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Demonetization, Cashless Economy and Development

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Abstract

The argument posited in favour of demonetization is that the cash that would be extinguished would be "black money" and hence, should be rightfully extinguished to set right the perverse incentive structure in the economy. While the facts are not available to anybody, it would be foolhardy to argue that this is the only possibility. Therefore, it is imperative to evaluate the short run and medium-term impacts that such a shock is expected to have on the economy. Further, the impact of such a move would vary depending on the extent to which the government decides to remonetize. This paper elucidates the impact of such a move on the availability of credit, spending, levels of activity and government finances.

Keywords: Demonetization, Cashless transactions, credit, tax evasion.

Introduction

The demonetization of high value currencies on the mid night of 8th November 2016 by the government of India is a watershed in the history of monetary economics of India. The economists, intelligentsia, social scientists, politicians and the common men are in confusion regarding the size of its impact on the black money, counterfeit currency corruption and terrorist funding and finally on economic growth and development. Demonetization is an act by which government of a nation strips the circulation of one or more than one currency unit of its status as a legal tender. The process of demonetization involves either totally withdrawing currency unit or withdrawing currency units and introducing new currency units of the same demonization which are being demonetized or completely replacing the old currency with new currency of

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denomination. This process of demonetization is largely done keeping in mind the goal of unearthing black money accumulated through corrupt means. John Eatwell Palgrave's Dictionary of Political Economy defines demonetization as the discontinuance by a government of the use of a coin and its official withdrawal from circulation. N B Ghodke, Encyclopedic Dictionary of Economics defined that under the paper currency standard, the term "demonetization" implies a wholesale withdrawal of currency notes from circulation. Thorpe and Thorpe (2010) opined that demonetization refers to the withdrawal of currency from circulation which is done to control black market currency and unaccounted money. Not only India but several countries to name a few such as USA in 1969; Zaire in 1990; Australia in 1996; Zimbabwe in 2010; and North Korea in 2010; have resorted to demonetization; while the effort resulted in success in the developed liberalized economies of the USA and Australia it could not ensure any success in the underdeveloped African countries. The first demonetization in the independent India was done in the year 1946 and another one in the year 1978. At that time the currency note of higher denomination constituted only three percent, of the total currency in the circulation. Notes demonetized in 1946 were of the value of Rs. 143.97 crores as against the total notes issued of the value of Rs. 123593 crores. Again in the year 1978, the higher denomination notes RS. 1000, Rs.5000 and Rs. 10000 which were reintroduced in 1954 after the demonetization in the year 1948 were demonetized.

The demonetization of high value currency as on that day amounted to only Rs. 146 crores. Therefore, its effect on the inconvenience was minimal. The Direct Taxes Enquiry Committee in its interim report admitted "demonetization" was not successful then, because only a very small proportion of total notes in circulation were demonetized. As far as the demonetization of November 2016 is concerned, the rupees 500 and 1000 constituted a gigantic share of 86 percent of the notes in circulation during 2016. According to RBI figures as of March 2016, currency in circulation amount of Rs. 16,415 billion: of this Rs. 500 notes accounted for 47.8 per cent in value and Rs 1000 notes constituted 38.6 percent and together they were more than 86 per cent of the value of notes in the circulation. Secondly size of the economy, the growth rate of the economy and the role of the private sector and services sector to economic growth and development was small in the year 1946 and 1978 as compared to the year 2016. Thirdly, the number of people within the net of the income tax was also not so large during 1946 and 1978. There are more than 11crore PAN card holders now and the numbers is on increase. Fourthly, in

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the year 1946 and 1978 public were already aware that the demonetization as that time could not produce any substantial gain to the economy. One of the key features of the demonetization 2016, which is different from the demonetization done in 1946 and 1978, is that it was kept very secret, so that the black money hoarders could not get any time to convert their black money and counterfeit currency into white money.

Objectives

(i) To unearth black money in the economy
(ii) To put check on corruption
(iii) Demolish counterfeit currency used by the organization both inside and neighboring countries in the founding of the terrorists and extremists activities in the country.
(iv) Over and above, one of the objectives is that the taxable income earned from this exercise will be spent on economic growth boosting the development activities and also the economic upliftment of the poor. Finally, the demonetization endeavor intends to have a cleaner growth and equity in development.

Black money variously known as “black income”, “dirty money”, “unaccounted income” “counterfeit currency” is acquired through corruption, bride, black market and hording, arms trafficking, terrorism, smuggling, illicit trade in banned substance and money laundering. This unfair income and wealth which does not come under the net of income tax and is accumulated by a small percentage of people-largely corrupt and criminals is stumbling block in the path of the economic growth and development of India. In a nutshell, black money is “unaccounted Money” and the income which has escaped taxation and it may hoarded in the form of cash and invested in other precious assets like landed property, house, gold, jewellery and other valuable durable assets.

