



Demonetization: Endeavor to Script the New Paradigm of Political Economy of India

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KEYWORDS

The decision of government to demonetization of Rs 500 and Rs 1000 currency notes on 8th November, 2016 left no one in India untouched and taken everybody by surprise. There are fervent appeal from Prime –Minister and his party colleagues in power in Delhi and states to bear the short term in-convenience for better future. The opposition is still struggling how to confront this decision of government. They cannot oppose the move, as it is being, pitched high in the rhetoric as “surgical strike” on corruption. At best the opposition is talking about the in-conveniences to people, serpentine lines to withdraw money from banks and ATM and shortage of currency .questioning the timing as Rabi crop sowing may delay, and exports are sluggish. These arguments have been neatly summarized by former Prime – Minister Man Mohan Singh as an example of “Monumental Mismanagement.” Beyond there is no substantial argument against the move, although some are raising apprehensions that government decision was selectively leaked but there are no hard evidences to it. Other is arguing that possible benefits are being exaggerated and this move may lose its effectiveness, if series of stern action are not taken against black money and corruption. Some are also talking in terms of political morality - “ authoritarian action” (Sen Amartya 2016) and “ in which country people are denied to withdraw lawfully earned money deposited in banks” (Singh Manmohan, 23 November 2016).

This paper is a modest attempt to understand the political economy narratives of the move. It is divided in two parts – first deals with economics of “demonetization” of the currency and second on its political narratives – which in some cases has turned foes as friends and friends as foe. Like arch rival of PM, the Bihar Chief Minister Nitish Kumar supports demonetization, Bengal CM extending hand to CPM, Shiva Sena opposing the move and advising government to heed the advice of former Prime-Minister. Thus paper argues that for sure there are little chances of political realignment in the country but the moves speaks a lot about the style of politics of Prime – Minister and the whisperings that this and similar moves may undermine the spirit of cooperative federalism that Prime –Minister as claimed is very fond of and consider it corner stone of centre state relationship.

Will short term in-convenience will yield Divided in Long run: The Cost - Benefit Analysis of Demonetization

One the very onset of discussion , let us mention that many argue that banning – Rs 500 and Rs 1000 note is not demonetization in the strict sense of the term which means withdrawal of the currency from circulation. In n present case old Rs 500/ note and Rs 1000 notes are being changed with currencies of other denomination and with the newly issued note of Rs 2000/- Government has clearly mentioned that it did not intends to discontinue the printing of Rs 500/ notes . As a matter of fact new 500 notes have been brought in circulation. The status of Rs 1000/- note is also, as the indication goes will be the same. The new Rs 1000/note will be brought in circulation However, almost every expert agree that demonetization in its purest form as total withdrawal of currency of particular demonization or partial withdrawal and replacement as it is case with India is always considered an extraordinary step in case of economic exigencies like hyper inflation and rampant corruption and parallel economy

For example 1991 Soviet Union, Ghana in 1982, Maymar in 1987 Nigeria in 1984 , Zimbabwe in 2010, Australia in 1996 , North Korea 2010 resorted to demonetization Australia it is argued, the move did not yield results and even say that it resulted in political upheaval and social unrest . In case of India – demonetization is not new , it has been done earlier by Janta Party government in 1978- when it withdraw high value note with the same stated objective curbing black money The present case also Government of India declared that objective is war on black money and corruption. . Leaving the mechanical technicalities – the basic issue is the impact of this “demonetization” on Indian Economy. The declared objective of the demonetization is war on black money and government has declared that many more stringent moves will come in succession to uproot the menace of black money, for example a limit on holding gold by individual has been imposed. The basic questions are about the concept and quantum of black money. Here three issues immediately come in focus one kind of black money is the counterfeits- and it is being claimed that this is a source of terrorist finance. Although exact behest of National Security Agency it is around 400 core or 4 billion a small amount of the total currency in circulation about 17.5 Lakh crores or 17.5. Trillion For sure this amount of counterfeit of 4 billion will be eliminated and it will give a jolt terrorist. The second issue if of black money .Here three important concepts needs to be. However this is to mention in outset that all aspects of black money are illegal and serious moral and economic adverse effect. These are simply being mentioned to understand the complexities of the issue. The first concept is (a) Black economy – The unaccounted economy – that is people do not pay taxes on their economic activities. These activities could be legal one but not reported to tax authorities and banned activities like drugs and arms etc. Here it is to mention that all income generated in black economy does not remains black – some of comes back in legal circulation. For example a drug trafficker pays to a taxi driver and the taxi driver buys his daily needs, this part of black money has come in to system. Second the money not reported by cloth merchant or education institution to the tax authorities is surely black money – but these business people often put this money in to other economic activities – expand business and by property etc. Here comes the other concept (b) Black income. Which is a flow concept and some part of when comes in to main stream ceases to be black. One example has been given above and the other is if an industrialist pays wages in cash from his unreported income, to the workers he/she turn the black income in to white. Or Part of that money he uses for buying property or jeweler or gold in this way the money the black economy operator has settled his liabilities by paying wages and you cannot accused the labor receiving wages. Secondly this black economy actor has brought wealth which will appreciate in near future. Thus here comes the third concept of (c) black wealth – which is a stock concept the operators of black economy are miser fools who gets happy with the rising stock. His happiness lies in generating more income from the black wealth and again diversifying the portfolio of the black wealth this process of parallel economy. The black income in various wealth portfolios ranging from currency note of the country , foreign currency to stocks, gold to property and again convert this stock (wealth) into income. The black money operator ensure that the portfolio should have larger share to the wealth form which appreciate - like land and gold or even hard foreign currency

which keeps on appreciating.

