

## **POLITICAL ECONOMY OF DEMONETISATION: WHETHER DEMONETISATION OR DIGITAL DIVIDE?**

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All of a sudden announcement of demonetisation on November 8, 2016 took every one by surprise, with a claim that this would address the issues of black money, corruption, terror funding and promote growth of the economy. However, it had immediate implications of multiple dimensions ranging from daily consumption, wage earnings, retail business to construction of houses, big business, etc. Although hard data are yet to be released by the Reserve Bank of India, which may help in analyzing macro indicators and the ground realities, using secondary data and published literature on the subject matter, this paper is an attempt to deal with the expectations and impacts of demonetisation on economy which creates a basis for digital divide for the promotion of foreign direct investment in India.

**Keywords :** *Black money, Demonetisation, Cashless economy, Political economy, Digital divide.*

### **I. Introduction**

The people of India were taken by surprise on November 8, 2016 at 8 PM, when the Prime Minister announced that Indian currency of Rs. 1000 and 500 denominations would no longer remain a legal tender. With this executive announcement, the Government of India withdrew about 86.9 per cent currency in circulation amounting Rs. 15.4 lakh crores (RBI, 2017). Basic objectives of this sudden announcement were to exercise checks on corruption, counterfeiting of currency, funding for activities of terrorists, tax evasion and black money, etc., without giving people any space for manipulations and scape. This paper is an attempt to understand the process and consequences as, to what extent the goals, that were set, were achieved. What cost the economy had to pay and is still paying and who were the beneficiaries of this demonetisation? This paper is intended to dwell into the political economy questions of demonetisation. The paper is based on secondary data and published literature and articles on the subject matter. The paper is divided into nine sections including introduction. Second section deals with immediate steps by the Government and RBI in tandem. Third section discusses theoretical underpinnings and history of demonetisation. While fourth section deals with claims and experiences, fifth section discusses demonetisation and corruption, sixth section highlights trends in tax administration. Seventh section

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analyses impacts of demonetisation followed by digital divide in eighth section and finally imperatives in the last section.

## **II. Immediate Steps**

People of India were instructed to exchange currencies of the denomination of Rs. 1000 and 500 in their possession by December and March 2017 at branches of commercial banks and at Reserve Bank of India respectively. The deadline for non-resident Indians (NRIs) deadline was June 30, 2017. A currency of Rs. 2000 denomination was introduced with pink colour and of different size. Similarly size of the currency of Rs 500 denomination was changed. For the implementation of these executive orders, the Banks were closed for next two days. Automatic Teller Machines (ATMs) were kept closed for next two days for reconfiguration to the size of new notes. Withdrawing cash was rationalized and people were allowed to withdraw initially only Rs. 2000, which was later extended to Rs. 2500 cash from their own accounts in banks or from ATMs in a day, as sufficient cash was not available in the banks and ATMs. Identity Card was mandatory for exchanging old currencies with new ones. Buying petrol and diesels at petrol pumps was exempted. Petrol pump dealers were asked to accept currencies of Rs 1000 and 500 denominations initially up to November 11, which was later extended to 14, 18, and 24<sup>th</sup> November 2016. Government hospital, railway tickets, air tickets, medicine and milks were also exempted. Road Toll Booths were closed for free pass of vehicles. Banks were opened on holidays. The country was seen in long queue at every branch of banks and at the ATMs. Point of Sale (POS) machine was also introduced at limited points to provide relief to those who had money in their bank accounts and debit cards, and were not in a position to spend for their necessities, as they did not have cash in their hands. After 13 days, farmers were also brought to exemption for the purchase of seeds and fertilizers from government shops.

