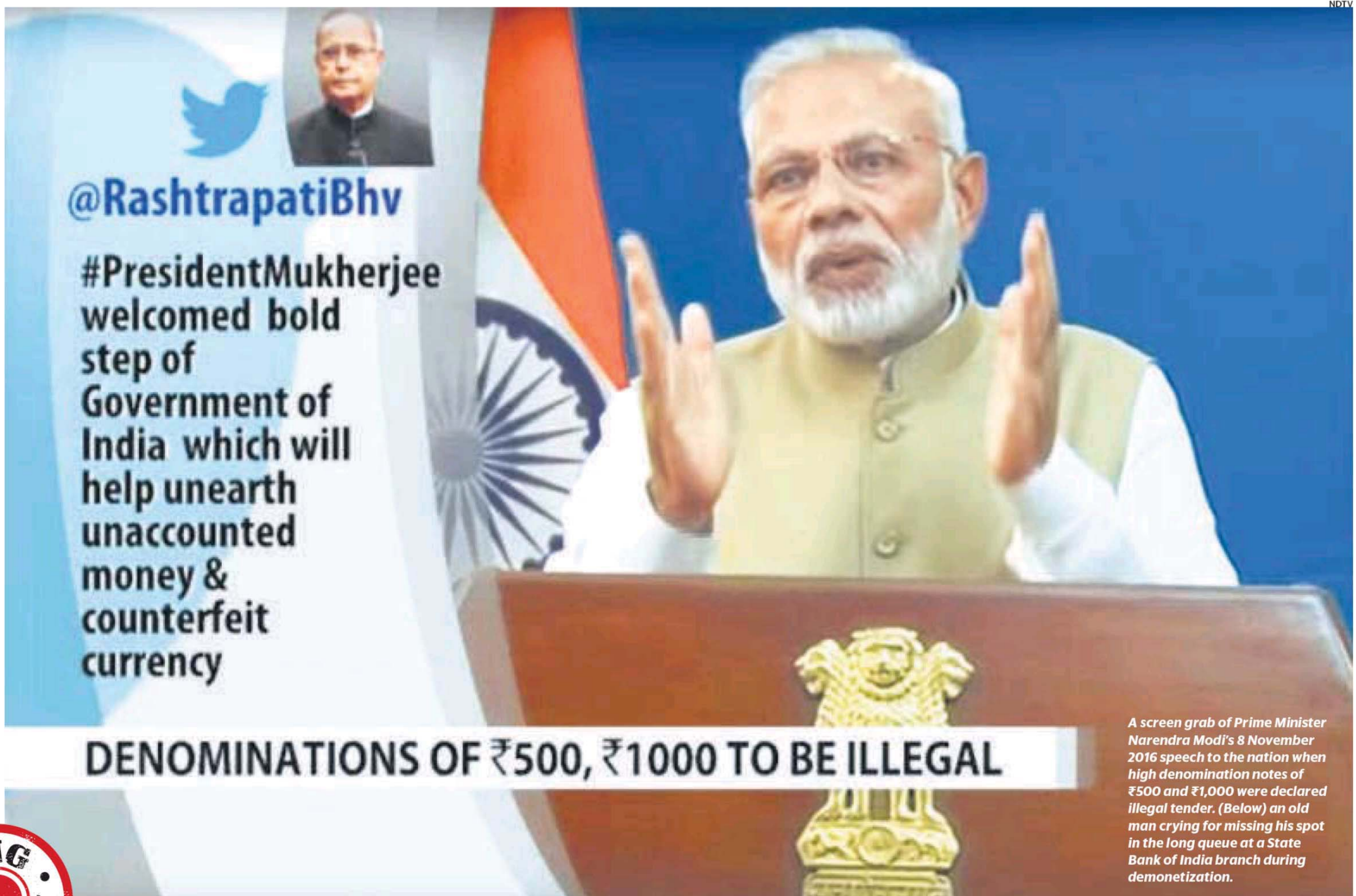
The less said the better about demonetization ending terror financing. As many noted at the time and thereafter, it is in the nature of terrorism that it wreaks a destructive impact with the most limited of financial resources. In any case, disaffection as expressed in terrorism in the two years since November 2016 has been no less than before, giving lie to the strange claim that demonetization would reduce terrorism.