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Existence of black money is one of the fundamental reasons for the endurance of high economic inequalities, poverty and unemployment in the country. According to NIPFP, black income is the

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aggregate of incomes which are taxable but not report on Black Money as a “cancerous growth in the country’s economy, which if not checked in time, will surely lead to its ruination.” The Committee report envisaged that “black money denotes not only unaccounted currency which is either hoarded or is in circulation outside disclosed trading channels but also its investment in gold, jewellery and even in precious stones made secretly and in land and buildings and business assets over and above the amounts shown in the books.” The Committee suggested the withdrawal of high value currency notes. The Black Money, White Paper of May 2012 brought out by the joint effort of the Ministry of finance, Department of Revenue and Central Board of Direct Taxes, New Delhi has envisaged that “manifestation of black money in the social, economic and political space of our lives has a debilitating effect on the institutions of governance and conduct of public policy in the country”. The Report, therefore, has advocated that the success of an inclusive development strategy critically depends on the the capacity of our society to root out the evils of corruption and black money from its very foundations.

Cashless Economy

Cashless economy means more and more use of digital mode and less use of cash in transactions. In other words, it does not mean the shortage or less supply of cash but less use of cash and more use of digital transaction i.e. debit card, credit card, internet banking and through mobile phone app. Daniel et.al (2004) has said that it is an economic system in which transaction are not done predominantly in exchange for actual cash. Transaction in cash is one of the vital and major modes of payment during purchase of goods and services. According to Humphrey (2004) developed countries of the world to a large extent, are moving away from a paper payment instruments toward electronic ones, especially payment card. The World Bank’s World Development Report 2016 envisages that in many instances, digital technologies have boosted growth, expanded opportunities and improved service delivery. Larger size of digital economics in the developed economies is one the factors of less corruption in these countries as compared to developing countries is the main source of black money, existence of large size of informal economy; and operation of all terrorist activities and also tax evasion. Therefore, in order to escape from adversaries of corruption and black money and to have more transparent and cleaner economic growth with social justice, less use of cash is one of the suggested measures. In other words, the cash less society will not only ease the burden on the government for printing of

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currency notes and onus on the people to carry these notes, but will also eradicate black money, corruption, pick pocketing, robbery, and tax evasion and curtail the size of informal economy in the developing countries. Use of cash is a facilitator of black money as transaction in cash do not leave any audit trial. As against this, use of bank debit and credit cards will discourage black money and unaccounted transactions, since they will leave adequate audit trials and hence dis-incentivize black money generation. In other words, while demonetization will unearth black money and its source, digital transactions will discourage the promotion of black money in the society. Sweden, where 89% is no cash payment, ranks 3rd in Corruption Perception Index. In India, an estimated 22 percent is non-cash payment and India ranks 76th in the Corruption Perception Index. This veritably proves that there is a strong negative correlation between the cashless transaction and corruption.

This means higher the cashless transaction lower the corruption and vice versa. Another important benefit of the cashless transactions is that it will reduce the burden of printing, transaction and other expenses incurred in currency operations. It is calculated that the Reserve Bank Of India and Commercial banks annually spend around Rs. 21,000 crores ($3.5billion) in currency operations.

Another indicator of cashless economy is cash to GDP ratio. In Sweden, the cash-to-GDP ratio. In Sweden, the cash-to-GDP ratio is just 1.73 percent. The cash-to-GDP ratio in India is 10.86, which is more than nine times high. The demonetization and withdrawal of high value currency from circulation would lower the cash-to-GDP ratio. According to Soumya Kanti Ghosh, group chief economist, State Bank of India “after complete re-monetization, the currency levels may settle for a little less than 10 percent of GDP”

One of the essential requirements of the cashless economy is financial inclusion. Financial inclusion means people must be linked and be part of the financial system of the country. By opening of accounts in the financial institutions such as banks and post offices, people will be financially included in the mainstream of institutional financial system. The World Bank data shows that up to 2014, only 52.8 percent adult population of India had accounts in the financial institutions. Out of the total only 10.7, 3.4 and 1.2 percent have used debit card, credit card and internet banking system for making a payment. This means that the digital transaction is very meager in India. It needs to be drastically improved.

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Demonetization and Cashless Economy: Perspectives

The perspectives on benefits of demonetization are as follows:

(i) It will check money hoarding and as a result more and more money will come to the banking system in the form of either current or saving account. The savings will push up investment and lead to capital formation in the economy;

(ii) The opening of new bank accounts for depositing the banned currencies shows that it has promoted banking literacy among the general population and connected the common man who has out of the net of the banking system; with the banking system

(iii) The deposit of huge amount of money in the Jan Dhan Bank account and opening up a large number of new Jan Dhan Accounts clearly shows that common men who were earlier scared of Bank and lacking banking habit are being brought to the banking system.