## **III. Theoretical underpinnings and History of Demonetisation**

Currency is one of the instruments of money of any economy in circulation in different denominations. Money has broadly four functions - a medium, a measure, a standard, and store, (Crowther, 1940, pp. 20-21). However, quantity theory of money propounded by Fisher explains value of money by quantity and its velocity, which is equivalent to average price multiplied by volume of transactions. This includes not only currency but credit and other instruments and their velocity as well. Besides currencies and their circulations from one hand to other, velocity of money includes other instruments,

such as, cheque, bonds, securities, demand draft, certificates, plastic cards, etc. Keynes has explained in his income theory that people keep money for day to day transaction, precautionary measures for fetching unforeseen needs and also speculative motive for business and profits (Keynes, 1935). In Indian economy money constitutes merely up to 6 per cent of total currencies and credits in circulations.

History of demonetisation of Indian currency has not been new. The Reserve Bank of India (RBI) printed highest denomination of Indian currency of Rs 10,000 in 1938, which was demonetised in 1946. The RBI printed and introduced again currency of 1000, 5000, and 10000 denominations in 1954, which were further demonetised in 1978. A currency of 500 denomination was introduced in 1987 and of Rs 1000 in the year 2000. On 8<sup>th</sup> November 2016 again currencies of 1000 and 500 denomination were withdrawn and of 2000 denomination introduced.

History of demonetisation in the world has also not been new but in a planned way with full preparation. There are success stories and failures as well. For example, USA stopped printing currencies of 1000, 5000, 10000, 100000 denominations in 1946 but demonetised them after 13 years in 1969. Similarly, Britain announced about its plan to demonetise its currency two years ago in 1969 and demonetised in 1971. However, Ghana demonetised in 1982 but it rolled back. Nigeria did in 1984 but collapsed. Myanmar did in 1987 at the cost of huge killings. Demonetisation in USSR in 1991 did not go well. Australia switched over in 1996 from paper currency to polymer. North Korea demonetised in 2010. Philippines introduced new currency in 2010 and demonetised old currency in 2015 and finally recalled in 2017. Zimbabwe did in 2015, etc. Historically, demonetisation is an instrument to withdraw money in circulation to control inflation in the economy, that too, when Central Bank of any economy fails to control circulation of money through quantitative and qualitative measures. History does not suggest much evidence of curbing black money through demonetisation. Therefore, even if circulation of money is stopped, as it has been done in case of Libia, Zimbabwe and India, it is difficult to expect that the black money will automatically exhaust.

#### **IV. Claims and Experiences**

It was claimed that demonetisation was to help poor and honest people and to wipe out corruption, black money, terrorism, etc. Demonetisation was supposed to bring black money back to economy. Additional funds were expected to be available for poverty

eradication. People of India obeyed instructions and in order to get exchange of old currency a long queue was seen everywhere in the banks having even a single currency of 500 and 1000 denomination in the hands of poor, cultivators, agriculture labourers, housewives, daily wage earners, retailers, old retired pensioners, ill persons, parents and family members of prospective brides and grooms, and those having no accounts. These possessions of currencies cannot be equated by any rationale with having such currencies in possession of builders, contractors, big business, smugglers, brokers, political parties, criminals and terrorists, who were seldom seen in queue. There was a long queue on ATMs to withdraw rupees 2000 and later rupees 2500 from their own accounts. Tax payers' accounts were also not separated for withdrawals from their own tax paid money. Media reported of tragic death of more than 150 persons standing in queue for withdrawals from ATMs or exchanging their currency in banks. Later the limits were further extended with easing supply of currencies. However, exchange of currency on discount was also carried out by middlemen.

Demonetisation has been claimed as good. But it raises questions. Is it good because the tax payers legitimate income parked in the bank after tax payment can not be withdrawn for their basic necessities; may it be seed and fertiliser for cultivation, treatment of their ailment, funerals of their relatives, wage earners queue to change their even one note of 500 or 1000, common man can not purchase their food grains and vegetables, parents can not arrange the marriage of their daughters, daily wage earners lost their wages, or big fish do not keep cash, they invest in real estate, jewels, shares, etc. Or it is good because our govt. does not differentiate 1000 rupee note with poor green grocers, daily wage earners and with industrialists, liquor business, and temples. Or because our govt. is incompetent to nab big fish, or no political party including NDA is ready to disclose their income from corporates. Or because, 70 per cent informal jobs are meaningless for our govt. which contributes 45 per cent of GDP, or because more than 90 per cent of workers are in informal sectors who operates in cash, or because only 37 per cent of rural population have accounts and remaining do not have constitutional fundamental rights to live, or because, 39 per cent illiterate women should not have right to literacy and govt. has failed to bring them to literate world, or 27 per cent of general population do not have literacy because of the failure of the govt. Or because govt. machinery has been strengthened properly to deal with smugglers, plunderers, or powerful corrupts have captured the govt. who has failed in bringing them behind the bars directly?

