Demonetisation in India: Objectives, Achievements and Lessons

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1. Backdrop and the Theme Frame:

Demonetisation, withdrawing legal tender status of the existing currency and remonetising the system with new currency with legal tender status, is one of the monetary policy instruments. Demonetisation as a policy instrument is employed by the Central Bank of a Country in "Collaboration" with the respective Government to address multiple problems such as inflation, black money, counterfeit currency, less flow of cash into the banking system, terror funding, and so on. As an instrument, demonetisation has been employed by different countries from time to time with a different set of objectives. For example: in 1987Myanmar employed it to curb black money, but there was a mass protest. In Jan 1991, Russia tried with this instrument to fight inflation but there was a political turmoil. In North Korea this experiment tried in 2010 was a failed attempt. In 2015, Philippines used demonetisation policy to protect against counterfeit currency turmoil, but it was not a successful experiment. Recently there was a mass protest in Venezuela against the experimentation of demonetisation.

In case of India, demonetisation is not a first time surgical strike on November 8, 2016, as claimed in some quarters. As a policy instrument it has been experimented from time to time with varying intensity of impacts and success. For example, on January 12, 1946 Rs.1000, 5000 and 10000 notes were withdrawn through demonetisation, even though there was no full support from the Reserve Bank of India. Due to ban on only higher denomination notes as legal tender currency, there was not much of an impact on the common man. Again, on January 16, 1978, notes with denominations of Rs.1000, 5000 and 10000 were phased out as legal tender currency. This withdrawal constituted only 7% of total notes in circulation. This time demonetisation was said to have no economic rationale, but only for political considerations. Since the notes were of higher denomination, and only 7% of the total notes in circulation were withdrawn, it affected only a small segment of the society and the economy. But, the demonetisation policy of November 8, 2016 stands in contrast to earlier experiments. About 86% of total currency in circulation was denominated, and Reserve Bank of India was brought into the loop in the final moment. Initially there were restrictions on withdrawal from banks and ATMs, implying a kind of rationing. Further, demonetisation was wrapped up with patriotism and nationalism (More on this later).

Against this backdrop, following key issues are addressed:

- Is the recent demonetisation policy in India crafted in the framework of the concept of Post-Truth?
- What have been the original objectives of demonetisation, and what have been the changing goal posts?
- What are the impacts of demonetisation on political, economic and social environment, and impacts on what and impacts on whom?
- Could the country derive some lessons from the recent experiment of demonetisation?

2. Traces of influence of post-truth on 2016 demonetisation policy:

Even though the concept of Post-Truth (PT) has been in use for quite some time, it entered Oxford Dictionary only in 2016. This heralded the birth of a new word, a new arrival in the history of ideas, and a defining word of our time. Oxford Dictionary defines PT as: "Relating to or denoting circumstances in which objective facts are less influential in shaping public opinion than appeals to emotions and personal belief". It is a deviation from rational evidence-based reasoned discourse, and objectivity is treated as an outdated concept. Further, judgement becomes more relevant than the objectivity. In fact, PT agrees with our emotions rather than agreeing with facts. In fact, facts could be generated and twisted to support prejudices and opinions. Added to this, it is more appealing to people, if certain related ideas are quoted from epics. In cast of PT, borders blur between truth and lies, honesty and dishonesty, and fiction and non-fiction. Hence, PT uses tools of psychological persuasion, fear, threats and so on. Expert opinions are silenced through internet and its variants like Twitter, and other forms of social medial. The social space makes it easy for any one with half-backed ideology or conspiracy to connect with similarly inclined souls. In the world of online cut and paste, lies and myths can propagate easily. One can use internet to spread invented stories and conspiracy theories. The apprehension is whether the internet is a perfect incubator for PT proliferation, without realising that PT is not after truth, but it is anti-truth. But the concept of PT is disturbingly normalised. In fact, Brexit and Trumph (in his election campaign) heralded effectively a bold new world of PT.

