

INDIA : CURRENCY DEMONETISATION AND THE WAY AHEAD

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ABSTRACT

In the backdrop of the recent Demonetisation promulgated by the PM on the night of 8th Nov., 2016, this paper attempts to put together the opposing views among economists, highlight the direction in which cash is headed and also lists the way ahead for India to emerge as a cleaner and transparent marketplace. Some economists opine recent demonetisation as a big bang structural reform the Indian economy needed. Almost all asset classes were reeling under huge price bubbles and assets like a decent house, gold had almost become inaccessible for the aamaadmi. In the short run, definitely the entire nation will pay the costs, however in the long run, this step will prick the asset price bubbles and cause prices to hover close to their real values, give a hit to parallel economy and reduce overall crime. On the other hand, for some economists, this demonetisation is more of a palliative to suppress the ills in the economy. Only some black money holders will get trapped and be impoverished for a lot of others may still find channels to offload their black money. Evidence from other nations show that the stride towards cashlessness is an inevitable step and for countries hitherto dependent on cash, its better late than never. The question is not whether or not to move ahead. Its rather about how to manage all the bedlam that the demonetisation has caused. The demonetisation in India is a clear indication of where the nation is moving. Cashless India is apparent, inevitable and needed! The paper also goes on to suggest measures such as gold registry along with real estate digitisation and periodic demonetisation of BCNs to give a final blow to the black economy.

Key words : demonetisation, cashless payments, big currency notes, black money, shadow economy, parallel economy, asset price bubbles

INTRODUCTION

The way we make payments has changed more in the last 10 years than it did in the previous 100 years and almost all changes are taking share away from cash based payments. The global cashless journey has begun. While its been a gradual trek for some nations, for others who followed the trodden path, it has been rather swift. Online apps or mobile wallets such as Patym, Mobikwik, Oxigen, Freecharge, mRUPEE, America's PayPal and Venmo, Kenya's mPesa, Bangladesh's bKash, are clear indications of paper money chasing the course of other "information goods," such as printed photographs, cassettes, and DVDs in being taken over by digital substitutes.

A major question here is that if cash is still relevant, what is the need to replace it? Talking about India, in the backdrop of the recent demonetisation of old currency notes of Rs.500 and Rs.1000 by the PM; the Ministry of Finance, Deptt. of Economic Affairs, noted that while the total number of bank notes in circulation rose by 40% between 2011 and 2016, the increase in number of notes of Rs.500/- denomination was 76% and for Rs.1000/- denomination was 109% during this period. This shows the extent of the shadow economy eating away our real economy. The big currency notes (BCNs, now synonymous with black money) were hitherto lubricating terrorist funding and the parallel economy, drug

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and human-trafficking, money-laundering, racketeering; causing asset bubbles in major asset classes such as real estate and gold and widening the gap between the haves and the have nots.

OBJECTIVES

The objectives of the current paper are as follows:

1. Explain the concept of demonetisation and delve into its historical roots in India and elsewhere.
2. Put forward the different viewpoints endorsed by the economic community on the recent demonetisation in India announced on the night of 8th Nov.,2016.
3. Document the next logical step – Encourage Cashless transactions and capping payments that can be made in cash.
4. Suggest benefits of transacting cashless and how they can be made sustainable.

We shall now deal with each of these objectives one by one.

DEMONETISATION : CONCEPT AND PRECEDENCE

Demonetisation means stripping a currency unit of its legal tender status and retiring it, and maybe replacing it with a new currency unit (as in India in 2016). Demonetisation is not new to the world. According to The Economist, dated March 5, 2016: "To make life difficult for criminals, Britain has barred banks and money-changing firms from providing £500 notes; the biggest British note is a mere £50 (\$70). Canada started withdrawing its C\$1,000 note from circulation in 2000 for the same reason. Singapore is phasing out the S\$10,000 note, the ECB too seems to be moving in similar direction. In early February it announced an investigation into the use of the £500 note". Demonetisation has also been used in the US, barring legal tender status of bigger than \$100 notes. In India too, demonetisation has historical roots. India demonetised Rs.1000 and Rs.10,000 currency notes first in the year 1946 to expunge black money from the economy. However, higher denomination currency notes – Rs.1000, Rs.5000 and Rs.10,000 were

reintroduced in the year 1954 only to be demonetised again in January 1978 by the then PM Morarji Desai. The move in 1978, did not fare well as the demonetisation lacked the then RBI Governor's support.

ECONOMISTS' VIEWS ON RECENT DEMONETISATION

The economic community is widely divided on the recent demonetisation promulgated by the PM on the night of 8th Nov., 2016. For some, this demonetisation has been a structural reform that the Indian economy desperately needed. In the short run, the nation will pay the costs of this step in the form of inconvenience and lost productivity (standing in long queues in banks to exchange their old currency notes, making payments to small vendors, ATMs not vending cash, lost sales for conventionally bought items.). However in the long run, with (theoretically) accounted and clean money circulating in the economy, this step is expected to deflate asset price bubbles and cause prices to hover close to their real values, reducing the parallel economy and hence reducing overall crime. However for the opposite school of thought, the recent demonetisation is more of a palliative to suppress the ills in the economy. Only some black money holders will get trapped and be impoverished for a lot of others may still find channels to offload their black money @ 20-30%. According to them, the euphoria regarding demonetisation is unwarranted.