It appears that the autonomy of Reserve Bank of India (RBI) having long institutional experiences, has been compromised. It may be substantiated also. Because the RBI demonetised successfully in January 2016, a currency of 500 denomination, printed up to the year 2005, without any hue and cry. Every year RBI replaces certain per cent of old and damaged currencies as a routine without any hassles. However, this has given a significant rise in the business of multi brand retails, online business at the cost of petty traders and informal sectors. Government could realize the concerns of farmers after 13 days but it was very sensitive to online transactions from day one.

### ***Address to Nation***

The Prime Minister of India addressed to nation on 31st December 2016 at 7.30 evening, a few hours earlier to New Year 2017, after fifty days of demonetisation. Listening to his speech for the moment, it appeared that it was a pre cursor of a political budget speech part one. It was expected that PM would take the reference of demonetisation announcement and address accordingly. Directly he did not tell the nation about the amount (?) out of Rs. 15.4 lakh crores of 500 and 1000 denominations that came back to the banking system. This concealment of deposit may have problems of final data but he could have referred to latest data so far. This implies that nothing was found significant and exciting about disclosure. It is not surprising, if it would have disappointed the government. The nation was not told about the black money either for which demonetisation was targeted. No data was shared for combating counterfeiting, terrorism, not even the claims. There was official announcement earlier that the limit from the ATM has been increased to Rs. 4500 only. The PM did not tell the nation about the deadline for lifting the ban on cash limit in Banks and ATMs either. His announcement about increase in *Rabi* showing by 6% or fertilizer purchase by 9% was in corroboration of announcement of the Finance Minister, which might be contested by reasoned argument. However, his announcements - regarding relief to farmers by waiving interest on loan for two months and raising the loan limit to Rs 41000, lower interest to loans amounting rupees 9 lakhs (by 4%) and 12 lakhs (by 3%) for urban housing and 2 lakhs (by 3%), increasing credit guarantee for MSME from Rs. one crore to two crores and relief in assessing their income at 6% instead of 8%, relief to senior citizens up to 7.5 lakhs annual income by assured interest of 8% for 10 years, relief to pregnant women, etc., was an acknowledgement of restlessness of farmers, real estate, MSME, informal sectors, senior citizens, etc. It implies that the government tried unsuccessfully to

cover up the damages that economy has already suffered so far. The people were addressed fighter against black money and corruption but there was no mention even about the tragic death of the people in queue of banks and ATMs. It was nice that the government expressed its concerns for the suffering people and to bring back the economy on track. Still the rationale of demonetisation was not explained with hard data as to why it was necessary. What were the bases of economic principles on which this could be justified. Obviously, the government was defenselessly defensive on demonetisation. This speech was in fact an agenda to the Finance Minister for detailing his budget for next year but there was no mention of deadline for relief and normalization of banking system. ATMs were still cashless in rural areas. Of course, there was visible shift from black money to black marketing, inflation and lower tax base of 24 lakh people having rupees 10 lakh income. The GST was to be effective initially from April and later from July 2017, when big business was to get relief in taxation and smaller was to be brought into tax net. No definite commitment was visible on corruption and black money with political parties. Undoubtedly, for the first time in the history of Indian democracy pre budget, pre republic address to nation by the PM was a clear shift from the reference point and the RBI is yet to announce the details of cash received from the demonetisation measure so far.

