DEMONETIZATION DECISION:
A REVIEW OF UNPRECEDENTED ORDERLINESS OF 8/11

Shyam B R*        Dr N K Ramachandra Gowda**

Abstract:
Modi’s Demonetization is a short term pain for long term gain, the 8/11 master stroke or surgical strike on black money is a change in the Indian Economy. Bigger/higher denomination notes are the root cause for black money in the country and are predominantly used either by tax evaders or worse by financers or illegal operations such as drug trading and terrorist activities. Though there may be initial discomfort and inconvenience this is not the end, this is not a full stop, but a war against black money: agony, ecstasy and the queues. It is an innovative thought and the Prime Minister seems eager to ensure that it gets implemented the right way and this decision will change the way the next generation sees the system, this change is going to be historical (His Story). Thus, this paper brings a review of demonetization decision and highlight that this decision will have a positive long-term impact on the economy.

Key Terms: Demonetization, Remonetization, Corruption, Black money, Fake currency, Economy.

1. INTRODUCTION

Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit. The opposite of demonetization is remonetization where a form of payment is restored as legal tender. The Oxford English dictionary describes “corruption” as dishonest or fraudulent conduct by those in power, typically involving bribery (Vanguardngr, 2016). The surprise announcement of Prime Minister Modi on 8/11/16 making the Rs 500/- and Rs 1000/- note pieces of paper shocked the enter nation with unprecedented repercussions.

Currently, Rs 17,54,000 crore worth of notes are in circulation according to the RBI’s database of the Indian economy. Of this Rs 500 notes constituted almost 45% of the currency in circulation while 39% of the notes were of the Rs 1,000 denomination. However, in terms of volume, Rs 10 and Rs 100 notes constituted 53% of the notes in circulation. This measure would mean that from midnight, almost Rs 6,32,600 crore in circulation in the form of Rs 1,000 notes would be illegal tender. To replace them, Rs 2,000 notes would be introduced, which according to the government would be limited in circulation.
Aim of the Move

There are multiple reasons why nations demonetize their local units of currency. Some reasons include to combat inflation, to combat corruption and to discourage a cash system. The process of demonetization involves either introducing new notes or coins of the same currency or completely replacing the old currency with new currency. In 2016, the Indian government decided to demonetize the 500 and 1000 rupee notes, the two biggest denomination notes. These notes accounted for 86% of the country’s cash supply. The government’s goal was to eradicate counterfeit currency, fight tax evasion, eliminate black money gotten from money laundering and terrorist financing activities, and promote a cashless economy.

- One of the goals of demonetization is to destroy the current stock of black money held in the form of cash (real black marketers).

- Demonetization has a direct relation with the poor, with poverty and with poverty alleviation (Outlook India, 2016).

- Demonetization has created two radical things: it has forced us to engage with practical acts of citizenship and the idea of good life.

Demonetization Decision and its New Mantra

- We came to Power for the Poor, not for our own sake (Greater Kashmir, 2016). The poor, the lower middle class and middle class have been suffering since the last 70 years due to corruption and black money. This decision is in favour of the people and against black money, corruption, and counterfeit currency. Our target is fighting a long battle against all these - Modi’s government.

- Eliminating 86% of the value of the currency with the public was bound to be shocked. The government has called this ‘Short Term Pain for Long Term Gain’ and many citizens on TV have said they are willing to endure short-term pains.

- In Hot Soup of Modi’s 8/11 master stroke or surgical strike on black money. Modi calls it Kadak Chai: I am trained to make “Kadak” (strong) tea since my childhood and I know poor people like this type of tea, while the rich feel its “bitterness” he said in reference to his beginning as a tea seller (Hindustantimes, 2016).

- Theoretically speaking, demonetization has greater advantages but when the process is handled by Modi and his team, it is like ‘Bandar Ke Haath Mein Ustra’. The government decided to ban Rs. 500 and Rs. 1000 notes from circulation in the market. The decision was taken to minimize the black money and corruption in addition to the menace of terrorism.

