Background Note

No. 6

Public Discussion on
Demonetisation and Black Money

Thursday, April 13, 2017

Venue: Kasturi Srinivasan Hall, The Music Academy, Royapettah, Chennai.

THE HINDU CENTRE
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Politics and Public Policy

The Hindu Centre for Politics and Public Policy

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Public Discussion on

Demonetisation and Black Money

Panellists

S. Subramanian
Raghavan Srinivasan
C. Rammanohar Reddy

Moderated by

Sashi Kumar
Chairman, Media Development Foundation

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ASIAN COLLEGE OF JOURNALISM

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Programme Schedule

Session	Programme
6.00 pm	Introductory remarks by **V.S. Sambandan**
6:05 pm	Panel discussion moderated by **Sashi Kumar.** Panellists: **S. Subramanian, Raghavan Srinivasan** and **C. Rammanohar Reddy**
7.00 pm	Audience interaction moderated by **Sashi Kumar**
7.30 pm	Concluding remarks by **Sashi Kumar**

Panellists:

S. Subramanian is a former Indian Council of Social Science Research (ICSSR) National Fellow and a former professor of the Madras Institute of Development Studies. He is an elected Fellow of the Human Development and Capability Association (HDCA). He has worked extensively on measurement and other aspects of poverty, inequality, and demography, and on topics in collective choice theory, welfare economics, and development economics. His work has been published in journals such as Journal of Development Economics, Economics and Philosophy, Social Choice and Welfare, and Theory and Decision. He is the author of The Poverty Line (Oxford India Short Introductions series, 2012), among other books. He has been the recipient (along with his co-author) of the 2001 Dudley Seers Memorial Prize awarded to the best article published in the Journal of Development Studies. He was a member (2015-16) of the World Bank-appointed Commission on Global Poverty under the Chairmanship of the late Sir Tony Atkinson.

Raghavan Srinivasan (he has also written as Ravi Srinivasan) is a senior business journalist and columnist, who has been reporting, analysing and interpreting the India growth story since the inception of economic reforms in India. Even prior to the start of reforms, he was one of the pioneers of corporate journalism in India, bringing first-hand experience and insight to reporting on Indian businesses, since he switched to journalism after nearly a decade-long stint in marketing in major corporates. An investigative journalist of repute, he has been responsible for breaking major stories like the Harshad Mehta stock scam, the return of Coke to India, and the collapse of UTI, among many others.

Currently the Editor of *The Hindu BusinessLine*, he has, in the past, led editions and held senior editorial positions in major newspapers around the country, including *The Times of India*, *Indian Express*, *Hindustan Times*, *Mail Today*, *Financial Express* and *Business Standard*.

C. Rammanohar Reddy is a writer and commentator based in Hyderabad, and Advisor, The Hindu Centre for Politics and Public Policy. After a bachelor's degree in Physics, he obtained a Post Graduate Diploma in Management from the Indian Institute of Management, Calcutta. Following a two-year stint at the Planning Commission of the Government of India, he pursued an MPhil in Applied Economics, and then a PhD in Economics, both at the Centre for Development Studies (CDS), Thiruvananthapuram, with degrees awarded by the Jawaharlal Nehru University. He was briefly on the faculty of CDS.

From 1988 onwards, he has been in the media. From 1988 to 1993 he was an Assistant Editor at *Deccan Herald*, Bengaluru, where he wrote commentary on economic policy. From 1993 to 2004 he was with *The Hindu*, first at Chennai and then Hyderabad. His areas of work were again a focus on economic policy, writing editorials, articles for the editorial page. He also reported on the annual/ministerial conferences of the World Trade Organisation and the IMF-World Bank.

He left *The Hindu* in 2004 when he was Associate Editor to become the Editor of *Economic and Political Weekly*, Mumbai. He was Editor of EPW until March 2016, for over 11 years. During this period, he oversaw the expansion of EPW into new areas, the establishment of new areas of activity and the strengthening of a digital edition of the journal.

Moderator:

Sashi Kumar is a print and broadcast journalist, filmmaker and media entrepreneur. He founded and chairs the Media Development Foundation which administers the Asian College of Journalism. He was among the earliest Newscasters in English on national television, Doordarshan, Middle East Correspondent of The Hindu and news anchor on Radio Bahrain in the mid-1980s. He has anchored and produced numerous shows, documentaries and features for national television in India. In 1992 he founded and launched Asianet, India's first satellite TV channel in a regional language (Malayalam), and the country's first statewide cable TV network in Kerala. In 2004, he scripted and directed 'Kaya Taran', an award winning Hindi feature film based on the 1984 anti-Sikh riots and the 2002 Gujarat riots. He has acted in a few Malayalam feature films. He writes a regular fortnightly column titled 'Unmediated' in Frontline; it is also the title of the book comprising his essays and articles published by Tulika Books in 2013. He has received many awards for his work in journalism and films.

