

Show Me the Money

A handy guide to negotiate the tricky terrain of demonetisation in India

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WHEN IT comes to economic matters there has been little else in the popular press these past four months other than demonetisation or *notebandi*. Almost everyone seems to have a view on it. The best and the brightest in the Indian economic firmament have also spoken, and some of them have taken rather hard positions.

It is clear that the issue of demonetisation may be looked at from multiple perspectives. Prime Minister Narendra Modi has obviously used it as a potent political tool, and has demonstrated that the measure did not hurt him in the UP political hustings.

But, it would be fair to say that most serious observers of the Indian economic scene are not persuaded that *notebandi* could possibly have had any positive results. Some of the terrains of monetary economics can be genuinely dense and difficult to grasp. In order to help the lay person decipher the key issues pertaining to demonetisation, C Rammanohar Reddy has come out with a book that seeks to unravel and demystify this concept and say it in as dispassionate a manner as is possible.

Reddy's credentials as the author of the book would seem to be impeccable. Ram is an economist by training, and during 2004-2016, as editor of the cerebral *Economic and Political Weekly*, he helped place the journal on a firm financial footing. Amidst reports of friction with the board, he stepped down

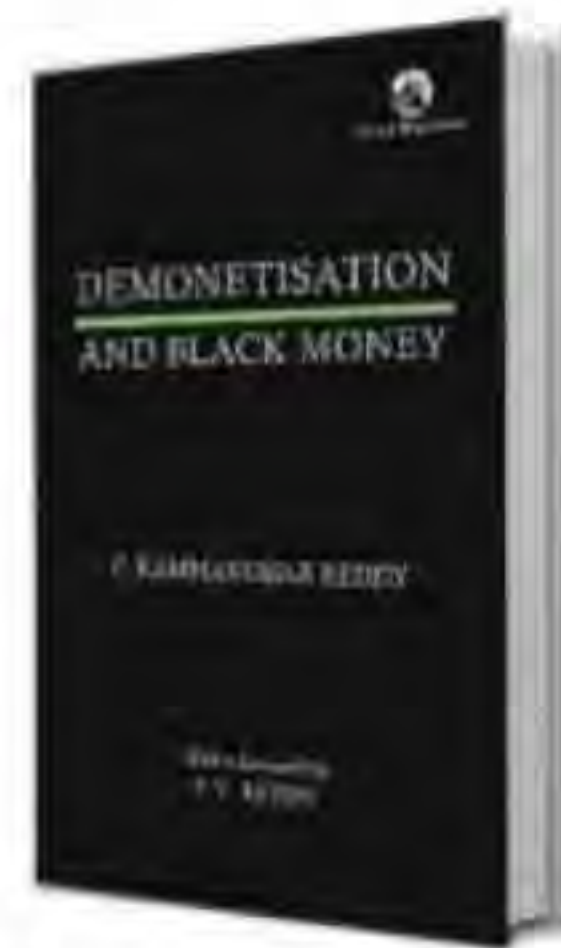
from his job, but what the reader here gains is the assessment of a person who is conscious of the broader political and sociological implications of this measure.

In the very first chapter, black money is defined as income earned either through illegal activities such as extortion, trafficking and drugs or income earned from legal activities, but on which taxes and dues are not paid to the government.

The book provides a detailed discussion of how money laundering leads to the creation of black income or black wealth (*kala dhan*). People rarely hold large amounts of *kala dhan* in the form of cash, which would depreciate with inflation, and typically prefer to hold it in the form of land or gold.

The book points out that there was Rs 14.18 lakh crore in denominations of Rs 500 and Rs 1,000 as on November 8, which ceased to be legal tender at the stroke of the midnight hour. Mr Modi announced that the invalid old notes could be deposited till December 30. The government worked with the assumption that a good fraction of those notes would not be surrendered, which would definitionally constitute the *kala dhan* that would be available with the government to use it as it pleases.

The actual experience was otherwise. As of December 10, 2016, three weeks before the deadline, as much as Rs 12.44 lakh crore, or 88 per cent of the demonetised currency had been deposited back in the banking sector. We still do not have the exact picture, but it seems that almost the entire stock, barring a very tiny



DEMONETISATION AND BLACK MONEY

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portion, of demonetised currency has been returned to the banking system. If true, this whole thing was clearly a futile exercise.

With the almost guaranteed failure of the demonetisation move, the Prime Minister shifted the narrative to the need for a cashless, or a digitised, economy. Chapter 8 of the book has a very useful discussion of the possible pitfalls of the "digitalisation" move in an economy where the bulk of the popula-

tion does not have bank accounts, credit cards or even the rudimentary level of computer literacy required to take advantage of the digital system. The notion that the Indian economy is made to run with too much cash is erroneous. This is revealed in a useful table on page 89, which shows that currency as a proportion of GDP is higher in Japan and Hong Kong.

The main reason why the measure inflicted the level of serious pain that it did was because these two currency notes accounted for over 86 per cent of the total value of currency in circulation. One wonders if even the Prime Minister was aware of this fact. There is no way we would know this. All reports one has come across would seem to suggest that this whole thing was very much a one man show. There are reasons to believe that even the Finance Minister and the Chief Economic Adviser were not privy to this decision. This raises some disturbing questions regarding the nature of governance that we have at the highest level.

In Independent India there has been only one other instance of demonetisation, and that happened on January 16, 1978. The notes demonetised then were currency of Rs 1,000, Rs 5,000 and Rs 10,000 denomination. The demonetised notes constituted only 1.78 per cent of the total value of notes in circulation in 1978, in contrast to the present 86 per cent plus. There was hardly a flutter in economic activity at that time. Few people were even aware that such a thing had happened.

All this and much more is available in this wonderful new book. I would say that for anyone interested in this four-month old saga that the country has had to needlessly live through, this should be a must read.

The author is former director, Delhi School of Economics