- Single people make great leaders because they have got loads of time to think up stuff in the middle of the night without worrying about the son’s school fees or the wife shouting at them. But think up should also mean think through and think through is ideally done by bouncing ideas off someone anyone. Tagore did say that if no one marches with you, march alone. But he was from a really big joint family and he probably wanted a break from them constantly asking, when are you getting married man? Also, he never wrote. March alone with no cash and rely entirely on NEFT (the present new mantra).

Demonetization Decision: A Water Tank Clean Experiment

In a society where no one trusts anyone how do you force the public to trust the system with
their money and not cheat it? A fundamental Indian economics question? Experts say the magnitude of the global crisis at times is not felt in India because of the strong (parallel) economy of black money (The Pioneer, 2016). Black money, fake circulation cannot be avoided in any nation viz US, UK, Russia, Japan etc., this political will is positive, bold, innovative and good for hoarding against black money. This water tank cleaning experiment; where higher denomination notes are removed to avoid black money (is removing cash to reduce black money a good idea?), but this removing/cleaning should not be for short term and also in long term so that the water tank is clean forever and works with steely determination for the people of the country. Whoever comes in down the line have to practice this demonetization decision. This water tank clean experiment cannot be 100%, to be we should have all Ramas so to be called Ramarajya.

Thus demonetization as a cleaning exercise may produce several good things in the economy. At the same time, it creates unavoidable income and welfare losses to the poor sections of the society who gets income based on their daily work and those who doesn’t have the digital transaction culture. Overall economic activities will be dampened in the short term. But the unmeasurable benefits of having more transparency and reduced volume of black money activities can be pointed as long term benefits.

Positive/Favourable Outcomes of this Move

As it is, we are increasingly gravitating to net banking, digital wallets and online transfers. With this, the need for high-value notes will anyway go down, at least for legitimate users. As society moves progressively towards a cashless economy, some friction will be minimized even in question lives and every penny will be accounted for. Some of the positive outcomes of this move are:

- Will help the government to fight black money, corruption, terrorism and counterfeit currency with one single decision.
- A cashless transaction happens.
- Controlling terrorism and drug mafia funding.
- Most trade happens in cash and as a result of black money, fake currency pushing is avoided.
- Financial calamity unleashed by the move.
- Will lead to a jump in private investment and more public spending on welfare measures.
- Funds can be used for public spending for development of rural areas and upliftment of the poor.
- Inflation comes down as money flow is less and spending of a common man is less.
- The economy will flourish and with this real economy can be assessed which was not possible since independence.
- Bank can solve cash crunch. Cash has come into the banking system. This is low-cost money. Now banks will have capacities to provide more loans for infrastructure development, agriculture, and the private sector.
- Banks will start reducing interest rates (Outlookindia, 2016).
- There will be some short-term glitches but eventually, it will lead to a more affordable, transparent and sustainable real estate industry.

Impact of Demonetization

Black money is the bane of the Indian economy.
Minimum Impact

• Demonetization is not a big disaster like global banking sector crisis of 2007; but at the same time, it will act as a liquidity shock that disturbs economic activities.

• Loss of growth momentum; as India is the fastest growing largest economy; reduced consumption, income, investment etc. may reduce India’s GDP growth as the liquidity impact itself may last three-four months.

• Liquidity crunch for short term effect will be witnessed. Liquidity shock means people are not able to get sufficient volume of popular denomination especially Rs 500. This currency unit is the favorable denomination in daily life.

• Consumption will be hit as liquidity shortage strikes; it is consumption that is going to be adversely affected first. Consumption - production - employment - growth - tax revenue.

• Most active segments of the population who constitute the ‘base of the pyramid’ uses currency to meet their transactions. The daily wage earners, other laborers, small traders etc. these sections will lose income in the absence of liquid cash.

• Commercial real estate section witnesses a positive growth. There will be minimum impact on office industrial leasing and transaction and business, given that cash components don’t play a significant role in such transactions(Bharuchal, 2016).

