Demonetisation and the fight against black money

Black money is a catch-all phrase that represents the value of four kinds of transactions: a) transactions that are either unreported or under-reported to evade taxes—leading to lower government revenues, higher fiscal deficit, and/or inadequate delivery of public infrastructure; b) corruption, i.e., money that changes hand to curry favours in business deals and skirt administrative rules, resulting in allocation of contracts to inefficient firms, violation of safety and sustainability rules, and distribution of income in favour of certain personnel; c) transactions carried out in illegal goods such as narcotics, liquor, weapons, and human trafficking, which are welfare-reducing and remain unreported; and, d) payments for financing terror attacks and stone-pelting to destabilize country using counterfeit currency.

A multi-pronged approach was needed for a decisive redressal of the black money issue. The government approached the issue with measures such as promotion of banking and digital payment habits, making laws to go after culprits of black money and shell companies, control counterfeit currency circulation, initiate implementation of GST as an efficient tax system, bring donations to political parties under the purview of banking system, get requisite information to act on individuals having unaccounted money in foreign banks, and, importantly, increase the efficacy of all these measures through a surprise announcement of demonetisation of high-value currency on 8 November 2016.

From a very myopic world view, demonetisation seemed to be madness, for it had caused, expectedly, inconvenience to public for a certain period of time. However, statistics emanating from the latest Reserve Bank of India (RBI) report published on 30 August 2017 are very encouraging. Counterfeit currency worth Rs43.5 crore, the largest cache ever, was detected by the banking system during the fiscal year 2016-17. What has been detected is just that, the detected amount. A large chunk of counterfeits could not have been brought to the banks for it would have got detected. Further, the new currency issued by RBI to replace the demonetized one is also harder to forge. In fact, on 20 August, this newspaper quoted home minister Rajnath Singh as saying that incidents of stone-pelting in Kashmir had come down. While this one-time effort of demonetisation has given a big push to checking counterfeits, now this must be complemented by routine due diligence because, in the words of Wendell Phillips, “Eternal vigilance is the price of liberty.”

demonetisation has also had a salutary effect on banking and digitized transactions. As per Right to Information (RTI) information sought from finance ministry by *PTI*, deposits in about 290 million Jan Dhan accounts had soared close to Rs65,000 crore by 14 June 2017. If government had not initiated Jan Dhan Yojana prior to demonetisation, this positive impact would never have materialized. Post demonetisation, the surge in deposits also compelled banks to lower lending rates since they were flush with cash in bank accounts. Moreover, those who were averse to using cash wallets had begun to use them for making payments for a host of products and services from Uber to barbers. As per the finance ministry note reported in this newspaper on 30 August 2017, by May 2017, there had been a 56% increase in digital payments amounting to more than 1.1 billion transactions.

While the percentage of old currency notes that got exchanged was extremely high, in absolute terms, Rs16,000 crore did not return with RBI. Thus, black money equivalent of Rs16,000 crore got eliminated. Also, the cost of printing currency can be viewed as front-loading of retirement of notes, for the lifespan of currency notes in India, due to our unique handling practices, is low. Importantly, the surge in bank deposits has ended the anonymity of high value accounts. The RBI report mentions that more than 4.73 lakh high-value suspicious transactions were reported by banks and financial institutions during 2016-17, an unprecedented increase of more than 345%

over the previous year.

The passing of the Black Money Act and amendments to Benami Act just prior to demonetisation were strategic decisions. In addition, income tax department also dovetailed its Operation Clean Money in February 2017. By August 2017, data analytics by the I-T department resulted in Rs15,496 crore being admitted as undisclosed income, and, another Rs13,920 crore came in, by way of seizures. Further, 14,000 properties, each valued more than Rs1 crore, are currently under scrutiny as owners have not filed income-tax returns. Furthermore, there has been an increase of about 25% in income tax returns filed during the fiscal year 2016-17, and, an estimated 2.1 lakh shell firms have already been deregistered.

Looking forward, implementation of GST has also provided the right incentive for businesses to get into the formal sector. Though there are teething problems, overall, GST has been well-received by the industry. Similarly, donations to political parties have also been brought within the ambit of formal banking. Finally, government's efforts to get data from foreign banks have also borne fruit. Swiss authorities have planned for automatic exchange of information (AEOF) on financial transactions with the Indian government from 2018. All these pieces of the jigsaw puzzle are helping complete the big picture of the efforts to eradicate black money.

But what about the decline in GDP growth rate to a tad below 6%? Of course, it was anticipated that the double-exogenous shock of demonetisation and transition to GST would cause short-run disturbance in economic activity. However, even today, India is one of the fastest growing economies, where the 2017 average expected GDP growth rates for advanced countries and emerging markets are only about 1.9% and 4.1%, respectively. In fact, the only time a demonetisation can be carried out is when GDP growth rate is high enough to absorb a temporary shock. It would have been unwise otherwise. Importantly, there are many long-term benefits of the multi-pronged approach to demonetisation, which cannot be evaluated in rupee terms. For example, there is immense value attached to the intangibles such as credible threat to forgery rackets and enhancing the national security milieu, a shift in the people's mindset in favour of digital payments, a shift in the propensity of the informal sector to get into formal one, and the potential increase in tax base to finance public goods. Such long-term benefits are impossible to be captured in the current estimates of GDP growth rates.

Though demonetisation seemed to be madness, yet there was method in it.

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