Demonetisation and Black Money

On the night of November 8, 2016, when Prime Minister Narendra Modi in a nationally televised broadcast announced that Rs. 500 and Rs. 1,000 denomination notes would cease to be legal tender from that midnight, he specified three reasons—checking counterfeit currencies, fighting black money, and countering subversive activities that were harming India's security and economy. The following were the reasons, in detail:

1. The first stated reason was that it was to counter the effects of fake currency notes:

   "It has been found that fake currency notes of the specified bank notes have been largely in circulation and it has been found to be difficult to easily identify genuine bank notes from the fake ones and that the use of fake currency notes is causing adverse effect to the economy of the country."[1]

2. The second reason was that such currency notes "are used for storage of unaccounted wealth."[2]

3. The third argument was that "fake currency is being used for financing subversive activities such as drug trafficking and terrorism, causing damage to the economy and security of the country and the Central Government."[3]

The November 2016 demonetisation was not a first in modern India. It was not even the first time that the aim of ridding the economy of black money was invoked by the government of the day to demonetise high-value currency notes. The same reason was put forward in 1946 and in 1978, the two prior demonetisations of the Indian rupee, as we know it now. The official statement issued on January 12, 1946, could fit itself to the position taken by the government in 2016.

> "The working capital of black market operations is believed to be held in large measure in the form of high denomination notes, and Government are aware of the persistent public demand for effective action against these enemies of public welfare. Black market Operations not only hold the general community to ransom, but are also concealed from taxation authorities and so fail to contribute their proper share to the public revenues at the expense of honest citizens. This Ordinance is designed to achieve the purpose of bringing such operations within the knowledge of the Government, and of the taxing authorities in particular, with results of considerable value both to the Government and to the genera! public. The Government are satisfied that their action will not seriously inconvenience nor in any way prejudicially affect the ordinary honest citizen."[4]

The effect of the Ordinance issued on January 12, 1946, was that currency notes with values of Rs. 500, Rs. 1,000, and Rs. 10,000 ceased to be legal tender from that midnight. The impact of this attempt at demonetisation fell short of expectations. The 1946 demonetisation was set also against a set of unique conditions: the exercise came on the heels of the conclusion of the World War II, when black marketeers proved to be a problem in Europe, as a result of which the United Kingdom effected its own demonetisation by withdrawing the £10 note in 1943, and subsequently in 1945, when "an Order in Council was passed empowering the Bank of England to withdraw all its notes after giving a month's notice". India, then in the end-stages of British rule, followed suit.[5]

Even in 1946, when the quantum of money in circulation was lower, depriving currency notes of the status of being legal tender failed to address the issue of black markets. As one of the speakers at this public discussion, C. Rammanohar Reddy, points out in his book *Demonetisation and Black Money*, "[T]he drive to extinguish the holdings of illegally accumulated cash was not successful. According to the official history, in the end, less than 10 per cent of the value of the high denomination notes was not presented to the [Reserve Bank of India] RBI." The experience in 1978 was no different, with only 14 per cent of the demonetised currency extinguished.[6]

Sparking alienations within society

The 2016 demonetisation announcement, with a direct impact on nearly 86 per cent of cash in circulation[7], and the propaganda surrounding it also appears to have evoked a sense of "economic otherness". The two main limbs on which the idea of demonetisation was conveyed to the nation were:

1. a 'fight against black money,' and
2. To promote 'cashless, digital economy'.

The poor and those disadvantaged directly by the erosion of cash took solace in the fact that the economic "other"—the rich—were also suffering. A report from *The Times of India,* dated November 23, 2016, which reports the opinion of a 40-year old construction worker in Jaipur, is illustrative:

> "Modi has done a good thing indeed. We poor people are used to hard times, now at least even those who are rich will begin to line up and face some tough times. Look at me, you people can think of getting married, getting your children married. I live a bachelor boy, condemned to it by poverty. Now, even the rich will see some suffering, as all the money they have stashed goes useless. We will all be the same."[8]

On the other hand, there was a situation of the other "others"—those digitally connected and those who did not have to go through the pain of standing at winding queues to either deposit hard earned monies saved away at home for a rainy day, nor at ATMs to draw small amounts of cash to buy provisions at a local grocer who is not digitally connected. For this class, the suffering was by "the other".

This division within was one primary reason for the absence of a united opposition among the people to show their angst against what can easily be termed as the most disruptive economic policy decision that directly touched all of India's residents. This 'othering' within society, probably, also explains why the Bharatiya Janata Party performed well in the recently concluded State Assembly elections.

A Silver Bullet?