That leaves us with the main and perhaps only objective of demonetization of the HDNs of ₹500 and ₹1,000 notes which took out 86% of the currency in the market; ending the scourge of black money. In late 2016, the attorney general told the Supreme Court, which was hearing a petition against demonetization, that the government expected a quarter to a third of the HDNs in circulation not to return to the banking system, i.e., this would be the amount of black money destroyed.

It took almost two years for the actual picture to emerge: *The RBI Annual Report* for 2017-18 had this bald statement: "The total SBNs [specified bank notes] returned from circulation is ₹15,310.73 billion." Or as the newspapers put it so well, this was 99.2% of the ₹15,440.5 billion of the HDNs in circulation on 8 November 2016.

It is clear that along with the honest who stood in line and deposited their cash in banks, the dishonest had got the better of the government. They had invented innumerable ways to deposit their illegal holdings of cash in the banks. This should not have surprised the government. The previous governor of the RBI, Raghuram Rajan, had advised the government that demonetization would not achieve its objective of unearthing black money because, among other things, the tax evaders would find ways to launder their holdings.

Yet, such advice was ignored and the Prime Minister's Office went ahead with a decision that by all accounts, the prime



A screen grab of Prime Minister Narendra Modi's 8 November 2016 speech to the nation when high denomination notes of ₹500 and ₹1,000 were declared illegal tender. (Below) an old man crying for missing his spot in the long queue at a State Bank of India branch during demonetization.



minister himself took the lead on, based on a half-baked set of suggestions from a Pune-based NGO. In the end, far from turning into "worthless pieces of paper" (words used by the prime minister in his 8 November 2016 speech), almost the entire stock of illegal cash holdings had been successfully legalised.

NEW GRAND NARRATIVE

When, soon after November 2016, the aim of destroying black money looked to fail, the government's attention shifted to creating new objectives and to then arguing that the deposits of the HDNs in banks was a positive development because this gave the government information that it could use to track down the money-launderers. To take the second first, it is revealing that more than 18 months after the Union finance minister announced in the February 2017 budget speech that his ministry would harness the powers of "data analytics" to track down the crooks, we are yet to see a single press release about the success in even a single case.

The big shift in objectives was of course to talk about digitalisation, better tax compliance, "formalisation" of the economy, the goods and services tax (GST) and demonetization as inter-connected parts of one giant mosaic of a modern and clean economy in which the success of the announcement on 8 November 2016 was crucial. Unfortunately, the reality says otherwise.

To begin with, first, nobody was going to be fooled with this new grand narrative. Everyone knew that this was an ex-post rationalisation as the black money objective began to collapse. Second, demonetization—a surprise decision eight months before the tortuous introduction of GST—

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was a disruption that did not make the transition to GST easy. Third, digitalisation was not a new initiative; it had been in progress since the early 2000s. Demonetization did compel an acceleration in the process (which subsequently slowed but has since remained at a higher level of adoption), but as many have said we did not need the sledgehammer of demoneti-

MINT SHORT STORY

WHAT

The continuing impact of the 8 November 2016 decision to withdraw 86% of currency in circulation. 'Notebandi' was meant to curb black money and end terror financing, but it failed to meet its stated objectives.

HOW

Along with the honest who stood in line and deposited their cash in banks, the dishonest got the better of the government by finding ways around the system. This should not have surprised the government.

BUT

The voter has not punished the government for this folly. The BJP does not project it as an achievement in its poll campaigns; nor does the opposition use it as a stick to beat the BJP.

zation to push digitalisation.

Fourth, this new talk of "formalisation" of the economy driven by digitalisation, demonetization and GST seemed to see the vast informal sector as nothing more than a community involved in regulatory arbitrage and tax evasion. Such talk ignored the fact that while there are indeed arbitrageurs and tax evaders in the informal sector, India's ocean of informal activity consists of workers involved in low productivity jobs because there is no alternative.