(iv) It has strengthened the banking system, as many bank branches were facing acute problem of NPA. The rise of savings in the bank will enhance their credit capability and thus promote investment in the economy

(v) The excess income deposited in the banks can generate taxable income for the government which can be spent on welfare programs for the poor different sectors of the economy

(vi) During the re-monetization process the supply of money market will be slow. It will help to control inflation in the economy.

(vii) Money unearthed through the demonetization will be helpful to produce poverty and inequality in the society.

(viii) People who have earned black money through corruption and unfair means will be exposed and be punished so that it will pave the way towards a corruption free society. It will help to create a corruption free administrative and political environment in the country.

(ix) Earning through the unearthing of black money and also through raid on corrupt businessman the fiscal deficit. NITI Aayog Vice Chairperson, Rajiv Kumar expects that will bring significant tax gains and help the economy back strongly in the years ahead.

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(x) It will enhance the flow of FDI to the economy, as the foreign investment requires a corruption free environment.

(xi) As this step will it will be helpful to control the outflow of illicit money to other developed country foreign bank account. The raid on the black money holders will unearth and control money laundering and hawala transactions also.

(xii) The demonetization has inflicted a big blow to the terrorists' camps, training and terrorists' attacks. The cash less transactions will check the use of counterfeit currency and discourage terror funding.

(xiii) The demonetization and cashless transactions will be helpful to reduce the size of informal economy in the country. It will promote social and cultural development in the society. Corruption and black money erodes social and cultural systems. It will put a break on unethical social development.

Suggestions

i) It should be a continuous exercise by the government and be replied at suitable intervals to discourage the hording of black money in the form of cash. It will encourage digital transactions and banking habits among the people and improve the banking system also.

ii) The tax net needs to be increased. Simple progressive taxation is suggested. Besides the poor and lower middle income group with annual income group with annual income of less than rupees five lakh should be exempted from the tax net, so that they can invest it in purchasing household amenities for improving their quality of life. The filling of returns must not only be simple but also be do away with by deducting tax at source will making any payment.

iii) The size of the informal economy needs to be curtailed. All payments to the workers in the informal sector with the business, landlords. And other rich and higher middle classes houses have to be made digital.

One of the essential prerequisites for the promotion of digital economy is safe digital transactions. Adequate arrangements have to be made for digital security. Strong action need to be taken for prevention of digital crime and compensation is made to

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the common men if they lose money because of digital crime. A system of digital investigation and insurance should be created.

iv) In order to promote more and more digital payment, government needs to take steps to reduce the interest charged on the debit and credits cards and particularly credit cards. Special concessions need to be given to the small businessmen, vendors and petty shop owners, tea and beetle sellers, etc.

v) Adequate number of bank branches need to the opened in rural areas. The other non-banking financial intermediaries such as Life Insurance companies need to be involved in the re monetization process of the government. So that they should not indulge in nefarious activities of black money.

vi) One of the essentials prerequisites for the promotion of digital economy is safe digital transactions. A system of digital investigations and insurance should be created.

vii) The self-help groups can be of great help to the people in the promotion of digital banking systems in the rural areas. More and more areas SHGS must be given the charge of bank mitras who can extend their help to the bank and credits for making payment in the purchase of goods and services in the countryside. The “Gram Sabah’s” in PRIs (Panchayati Raj Institutions) and Ward Sabah’s in ULBs (Urban Local Bodies) must take up the issue of digital economy at the village level.

viii) Like pulse Polio Campaign, the Digital India campaign twice or thrice a year in a mass scale can be conducted in the country. Besides, the digital infrastructure also needs to be improved.

ix) Strong political will among both the ruling and opposition parties is necessary for the implementation of any economic reform including de-monetization and cash less economy in the country.

Conclusion

The Crisil Report says that “the demonetization move could change the face of the Indian economy”. According to Mauro F Guillen “the move could stifle some business that area legal and clean, if they use cash payment. India is a great democracy where the people at large despite where the people at large despite supported the demonetization drive by the government for unearthing black money and counterfeit currency.

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Demonetization and cash less economy in the long run will have negative on black money and positive impact on economic growth and development. By controlling black money, these two measures i.e demonetization and promotion of cashless transaction will help the nation to achieve a cleaner and transparent growth rate of black money. Income earned through demonetization, if spent on various development activities such as roads, sanitation, health, education, employment, generation and other livelihood projects and programs will enhance development and raise the quality of life of the people.

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