## **V. Demonetisation and Corruption**

Corruption and black money have been rampant in India (Kumar, 2006). Major sources of black money have been real estate, gold and jewellery, speculative business, liquor business, smuggling, etc. Government of India has country wide networks of many central agencies, such as, Income Tax Department, Anti Corruption Bureau, Economic Enforcement Directorate, Central Board of Direct Taxes, Central Bureau of Investigation, etc., but fact remains that corruption and volume of black money have been swelling.

Declaration of demonetisation on November 8, 2016 was claimed to be a historical surgical strike on black money, but it appeared that it was done without a proper homework. Withdrawal of 86.9 per cent of total currencies in circulation might have needed certain preparations, such as, supply of new currency in the banks, calibration of ATMs suitably to maintain the flow, security issues, and most importantly the targets. Contrary to that it created an unprecedented chaos and financial emergency like situation without recognizing that black money in terms of currency in circulation was merely about 6 per cent of total black money. Major concern is how

to identify the sources of generation of black money and plug in the hole. In a country, where except Left Parties and *Aam Aadmi Party*, all the political parties unitedly denied for Right to Information including the party in present govt., which claims for fighting corruption. It is rightly said: "Demonetisation may destroy a tiny part of black wealth but it would not stop black income generation" (Kumar, 2017, p.16). However, counterfeiting of currency was found from the day one besides unauthorized availability of Rs 2000 notes in the private command. Needless to mention that currency of 500 and 1000 denomination was withdrawn in the name of convenience of portability, but issuing a currency of higher denomination falsifies that basis.

## VI. Tax Administration and Governance

Governance is an important factor in transparency of tax administration. India had varied experiences of taxes in Centre, State and Concurrent lists and therefore comprehensive tax administration at centre and state levels, for example, Central Board of Direct Taxes (CBDT), Income Tax, Excise, Customs, Sales Tax, etc. After demonetisation many cases of raids have been under the scanners of Income Tax department. Unless tax administration is strengthened, we do not see any reason to become complacent and relaxed. Moreover, after new regime of tax administration, GST putting in place, there is GST Council and GST Networks for monitoring. Needless to mention that, launching GST itself has a huge task of implementation and monitoring, which needs sufficient funds for tax administration. However, if we look at the budget provisions for tax administration, it will be disappointing. For the year 2015-16 actual expenditure was Rs. 26000 crores, which was reduced to 22600 crores in revised budget for 2016-17 and it was further reduced to half in the budget estimates for the year 2017-18. It has serious implications on transparency of tax administration. If this is the design of the tax administration, only two probable options are left. The first option is that the government will privatize and outsource tax administration like other strategic sectors including defense and the other option is to let loose the corporates. GST has made an online self-assessment of business, which provides an opportunity for tax evasion to empower business houses to misappropriate further. It is said that demonetisation will increase tax collection, which may not come true as tax administration is also not so equipped (Kumar, 2017). Honest taxpayers, who have deposited their money into banks, have been banned to draw their money deposited in their accounts. Is it the way to nab black money? Not at all. So far terror funding and attack are concerned, these

were having no let up, be it Pathankot, Uri, or stone pelting in Kashmir., etc. Hence demonetisation does not appear as a tool for countering corruption.

## VII. Impacts of Demonetisation

“The government believes that its action has been successful because it took the form of random shock to the system. It is in this context that we should take note of a well known observation made by Robert Lucas (1997) who in his nobel lecture said: Unanticipated monetary contraction can induce depression. India’s random demonetisation exercise therefore may well turn out to be a test case for Lucas’ prediction” (Dasgupta, 2016). Although reliable hard data are yet to come, data available with us so far gives correct indication, a few select indicators may throw up lights.