• Experts in Unison opine impact will be felt across the board with tier II and tier III markets taking a bigger hit. But with real estate regulatory authority (RERA), goods and services tax (GST), the benami act, and now this recent move, the real estate sector can expect a Depressive transformation ahead.

• It won’t affect the big realtors much.

• Startups and e-commerce companies that provide services, deliver goods and food on cash on delivery will suffer in the short term as consumers aren’t clear on the process and are panicking without reason.

Maximum Impact

• Inconvenience to poor people and the disadvantaged lot such as the old people, disabled, sick, transgenders and prostitutes will be impacted. The above category of people will be deeply inconvenienced to go to banks to exchange their money.

• People who need money for some urgent work like to see a doctor, pay hospital charges, medical emergency, traveling etc will be in a highly difficult situation as no one will accept their money if in denominations of Rs 500 or Rs 1000 notes.

• There will be a panic like situation for many cash holders due to lack of awareness. Big rush conditions in banks and post offices may disrupt the other regular services of banks and post offices like loan disbursal, postal services etc as most of the manpower will be utilized for this note exchange activity in the upcoming weeks.

• Villages, cash is reaching in trickles while those poor, without bank accounts, have been left stranded and stricken.

• The financial privacy of families who store money in cash may be exposed to the gaze of others, in the process of money exchange at banks risking their life situations like kidnapping.
• Impact on agriculture will be seen as the month of November and December are the season for the sowing of rabi crops and samba crops. This season requires a lot of cash in hand for purchasing seeds, pesticides, fertilizers, hiring labourers etc. All these activities will be severely hampered due to want of required cash.

• The informal sector will be impacted in more as contract laborers in organized and unorganized sectors are paid their daily wages in cash. Now the contractors can delay the wage payment for few days till things settle down.

• City malls see sales going south; retail sales have gone down by 15-20%; the bulk of cash on delivery sales have been stuck due to lack of money.

• The biggest impact is felt in the secondary housing market and the ancillary industry such as home furnishing, interior designs etc. where there are significant cash components involved.

• With the transactions in different markets collapsing, overall consumption is likely to take a beating. This will lead to lower indirect taxes (primarily customs duty and excise) for the government.

• With demonetization exercise kicking in, the state government’s top earners - commercial taxes, stamps and registrations and excise departments are experiencing a fall in revenue.

• Demonetization exercise has affected the real estate sector, as it has traditionally seen very high involvement of black money and cash transactions. Such incidents have been in the secondary of the sales market, where cash components have traditionally been a variable must. In other words, the resale properties segment will take a big hit(Morningstar, 2016).

• India’s favorite metal: gold and silver will drop.

• Stock and commodities will drop.

• Most of the business in India has cash transaction with less than 2% business transactions taking place electronically. This move will cause a severe cash crunch for both the customers and the sellers. Hence Indian economy will slow down in coming weeks.

• Tourists in India will have to queue in banks to get the notes changed. Also, Indians who are on foreign visits may not be able to come back to India immediately, hence locking their money.

Conclusion

Everybody seems to have already worked out whether demonetization is a good thing or bad thing, even before any data has come out and having worked that out we are all looking for examples which suit our point of view, economist’s call this confirmation bias. As Richard Thaler writes in Misbehaving - The making of behavioral economics: people have a tendency to search for confirming rather disconfirming evidence. This tendency is called the confirmation bias.

The broader effects of this move will help the entire sector grow in the long run. Firstly, it will create a level playing field among all stakeholders (Daily News & Analysis, 2016). Which until now come with a higher risk weightage, is bound to see some softening with the increased transparency(SmartInvestor.in, 2016). However, short term pain is inevitable when we look for any eventual long-term cure for the disease. There has been, for long, a strident demand for transparency in all sectors.
so that it becomes more organized, and cash dealings must necessarily be the first symptom of the disease to be dealt with (Morningstar, 2016).

Demonetization of high denomination notes is not the end, just a start of deep and continuous struggle against black money. A new normal of white transactions with crackdown on black money has been created (SmartInvestor.in, 2016). The objective behind the decision is laudable. While punishing black money hoarders, common people must not be affected.

References