Are there some traces of PT in the recent policy of demonetisation in India? As already stated, the policy has been wrapped up with patriotism and nationalism. Those who support demonetisation are patriots, but those who oppose it are not patriots and they are antinational. There has been a twitters militia to silence dissent, and attack (in social space) those who oppose demonetisation. At the end, the policy is said to have been based more on rhetoric and less on arguments. Have we reached a stage where it is difficult to retain the meaning full notion of truth in public space, and people are influenced more by “lies” than “truth”?

To fail will not be a failure of policy, only a temporary difficulty. Every fragment of evidence, however weak, has been showcased as the success of policy, and every evidence of failure, however strong, has been projected as a temporary difficulty.

3. Original Objectives and Changing Goal Posts:

The original objectives of November 2016 demonetisation in India were to eliminate:
- Black money
- Counterfeit currency
- Terror funding.

The derived (from the original objectives) and supplementary objectives have been:

- Eliminate corruption
- Increase tax compliance
- Enlarge tax base
- Improve tax revenue
- Raise tax to GDP Ratio.

When original objectives were not realised in a perceptible manner, the goal posts have been altered: More emphasis on cashless economy goal and digital payment goal. It is incontrovertible that black money, counterfeit currency, and terror funding should be eliminated. But, it is rational to argue that the use of any policy instrument like demonetisation has to be contextual. Then what was the context in which Indian economy was placed at the time when the policy of demonetisation was announced: GDP on the road to recovery, low and declining Index of Industrial Production (IIP), declining exports, and investment cycle was yet to be revived, and even now it is not revived without which the growth of GDP and employment is not assured.

4. Three Domains of Impact:

Any impact (of policy) analysis has to be performed keeping the original objectives of demonetisation in view. The impact analysis has to address the following issues:

- How much of black money has been unearthed, counterfeit currency identified, terror funding reduced as well as cross border terror reduced?
- With respect to supplementary objectives, how much of corruption eliminated, tax compliance increased, tax base enlarged, tax revenue improved and tax to GDP ratio increased?
- With respect to changing goal posts, what has been the success towards cashless economy drive, and towards digital payment drive?

There are only some sporadic indicators of positive impact of demonetisation and Goods and Service Tax (GST). We need to realise that the impacts are the outcomes of both the monetary reform (i.e. demonetisation of November 2016) and fiscal reforms (rolling out of GST from July 1, 2017). For example, 3% increase in individual tax filers after demonetisation, and 50% increase in indirect tax payers (of course with GST). But, revenue effects of these are yet to be sorted out. But, the drive towards cashless economy appears to have declined with remonetisation. Hence, it is difficult to be conclusive either on original objectives, supplementary objectives, or changed goal posts. Because, after these two major reforms-one monetary and another fiscal – the economy is still passing through transitory zone. Hence, the main focus is on three domains of the impact of demonetisation viz, economic, social and political.

4. A. Economic Impact:

The economic impacts could be gauged from both micro and macro perspectives. In the micro and sectoral perspective, some enterprises and sectors like microenterprises, small enterprises, retail outlets, agriculture, construction, gems, jewellery, textile, and leather and so on depend dominantly on casual labour and on cash based transactions. These are all in the informal or unorganised sector. These are the ones which have been hard hit with cash-crunch after demonetisation, millions of labour has become jobless, and they have had to migrate to their places (villages).

The fall in employment in these enterprises and sectors are bound to have negative impact on production and transactions, and thereby on GDP of the Country (Details later), in addition to negative impact on livelihood opportunities of millions of people depending on these enterprises and sectors.