The Reserve Bank of India has estimated that the growth rate may slide down to 7.1 per cent from 7.6 per cent. A 0.5 per cent decline in the National Income. Gross National Income (GNI) of the Indian Economy at current prices during 2015-16 as per Economic Survey of India was Rs. 1, 34, 09, 892 crores. A decline of 0.5 per cent will amount to Rs. 67,049.46 crores. The Gross Value Added (GVA) for the year in reference was Rs. 1,22,52,306 crores. A decline 0.5 per cent will amount to Rs. 61, 261.53 crores. If we go by Gross Domestic Product (GDP), which was Rs. 1,35,67,192 crores for the year 2015-16. A decline of 0.5 per cent will amount to Rs. 67,835.96 crores. We can add cost of printing, logistics and allied expenses of new currency on the top of it.

According to Central Statistics Office (CSO) latest release, the growth rate of Indian economy was 7.9 per cent in 2015-16 and second advance estimates is 7.1 per cent, i.e., 0.8 per cent lower. The GDP for 2015-16 was Rs. 1,35,67,192 crores. If it would have grown in the same pace the GDP of this year would have grown to Rs. 1,46, 39, 000 in 2016-17. Growing by 7.1 per cent means Rs.1,45,30,462.63 crores, i.e., Rs. 1,08,537.37 crores less. In case of Gross Value Added the growth rate is still lower by 1.1 per cent from 7.8 per cent to 6.7 per cent. Industry has been estimated to grow by 5.8 per cent, which was 8.2 per cent, i.e., 2.4 per cent lower. Service sector is equally bad and expected to grow by 7.9, which was 9.8 per cent last year, i.e., 1.9 per cent lower. When the ‘Hard Working’ CEO of India was criticizing professional skills of economists (*Harvard Trained*) in the Parliament or celebrating the growth figures in his election campaign he wanted to convey to economists by celebrating the growth rates. More serious is of jobless syndrome, where nothing is there to offer

to the youth unemployed. Whatever, additional employment could be generated so far, although very less, it was taken out in one stroke of ill-conceived demonetisation. Can it be argued that loss of livelihoods of the loom workers of Varanasi, artisans of Aligarh lock factory workers, Brass artisans of Muradabad, artisans and retailers spread in the villages, farmers and daily wage labourers of the country, were not contributing to the growth of the country? One day strike of Banks in a state like Bihar was estimated as a loss of Rs.10 to 12,000 crores business, think of 50 days financial emergency to the entire country including other services and implied losses! Moreover, trust on Banks and RBI has shaken because RBI Governor's guarantee inscribed in the currency: "I promise to pay the bearer the sum of one thousand/five hundred rupees" lost its relevance. The dates announced were pre-poned to December 2016 from March 2017. Moreover, this financial emergency halted the economy, losses of billions to daily market operators particularly petty traders who dealt with cash, perishable commodity producers, such as vegetables, caused unemployment to daily wage earners costing their bread and lives, etc. Growth rate of economy was bound to decline.

The RBI (2017) in its paper took a safer position. "The analysis in this paper suggests that demonetisation impacted various sectors of the economy; however, the adverse impact, in general, was short-lived as it was felt mainly in November and December 2016. The impact moderated significantly in January and dissipated by and large by mid-February 2017, reflecting an accelerated pace of remonetisation." Therefore, the RBI also acknowledged the negative impacts on economy from November 2016 to February 2017. About 78 per cent consumption was paid in cash, there was significant contraction in demand in general due to paucity of cash in hand and contraction of production because of inability to pay the wages in cash in unorganized sector. Real estate and construction suffered most besides growth rate of service tax collection (RBI, 2017). RBI acknowledged the fact that "overall, demonetisation has had some negative macroeconomic impact" (RBI, 2017, pp.42-44).