No let us turn to the estimates of the black economy, black income and black wealth. Conservative estimates put the size of the black economy in India at Rs 45,000 billion or Rs 45,00,000 crore or 45 trillion. It is argued that large part of this black economy in the form of wealth whose values appreciate over time like real estate, gold and jewellery etc. and around 20 per cent of such black wealth in the form of cash possession (which arises from bribery, business malpractices etc. If this part of currency is destroyed or does not return

A look at the two concept monetary statistics is also essential. (a) The Base money (b) the broad money. Statistics reveal that stock of base money in the books of the Reserve Bank of India (RBI) on 4 November was Rs 22.5 trillion. There are three components of base money—currency in circulation, bankers' deposits with the central bank and other deposits. Currency accounts for an overwhelming 80% of the total stock of base money in the Indian economy. (B) The Broad money is defined as currency in circulation and demand and time deposits with bank. We all know the banks by advancing loans create deposits. The broad money is about five times larger than base money i.e. about 112.5 trillion. Currency accounts for only about 13.7 percent of the broad money i.e. about 15.75 trillion and it is argued that about 86 percent of it is in the form of Rs. 500 and 100 notes. It is argued that large part of this currency will be deposited in banks, some fraction of it, kept as black money may not come back to bank, and this unreturned currency is a benefit to government. Say if 4 trillion rupees does not return back – it will reduce the liability of government of India to Reserve Bank of India as all bank notes are promissory notes – the a undertaking of RBI, to pay the bearers the sum written on the note. The RBI has to be given necessary amount by Government of India to honour the commitment. Once the note is eliminated the promise ceases to exist. This has the positive impact on economy to reduce – black money and also to reduce the liability or deficit of government of India, reduce money supply and bring down inflation (Panagariya 2016).

The other possible benefit, that could be visualized easily is the bank will have more deposits and even RBI reduces the lending rate the bank will be in better position to dispense credit and lowering interest will reduce the cost of investment, hence investment may increase the economy. This may surge the growth rate to the about 10 percent and increase employment. The other issues that government is simultaneously promoting is digital payment, if it is achieved at a greater scale the benefits will be enormous – as it will bring transparency in the system which ensures not only better tax revenue, ease of doing business but above all the improvement in work culture

However, many critics argue that these benefits are mere conjecture and will occur; at all it will be happened in future. They argue that future is most uncertain and often summon J.M Keynes in support. As a former PM Manmohan Singh did in his Rajya Sabha speech, in support by quoting Keynes "in long run we all are dead" Even government say that there will be short run perils but there will be long run benefits which will be radically alter the functioning of economy. This argument is worth examining. There are two set of concerns (a) Lack of adequate cash is hurt transactions across the economy specifically in informal sector, which has heavy dependence on cash (b) Decline in property prices (real-estate values) may generate a negative wealth effect that may lower the demand. In other words it is being argued that large part of the informal sector will suffer. This will generate two types of shocks. The first shock will be demand shock and loss of productive hours and second will be supply shock. Since market will witness shortage of demand – the entrepreneur may also postpone economic activities. Former Finance Minister has provided a estimates of the short term losses will be about 1 percent of the Gross Domestic Product¹, (Chidmabram P. December, 4 2016). It also argued that the most of property transactions are opaque and demonetization will have a dampening impact on real estate. The real estate prices may

come down but not so much as it will make housing affordable but it will generate adverse wealth effect. The expected decline in the value of real estate could hurt consumer demand. The decline in home prices will not have much effect on the consumer price index, in which house rent is important component. The main impact may be on economic growth, a decline in construction activities will have reverse multiplier effect thereby reducing the adversely impacting cement and steel and other industries. The response to any demand shock should be cut in interest rates and increasing government spending on construction activities in present case. This will help the industries mentioned above. This will have larger multiplier effect. However analyst agrees that government has given an exogenous shock to the economic system and the challenge now is to minimize the pain—to the economy as a whole but especially to the informal sector. (Niranjan Rajadhyaksha 2016)

Is it only Mismanagement or has other meaning as well: Art of Governance and populism