At macro level, the first macroeconomic fundamental adversely affected has been GDP of the country. In fact, during the first quarter of 2017-18, the GDP was estimated to be 5.7%, and for the second quarter, it was estimated to be 6.3%. For the fiscal year 2017-18, the GDP of the country has been estimated by Central Stastical Organisation (CSO) to be 6.5%, but the estimate by the office of Chief Economic Advisor to Government of India is that it would be less than 7%. It is yet to be seen whether the loss of growth momentum is a short-lived and a transitory phenomenon or low growth momentum is likely to persist for some more years due to the fact that growth driver like investment is yet to be revived. During the period (2007-08) of high growth in India (more than 9% of GDP per annum), 38% of GDP of the country was invested. Now, it is around 27% of GDP. Unless these trends are reversed in case of investment, the major driver of growth continues to be missing.

With respect to inflationary trends, as measured by Consumer Price Index (CPI) since 2013, the CPI was 3.63% in November 2016 (the month of rolling out of demonetisation policy), and in fact it was 2.99% in April 2017, and 2.18% in May 2017. This is not a surprise due to the shock to aggregate demand, caused by demonetisation and thereby cash crunch. After remonetisation, inflationary pressures have started building up with CPI being 5.22% in

December 2017, and 5.1% in January 2018. This explains why Reserve Bank of India Monetary Policy Committee decided to keep Repo Rate at 6% without altering it.

Loss of jobs as well as low employment generation is yet another macroeconomic problem. For example, there has been a loss of one lakh job in weaving industry in Surat, Gujarat. It is estimated by Centre for Monitoring Indian Economy (CMIE) that demonetisation has led to loss of jobs to the extent of 15 lakh.

There has been some improvement in tax compliance, as stated under section IV. Booming digital startups, an outcome of cash crunch, has been yet another important development, even though the drive towards digital payment has declined with remonetisation, and thereby availability of cash. Banks are flush with liquidity due to deposit of old currency with the banking system. It is yet to be seen whether this increased liquidity with the banks would lead to decrease in rate of interest on deposits alone or as well as on lending. Lower rate of interest on deposits is more a possibility than on lending rate by the banks.

4. B. Social Impact:

Four social impacts of demonetisation are examined. First, since over 80% of Indian labour force is employed in informal and unorganised sector. With low income and job insecurity, this segment of Indian society has suffered the most due to loss of jobs and thereby their livelihood opportunities. Second, people have had to undergo the suffering of queuing up in lines at banks and ATMs, with all the uncertainty of getting cash, and with loss of working hours. This has led to disruption of normal life. Third, people living in unbanked areas with no bank account have had to face much more hardships.

Four, in a country of largest reservoir of poor and illiterate, pushing towards cashless transactions have been much more inhuman. It is difficult to understand how the system of cashless economy be transplanted in a country like India by “torturing” the people and by exposing them to many cyber risks.

4. C. Political Impact:

One pertinent question that has been discussed is why there was no mass protest even though there was mass misery. Absence of organised protest was interpreted as an act of solidarity with Government. This could be explained in the perspective of social theory of mobilisation of people for protest. The ordinary people have made up their mind to undergo misery to see that the corrupt and people with black money be punished, as stated in the original objectives of demonetisation. Strong leadership either form the opposition parties or NGOs has not emerged, because criticising demonetisation has been dubbed as an unpatriotic act, and as an act to protect the corrupt and criminals, and as an act to hide their own black money. One can see the traces of PT strategy by resorting to this kind of statements. Further, there has been an apprehension among the opposition party leaders and NGOs whether the subservient bureaucracy would harass them and leave those with political patronage and powerful to touch. With respect to impact of demonetisation, the argument crafted to make people to fall in line with government policy has been: Short run pains and long run gains. Short run pains have been visible and experienced, but the long run gains are speculative. The gains like clean and robust economy, corrupt free society, use of internet banking and digital transactions, more deposits with banks and more loans to public at low rate of interest, reduction in tax burden, and an opportunity for government to spend more on infrastructure and social sector due to increased tax base and revenue have been promised. Whether these long run gains will accrue, and accrue to whom is still a matter of debate?