Fifth, credit is claimed for and much is made of the fact that the cash-GDP ratio post demonetization is now about 1.5 to 2 percentage points less than before. It is always assumed that a less cash-

intensive economy is a mark of progress. Yet, Japan and Switzerland have much higher cash-GP ratios than India and no one sees them as being backward. True, the use of cash can mask an audit trail and facilitate tax evasion. But we should not be blind to the fact that the larger part of black money generation now takes place inside and not outside the circuits of the



banking system. Nirav Modi and Mehsul "Bhai" Choksi looted the banks and transferred wealth through banking channels; they did not do so with suitcases of cash.

Finally, there is the metric of improved tax compliance. Depending on what the data can be made to say, the metric that is used by the government to claim success is either (i) income tax collections, or (ii) number of returns filed, or (iii) the number of assesses or (iv) the income declared. Direct tax collections have indeed gone up. Some of it is to be expected as the money launderers make one-off payment of income tax. Some of it is also because to register under GST you also needed to be filing returns and with a PAN.

After a 6.6% growth in direct tax collections in 2014-15, there was an acceleration to 14.5% in 2016-17 and then to 18% (unaudited) in 2017-18. Yet, it is far too early to claim any transformation in tax revenue collections. Growth of over 15% in a year is not unusual. In 2010-11 as in 2017-18, direct tax collections jumped by 18% before growth fell off thereafter.

SOUNDS OF SILENCE

If the "successes" of demonetization seem hollow, there is a big black hole of silence as well. It is remarkable that while the dislocation of late 2016 and the first half of 2017 is behind us, we do not ask anything about how the people and the economic activities that were severely disrupted emerged from this policy blunder. How many were permanently affected? How many enterprises were compelled to shut down for

good? How many temporarily? What survival strategies did they use? Did indebtedness increase? This government did not commission a single survey of a geographical area or economic activity or socio-economic group in order to understand what happened, to separate the permanent from the temporary, and to draw up a package of relief and rehabilitation measures. To do so would have been to acknowledge a mistake, anathema to this government. After all the suffering and all the dislocation, do we have by any reckoning a cleaner economy now? Even if we accept that the return of all black cash into the banking system has now brought it all into the white economy, and has therefore been for the good, is the larger economy less afflicted by black money after November 2016?

Nobody would say so. The central engine of black money generation and use—real estate—has as many anecdotal

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reports as before of the use of illegal money in transactions. Illegal cash flows continue to flood elections like water. There has been no change in the spurge of money in elections since the Uttar Pradesh elections of 2017. We should expect a huge spurt ahead of the 2019 elections in illegal expenses, which are always made more by the ruling party since it usually

has access to more funds. In some respects, a government that said it wanted to root out black money has actually taken steps to facilitate the greater use of black money. Its system of electoral bonds (introduced in 2017 after demonetization) in which the donor is anonymous—and can therefore call in favours after an election—is designed for corruption.

Demonetization was a Himalayan disaster but the voter has not punished the government for this folly. The BJP does not project it as an achievement in its poll campaigns; nor does the Opposition use it as a stick to beat the BJP. A country crushed by corruption, and tired of seeing rivers of black money coursing through society, was successfully sold on the idea that this was a bold measure that would rid society of this ill. People were bewildered, but the honest by and large supported it while the dishonest successfully escaped detection. With time the support has faded and the bewilderment has been replaced by a cynical resignation. There is now fear too. There is a fear that if the State can at one stroke remove 86% of the cash in circulation and thereby dishonour something as basic as legal tender, what could it possibly do next?

This is perhaps the true permanent outcome of the demonetization of 8 November 2016—the demonstration of naked State power that now makes people fear that the State can without any thought and discrimination hurt who it wants and where it wants. Perhaps that was the true aim of demonetization.

Looking back, it now all seems unreal. Living a dark fantasy seemed the only way then to make sense of a Tughlaq-like decision. Some TV outlets were convinced that each new currency note would carry a chip that would allow the government to track cash when it was used for illegal transactions. Social media was filled with outlandish news that many counterfeit currency presses that had surrounded India and were ready to flood India with fake currency. And no less a person than the finance minister said demonetization had enfeebled the "stone pelters".

The only thing that was real at the time was the enormous patience and fortitude with which the citizen accepted the dislocation, pain and suffering that had been inflicted on her.

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