Geoffrey Crowther, the author of *An Outline of Money*, explains the three functions of money—as a unit of account, as a medium of exchange and, equally important, as a store of value.[9] The role of currency notes as a medium of exchange and as a store of value is very high for the common man in an India that is still predominantly unbanked. A document by the RBI, published in 2012, observed:

> "[C]ash remains the predominant payment mode in the country. Reflecting this tendency, the value of banknotes and coins in circulation as a percentage of GDP (12.04 per cent) is very high in the country when compared to other emerging markets, like Brazil, Mexico and Russia. The cash to GDP ratio in India has remained range-bound over the last three years. Similarly, the number of non-cash transactions per citizen is very low in India (6 transactions per inhabitant) when compared to other emerging markets. While no specific study has been carried out, the presence of a well established network of treasuries/currency chests and over 1,200 clearing houses across the country may have contributed to the slow turn around and adoption of modern electronic payment products."[10]

The situation in 2016 after demonetisation was announced and took effect with perhaps the shortest lag in an economic policy decision of such a magnitude was no different. According to a report published online,

> "[O]ver 95 per cent of all business transactions take place in cash.
>
> India has one of the lowest card swiping machine numbers per capita, worldwide. Data indicate it has some 690-odd terminals per ten lakh people. Even among emerging economies this is very low, with China having some 4,000 terminals per ten lakh people and Brazil having almost 33,000 terminals per ten lakh population.
>
> Moreover, most of these 690-odd terminals, over 70 per cent, are located across 14-15 cities in the country. Hence, over 75 per cent of cashless transactions are reported from these 15-odd cities. With such a low penetration of swiping terminals, the possibility of India becoming a cashless economy soon looks remote."[11]

The question also needs to be asked: 'who uses cash in India'? In this context, the views expressed by former Prime Minister, Manmohan Singh, himself a former governor of the RBI, point to the continued relevance of currency notes as a medium of exchange and as a store of value:

> "More than 90 per cent of India's workforce still earn their wages in cash. These consist of hundreds of millions of agriculture workers, construction workers and so on. While the number of bank branches in rural areas have nearly doubled since 2001, there are still more than 600 million Indians who live in a town or village with no bank. Cash is the bedrock of the lives of these people. Their daily subsistence depends on their cash being accepted as a medium of valid currency. They save their money in cash which, as it grows, is stored in denominations of Rs.500 and Rs. 1,000 notes. To tarnish these as 'black money' and throw the lives of these hundreds of millions of poor people in disarray is a mammoth tragedy. The vast majority of Indians earn in cash, transact in cash and save in cash, all legitimately. It is the fundamental duty of a democratically elected government in any sovereign nation to protect the rights and livelihood of its citizens. The recent decision by the Prime Minister is a travesty of this fundamental duty."[12]

Manmohan Singh's remarks place in context Crowther's construct of money as a medium of exchange and as a store of value in a country where financial inclusion leaves much to be desired, even after factoring in the steps taken by successive governments including the incumbent to bring more citizens into the banking system.

In contrast, the ideal black marketeer is very much part of the banking system. It is just that the person chooses to opt out of it voluntarily. In economics—which constantly strives to better its understanding of how individuals, firms, and countries, meet their unending needs with the limited means—causality is critical.

The Union Finance Ministry's *White Paper on Black Money* spells out in detail the manner in which the black economy is generated in India. However, this detailed document does not point to the cash economy as the cause for the black economy, though it does make the point that it is "related"[13]. The report also makes it evident that black money is the 'effect' of other causes which need to be addressed.

An ineffective medicine

The larger scepticism over the ability of demonetisation to make a dent on the black economy is because currency now is a poor store of value. Rational economic behaviour aims to maximise expected returns, while cutting down on possible losses. To start with, inflation is a killer of cash[14]. Though not as volatile and dramatic as an overnight loss on the stock market, it is systemic, and to that extent, an assured erosion of the value of money one holds.

The store of value, hence, for a person holding black money is less in cash compared with other asset classes which are appreciable. Therefore, for those with unaccounted incomes—initially accumulated by not adhering to the law of the land, be it in the form of corruption, fraud, or non-disclosure of proper accounts—the alternative cost of holding such earnings in currency is high, compared with the farmer, the small retailer, the grocer, and the daily wage earner, who would have to incur opportunity costs, in the form of lost wages, to join the banking system.

As there are other options to hold black money, it is not surprising that studies in India have unanimously stated that not more than five per cent of India's black economy is held in the form of cash[15]. The black money holder, clearly, is a prudent manager of wealth and would not choose to park it as cash. This is not merely out of the fear of getting caught but for more economic and practical reasons, such as the debilitating inflation and the existence of alternative asset classes, for instance, real estate, jewellery, and bullion that offer safer store of value.