5. Lessons Learnt and Coping Measures:

The "undesirable" impacts of demonetisation have been experienced as short run pains, and long run gains are perhaps still in the pipeline without much of a visibility. The focus of this section is to extract the lessons which the country has to learn from Nov, 2016 demonetisation policy, and to identify the coping measures needed to minimise the short run pains and to maximise the long run gains.

There are lessons and coping measures which could be derived from the recent demonetisation policy and its implementation. **First,** the country did not learn from the experiments and experiences of demonetisation policies of 1946 and 1978 with respect to intensity of hardship to common man and the scale of withdrawal of currency in circulation. Withdrawing 86% of total currency in circulation without considering the possibility of phasing out the withdrawal caused quite a pain to common people. Added to that, adequate preparation was not made at different levels to implement the policy effectively and efficiently. Adhoc decisions were made and measures adopted to contain the wrath of people, triggered by cash crunch. **Second,** eradication of black money is desirable. But, even the Central Board of Direct Taxes recommended in 2012 against demonetisation as an instrument to eradicate black money, instead of considering alternatives like improvement in tax administration.

Only 6% or less of the wealth is in cash. Black money is largely held in the form of benami properties, bullion, jewellery, and bank accounts abroad. Legal battle on benami property and other non-cash "black" assets is likely to be a long drawn process. In fact, Reserve Bank of India in its August 2017 Report has stated that 99% of banned notes have come into the banking system. Even considering huge deposits as black money, it will invite again long drawn legal battle. Hence, in the case of addressing the problem of black money through demonetisation may not offset short run pains. **Third,** there was a failure to realise the degree of preparedness needed at different layers of banking system, including the preparedness at Reserve Bank of India. Further, there has been a "demonstration" of lack of perception of banking habits of Indian people, including the situation of more than 50% of the people having no accounts in banking system. This lesson is quite crucial for designing and implementing demonetisation policy. **Fourth,** there is a need for realising that the government has to respect the autonomy of Reserve Bank of India, instead of treating that like any other Department in the government. **Fifth,** there is an urgent need for restoring confidence in the banking system, because some banking officials during the initial period of demonetisation were involved in corruption (as reflected in arrest of some of them) at the time of exchange of old notes and in providing cash to depositors. **Sixth,** eliminating corruption through demonetisation is not likely to be effective, because corruption in public life assumes different forms. Hence, corruption has to be handled through effective measures in public administration, not through demonetisation. **Seventh,** digital payment system should have a proper infrastructure including protection to participants in cashless transactions from cybercrimes. Hence, it is desirable to go slow on cashless drive. People need internet and digital literacy. Conduct of digital campaigns in rural areas and mobile ATMs may be quite supportive to effect transition to cashless mode. **Eighth,** a policy like demonetisation without adequate preparation is likely to lead to "Maximum Government and Minimum Governance". This is not desirable to ensure transparency in governing the country. **Ninth,** this is the time for us to realise that the paradigm of Post-Truth is not sustainable, and what we need is Pro-Truth for governance of the country. In this context, there is a need for learned debate on the needed measures and policies to replace the strategy of Post-Truth with Pro-Truth, and need for informing the society about public policy making. A strong coalition of Pro-Truth policy group has to be built up to discourage the Post-Truth tweeter group engaged in propagating what really is not "true", and in "attacking" the needed dissent in the country. **Tenth,** the political leaders of the country have to be "educated" on the following premises of good leadership:

- Emotions should not be infused into public policy debate:

Ex: "I know what kind of people and what kind of forces are against me. They will not leave me alive. They will destroy me".

This is a typical example of PT use in public policy debate.

- A good leader is expected to know four stages in the behaviour of human beings, when there is injustice meted out to them

❖ Silent Tolerance
❖ Silent Resentment
❖ Vocal
❖ Violent

Political leaders have to keep in mind that they cannot take people for granted. They should not expect people to undergo pain (either in the short-run or ling run). They will become violent, once PT tactics cross the threshold.