Besides economics this issue, the question is also related to governance and politics. As mentioned above the outcome of the move will depend on how effectively it is managed. The government has also argued and many other independent observer have also mentioned that people despite being in hardship are giving overwhelming support to the move and agree that it is as per the electoral promise. But they also agree that if the move is prolonged there may be some unrest. As per conservative estimates about: 2,300 crore notes have been cease to be legal tender since night of 8-9 November, 2016 and the capacity of RBI's printing presses is 300 crore notes per month and it is estimated that if notes of same denominations are replaced roughly it will take seven months and if notes of lower denomination are replaced it will take more time but in case of higher denomination the time will be shorter. But the issue is not only this disbursement is also an issue re-calibrating 2, 15,000 ATMs will need a month or more and the spread of bank branch is highly uneven across country.³ For sure the condition will take more time in normalization than being make the people believe. Government has started building environment that the in-convinces will take some more time but the trouble is worth taking for the sake of better future for prosperity. The issue is why government has played this gamble. Political and social analysts believe that it is unique initiative of leadership of central government basically of Prime Minister Narendra Modi, to directly reach to all – without any intermediation. It is well documented that Prime Minister often argued for improving governance which has been expressed as "less government and more governance". But the long queue on banks is not testimony of better governance. The need to ensure secrecy is being put forward the logic for it. However, the policy initiative is indicative that – political leadership of the government, i.e. Bhartiya Janta Party is evolving an alternative paradigm of politics. In this paradigm the dominant castes or pressure groups which have conventional strong hold has to be broken down, by cobbling up small social groups. The small social groups – individually do not have substantial numerical strength but when cobbled together they could become formidable combination to counter the dominant castes or pressure groups. This strategy requires a charismatic leadership which can directly interact with common man in their idioms. This requires essentially a programmed or policy that touches every one. One can recall the political discourse of seventies-when the political strategy of Mrs Indira Gandhi was to dismantle the regional leadership and directly communicate with the common people, for whom an economic programme is imperative – the *Garabi Hattao* (Eradicate Poverty) is a finest example of it. The demonetization move is also akin to it; it touches every one and draws the battle line between haves and have-nots. The political discourse is taking new turn

During last few decades Indian polity and economy is decentralized and the States are being ruled by different political outfits political identity are regional leaders. Citizen in many cases give credit of centrally sponsored programme to state government. This does not suit to the political ambition of BJP despite the fact that government claims strengthening cooperative federalism. But

what should be the course of action. The 2014 parliamentary action and emergence of Narendra Modi as charismatic leadership has provided an opportunity to BJP to increase its sweep to across nation. This requires a policy and programme which could be instrumental in the leader in direct discourse with each and every citizen. The demonetization is a disruptive economic political move. It a move that has put the opponent in defensive and even the arch critic of the policy cannot deny that the problem of black money need to be solved and for it strong political will is required. The move is so well mastered that even opponent has to remark that they do not doubt the intention of the government but critical only of modus operandi. The centralizing instincts of apparently seems to yield political divided (Louise Tillin 2016) but it also carry the risk of undermining the political plurality. Secondly most of the programme is implemented by state government, in this situation if state governments are not of the same political party – the risk of confrontation increases. It will take at least five years at least, if the winning spree of BJP continues to take state governments on its fold. In political actions and discourse five years is long time and often states interest over rule the political ideology. The experience of the congress regime of seventies it testimony to it.

1. The Centre for Monitoring Indian Economy has calculated the cost of demonetization for the 50-day period from November 8 to December 30 as Rs 1,28,000 crores. It involves Households (queuing, transaction cost): Rs 15,000 crore, i.e. loss of wages and earnings for the time standing in the waiting line. The second loss is loss of business activities because of the demand shock or slowing down of business at the tune of Rs 61,500 crore. The cost of printing new currency

Rs 16,800 crore and the bank staff cost of exchanging currency about Rs 35,100 crores. According to the Budget papers, the size of the GDP at the end of 2016-17 will be about Rs 150 lakh crore. One per cent of that will be Rs 1.5 lakh crore..

2. The wealth effect is a psychological effect of asset value prices on spending. If consumer confidence, improves with increasing value of assets, they spend more. This happens regardless of disposable income, but when the consumer confidence goes down because of lowering of assets prices – they spend less. Thereby decreasing demand and investment in the economy.

3. As per the recent data there are total 1,38,626 bank branches and Two-thirds are located in metro, urban and semi-urban areas. Only about a third (47,443) are in rural areas and the distance to the nearest branch could be several kilometers. There are Total: 2,15,000 ATM machine out of which 55,690 ATMs are located in the seven metro cities. About 90 per cent of all ATMs are located in 16 states and out of which Only 10 per cent of all ATMs (21,810) are located in 13 states and 7 Union Territories. The seven sisters i.e. north eastern states have only 5,199 ATMs of which about sixty percent (3,645) are in Assam.

4. Lokniti, Centre for the Study of Developing Societies (CSDS) studies the 2014 Lok Sabha election and found that, 42 per cent of beneficiaries MGNREGA a centrally sponsored programme gave credit to state governments

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