To view this in its entirety, one also has to place currency in its current context. In the post-War era, and with the disconnect from currencies issued by central banks to metals such as Gold or Silver, the legitimacy for a nation's currency is an outcome of a solemn promise by the head of the issuing authority. In the Indian context, this is the RBI, which holds monopoly in the issuance of all banknotes of Rs. 2 and above. Conceptually and technically, therefore, all Indian money is fiat money. It is as good as its promise to pay is honoured and in the Indian case, either by the RBI or the Ministry of Finance, which issues Re. 1 currency notes and all coins.

The manner in which demonetisation was announced, with doubts over the possible short-circuiting of the RBI's collective wisdom; the frequent changes in goalposts once the announcement was made; and in the extreme case, the change of the game itself, evident from the sudden invocation by the Prime Minister of the need to move to a cashless and digital economy, have resulted in serious questions of confidence on the state and its management of the currency.

Alienation from earnings

Another effect of demonetisation and the transition to a cashless (or less-cash) economy is its implication for individuals, particularly wage earners from the informal sector, who are the most vulnerable.

For Karl Marx, labour and the labourer were the centrepiece of the economy. The capitalist mode of production, as Marx points out, leads to four forms of alienation.[16] The first is the separation of the worker from his work. The second is the alienation of the worker from the production process itself. Third, (some would say that it is implicit in the first two forms of alienation) is the worker's alienation from self-actualisation, and the fourth, the alienation from other persons.

To these four, what is being witnessed all around the country after demonetisation and the push towards a cash-less economy, raises concerns of becoming a fifth form of alienation: that of a wage earner from wages and savings received and held as tangible currency, the value of which is independent of the number of physical transactions, unlike online transactions which could involve transaction costs.

The best test of a policy decision is its impact on a nation's trajectory. After the many promises made, the noble intentions voiced, and the expectations raised, there is little that has been delivered in terms of ridding the economy of black money.

Background note prepared by V.S. Sambandan.

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[1] Government of India, 2016. *The Gazette of India*. [Online]
[2] Ibid
[3] Ibid
[4] *The Hindu*, 1946. War on Black Markets. 12 January, p.4.
[5] Ibid, 1946. The New Currency Notes Ordinance [Editorial], 16 January, p. 4
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[8] Thomas, R., 2016. Nice to see rich people suffer: Jaipur labourers on demonetization. *The Times of India*, 23 November.
[9] Crowther, G., 1941. *An Outline of Money*. London: Thomas Nelson and Sons.
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[11] De, A., 2016. 5 reasons why India is not ready to give up cash. *Daily O*, 17 November.
[12] Singh, M., 2017. Making of a mammoth tragedy. *The Hindu*, 9 December.
[13] Ministry of Finance, 2012. *Black Money - White Paper*, New Delhi: Government of India.
[14] Smith, L., n.d. *Stashing Your Cash: Mattress Or Market?* [Online]
[15] Singh, K., 2016. Demonetisation may not end black money. *The Indian Express*, 21 November.
[16] Cox, J., 1998. An Introduction to Marx's Theory of Alienation. *International Socialism* , Issue 79.

About The Hindu Centre for Politics and Public Policy

The Hindu Centre for Politics and Public Policy is a division of Kasturi & Sons Ltd., publishers of *The Hindu* and group newspapers. It was inaugurated by the President of India, Pranab Mukherjee on January 31, 2013. The aim of The Hindu Centre is to promote research, dialogue, and discussion to enable the creation of informed public opinion on key issues facing India in order to safeguard, strengthen, and nourish parliamentary democracy and pluralism, and to contribute to the nation's economic, social, and political betterment.

The Hindu Centre has so far supported 24 short term public policy scholars, who have submitted Policy Reports on areas such as parliamentary democracy, freedom of expression, content of school textbooks, financial inclusion and rural broadband connectivity, which are published online. The Centre has also organised consultations and public discussions on key issues of national importance, including the creation of the Telangana State, violence against women, pre-election opinion polls, gender-based violence, Right to Education Act, the Sri Lankan Tamils refugees in India, sedition and free speech in India, the politics of welfare in Tamil Nadu, and, most recently, a discussion on the Union Budget. It has also organised a series of three lectures on Climate Change delivered by Jairam Ramesh, former Union Minister and Senior Visiting Fellow of The Hindu Centre, and Alan Rusbridger, former Editor-in-Chief, The Guardian, UK. The Hindu Centre also publishes frequent commentaries and analytical articles on current affairs. Its publications and resources can be accessed at www.thehinducentre.com.

The Hindu Centre's first Annual Lecture, *Will India Script an Uninterrupted Growth Story?* was delivered on March 13, 2017, by P. Chidambaram, former Union Minister, a distinguished Parliamentarian who has been elected to the Lok Sabha for seven terms since 1984, and now a member of the Rajya Sabha.

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