- When political leaders over-communicate, but under deliver people begin to lose trust in them.

6. Recapulations and Substantive Conclusions:

November 8, 2016 demonetisation is not a first time surgical strike as claimed in some quarters. It was experimented and experienced even before independence. But in intensity and scale, this time policy has turned out to be much harsher than earlier attempts.

There are traces of Post-Truth strategy in the formulation and implementation of the policy. This time policy is based on the premise of appeals to emotions and personal belief, and it is a deviation from rational evidence-based reasoned discourse. The policy has been wrapped up with patriotism and nationalism, and based more on rhetoric and less on arguments.

When the achievements of the policy were not perceptible with respect to original and supplementary objectives, the dominant objectives were shifted towards cashless economy by promoting digital payment systems.

Any policy has to be contextual. As on November 8, 2016.The macroeconomic context was not that conducive for this policy reform: GDP growth momentum was yet to recover, declining index of IPI, declining exports, and investment cycle was yet to the revived.

The impact analysis has to be conducted, keeping in view the original, supplementary, even changing goal posts. Since the policy impact is still transitory, the economic, social and political impact analysis has been attempted. However, some of the sporadic positive impact of demonetisation cannot be brushed aside: For example, there has been an increase in individual tax filers. Emergence of digital payment system and banks with enough liquidity to lend at lower rate interest have been other set of encouraging developments. Along with this monetary reform, fiscal policy reform in the form of GST has also been implemented. Hence, it has been difficult to sort out the net effects of these two reforms.

With respect to economic impact, at the micro and sectoral level the informal unorganised sector has been adversely affected due to the fact the transactions are cash-based at this segment of the economy. At macro level impact, GDP growth momentum and employment have been adversely affected. Even investment cycle has not recovered from going down the hill. It is understandable; CPI had declined to less than 3% during the initial period of demonetisation, due to aggregate demand shock experienced as a result of cash crunch.

In case of social impact, mass misery of the common people was quite visible. People without internet and lack of knowledge of cybercrimes have been tortured enough. The political impact perspective is lack of organised leadership for mass protest. The critics of demonetisation have been dubbed as unpatriotic and antinational, and people with black money. Even though short run pains were severe, they were contained with the promise of long run gains by adopting PT strategy.

The recent policy of demonetisation has provided many lessons which the country needs to learn and design coping measures to minimise the short run pains and to maximise the long run gains. The lessons are: to consider the possibility of phasing out demonetisation instead of such a high scale withdrawal of currency in circulation at once, to make adequate preparation instead of adhoc measures to reduce pains of the reform, to explore alternatives to demonetisation to tackle black money issue, to keep in view proper perception of banking habits of Indian people, to have a thorough understanding of the difference between “black cash” and “black non-cash assets” as well as their volume with black money group, to restore confidence of people in banking system, to learn to handle corruption through public administration, to develop adequate infrastructure and to spread knowledge among people to get into cashless transaction mode, to examine strategies for effecting a transition from Post-Truth to Pro-Truth syndrome of governance, to avoid inducting emotions into public policy debate, to understand four stages in human behaviour from silent tolerance to violence, and to avoid loss of trust by people only by over communicating, but under delivering.

Added to all these are many unanswered questions:

- Do social costs of demonetisation exceed social benefits?
- Whether alternative fiscal and administrative tools could have been used to eliminate black money and to reduce corruption instead of surgical strike of demonetisation? Will corruption continue slightly in a different mode?
- Is it possible to handle “black assets” with the provision of Benami Asset without a long drawn legal battle?
- Given a monumental mismanagement of implementation of the reform, has the country turned out to be one where there is maximum government and minimum governance as opposed to what was promised to the country in 2014.
- Instead of overnight out-lawing of 86% of currency incirculation, whether phased decommissioning could have been better to minimise collateral damage?
- Many more.

To answer these questions, each one of these will have to be subjected to cold hammer of logic and analysis.