There was news that the *Jan Dhan Yojana* accounts of poor have been misused by the rich. Honourable PM suggested the account holders to deny the withdrawal for them as it was illegal. It sounded fair also. However, it is needless to mention that our society is still controlled largely by dominant people in absence of empowered substantive democratic institutions. They impose their decisions and poor and deprived have to follow. It is known fact that the Govt. is yet to ensure *gramsabha* meeting, where people can participate and

speak fearlessly. Yet we are not ready to come out from the illusions. Dalit atrocities do not get registered through an FIR unless it comes to political groups working for them or in media. Honourable PM's dream, that rich people requesting poor to deposit money to their accounts and asking poor to refuse to return money what so ever, is far from the realization. It is difficult for an ordinary person to speak like this without having any proper safeguards on daily basis, if they know the ground reality of the clout of dominants. It is an open secret that Police Station is yet to create a friendly environment to entertain an FIR related with atrocities, minimum wages and other entitlements, land given to landless is yet to be possessed because of forceful illegal capture by rich and dominants, many of MNREGA job cards are still with contractors and *Mukhias*, a sizeable number of poor households are still waiting for ration card even after Right to Food Act. We have seen that no witness appeared after 58 murders/massacre at Laxmanpur Bathe in Bihar, if we do not want to count Una, where Dalits were tortured inhumanly, Akhlakh, Junaid, Pahlu Khan, etc., where no one came to their rescue. There are countless such unfortunate incidents in 'powerful democracy' and 'good governance' in India.

### VIII. Digital Divide

Historical division between rural and urban, rich and poor, privileged and deprived, etc., have been there since ages. Digital divide has further made division of India and *Hindustan* clear. *Hindustan* is with less cash and India is cashless. Sweden is the model for cashless but Cuba has never been and is still not our model, which made country literate in one year. This cashless India is broadly not for those, who are illiterate. It is not for 39 per cent of women, who are illiterate. It is not for informal economy of the *Hindustan*. Fact remains that only 54 per cent households of the country have accounts in Banks. In rural areas it is only 37 per cent households who have accounts. They largely operate in cash. ATMs are still less in numbers. About 46 per cent in general and 63 per cent of rural households in particular are yet to get an account despite a big hype of *Jan Dhan Yojana*. Moreover, about 45 per cent of the GDP comes from informal sector, 70 per cent of livelihood is from this sector, about 80 per cent people are engaged in this sector, 92 per cent females are working in informal sectors, and 39 per cent females are illiterate.

All concessions are for digital privileged citizens, devoiding guarantee in the Constitution regarding equal opportunity to citizens without discrimination. If our govt. has not built enough schools for poor, if it has not expanded banks to rural areas, if it could not provide

plastic cards to remote areas, if our govt. has failed and poor people from the remote areas are away from the light of development, is it the ground on which our Constitution gives right to our govt. to discriminate in the name of incentives to privileged? Is it the fault of honest wage earners and retailers, who could not deposit their money in the bank, as they do not have accounts? If the banks do not have capacity to cater people in their catchment area, is it the fault of people?

Shifting from foreign black money to demonetisation and then unprepared chaos and fall out, chorus of cashless digital India is far away from the Indian reality. Although, it is hardly believable, it is a planned strategy of corporate and finance capital to facilitate foreign direct investment under “Make in India” policy (FICCI, 2016). It is due to the fact that the political parties are in existence because of corporate funding. Exceptions apart, no political party is ready to disclose its source and accounts before people. Major source of corruption and black money is political funding and concessions and illegal protection after coming to power as obligation.

Later Government was seeking advices on NM APP. This was again an evidence of undermining the democracy of majority. There was no concern about the suggestions of poor, agriculture labourers, cultivators, informal local petty business led livelihood earners, who had voted them to power. A digital divide is apparently going on. Online democracy is being imposed on majority, where deprived people are ignored. Whose govt. is this? Is it only for online elite and rich or of poor also?

### **IX. Imperatives**

Thus, what is being claimed with demonetisation so far, could have been achieved even without demonetisation, but with proper planning and rigorous home work for effective implementation through environment of vibrant transparency of agencies and democratic governance. At the final calculation, we do not find any justification for which country was brought forcibly into financial emergency, loss of jobs, tragic deaths, crises to farmers, retailers and daily wage earners, which summarily endangered fundamental right to life. Growth rate of GDP has come down. Declining growth rate of manufacturing sector is a matter of serious concern. However, the worse is yet to come, as democracy of offline people is in danger through digital divide.

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