CASHLESS TRANSACTIONS AND CAPPING CASH PAYMENTS – NEXT LOGICAL STEP

Though the ubiquitous cash has resisted digital alternatives for long, but looking into the ills that paper money is causing, going cashless is one obvious way of reducing the parallel economy. According to a 2013 MasterCard Study, "The persistence of cash is surprising given its inconveniences and the risks of carrying it around. Electronic payments, in contrast, are proven to boost economic growth while advancing financial inclusion. For those reasons, countries are working to make payment systems

France

92%

NA

Illegal for French citizens to make purchases exceeding 1000 euros in cash.

[https://www.cashless-world.com/](https://www.cashless-world.com/which-countries-are-becoming-cashless-world/)

[Last Accessed: 16Nov,2016]

<https://www.corbette-report.com/the-war-on-cash-a-country-by-country-guide/>

[Last Accessed : 14Nov.,2016]

			<ul style="list-style-type: none"> According to Bitcoin Market Opportunity Index (BMOI), Argentina is the most likely jurisdiction to replace sovereign currency with bitcoin (virtual/crypto-currency) 	https://www.corbettreport.com/the-war-on-cash-a-country-by-country-guide/ (Last Accessed : 14Nov.,2016) http://www.leaprate.com/2014/08/argentina-to-be-the-first-cashless-society-due-to-bitcoin-popularity-bmoi-says-yes/ (Last Accessed : 14Nov.,2016)
Belgium	93% (as of April,15)	NA.	Restrictions on cash payments since 2014 - cash can no longer be used to pay for real estate, and there is a 3000 euro limit on cash payments for other assets (unless purchase second hand).	https://letstalkpayments.com/which-countries-are-close-to-a-cashless-world/ Last Accessed: 16Nov., 2016 https://www.corbettreport.com/the-war-on-cash-a-country-by-country-guide/ (Last Accessed : 14Nov.,2016)
Canada	90% (as of April,15)	NA	Introduced Mint Chip in 2012 as new form of e-payment better than cash	https://www.corbettreport.com/the-war-on-cash-a-country-by-country-guide/ (Last Accessed : 14Nov.,2016) https://letstalkpayments.com/which-countries-are-close-to-a-cashless-world/ (Last Accessed : 16Nov.,2016)
Denmark	75% (as of Dec,15)	2030	The Danish government said as of next year, businesses such as clothing retailers, petrol stations and restaurants should no longer be legally-bound to accept cash. A hotdog vendor confirmend- only tourists make payments in cash.	http://paymentweek.com/2015-12-23-denmark-pushes-forward-with-cashless-payments-9215/ (Last Accessed : 15Nov.,2016) http://www.telegraph.co.uk/finance/economics/11586778/Denmark-moves-step-closer-to-being-a-cashless-country.html 6May,15. (Last Accessed: 15 Nov.,2016)
France	92%	NA	Illegal for French citizens to make purchases exceeding 1000 euros in cash.	https://letstalkpayments.com/which-countries-are-close-to-a-cashless-world/ (Last Accessed: 16Nov.,2016) https://www.corbettreport.com/the-war-on-cash-a-country-by-country-guide/ (Last Accessed : 14Nov.,2016)

Netherlands	85% (of total value of consumer payments; as of April,15)	NA	<ul style="list-style-type: none"> Part of growth due to national Hotspot Project (2012). objective: increase safety and convenience for consumers in stores that accept debit cards. 	https://letstalkpayments.com/which-countries-are-close-to-a-cashless-world/ (Last Accessed : 16Nov.,2016)
Norway	NA	NA	<ul style="list-style-type: none"> According to Norway's largest bank, DNB, cash has fallen out of favour with everyday Norwegians and is instead primarily used on the black market and in laundering schemes. looking into the dangers of cash in the economy, it has been decided to phase it out gradually. 	http://www.thelocal.no/20160122/norways-largest-bank-calls-for-complete-end-to-cash
Sweden	According to central bank the Riksbank, cash transactions made up barely 2% of the value of all payments made in Sweden last year – a figure some see dropping to 0.5% by 2020.	Within about next 5 years.	<ul style="list-style-type: none"> First to implement paper money in 1661 and also the first to eliminate it (since 2010) Plastic money dominates If you pay in cash, something is wrong. even a 7-year old can make payments using a debit card 	https://www.theguardian.com/business/2016/jun/04/sweden-cashless-society-cards-phone-apps-leading-europe (Last Accessed : 16Nov.,2016)
UK	89%	NA	<ul style="list-style-type: none"> Cash is used for low value retail purchases, which too is being targeted by new solutions with PayPass. London busses cashless since 2014. 	https://letstalkpayments.com/which-countries-are-close-to-a-cashless-world/ (Last Accessed : 16Nov.,2016) https://www.corbettreport.com/the-war-on-cash-a-country-by-country-guide/ (Last Accessed : 14Nov.,2016)

With the advancement in technology, e-currency is the only way to ensure saleableness of money in time and space. In words of Carl menger,1892, "With the extension of traffic in space and with the expansion over ever longer intervals of time of provision for satisfying material needs, each individual would learn, from his own economic interests, to take good heed that he bartered his less saleable goods for those special commodities which displayed, beside the attraction of being highly saleable in the particular

locality, a wide range of saleableness both in time and place. These wares would be qualified by their costliness, easy transportability, and fitness for preservation...to ensure to the possessor a power, not only "here" and "now" but as nearly as possible unlimited in space and time generally, over all other market goods."

The question is not whether or not to move ahead. Its rather about how to manage all the bedlam that demonetisation has caused. Demonetisation in India is a clear indication of

where the nation is moving. Cashless India is apparent, inevitable and needed. A doable way to do this after demonetisation is to cap payments that can be made in cash (lets say to 2k). Any payment bigger than 2k to be made electronically. To have more and more people pay electronically, banks can be made to offer discounts to customers who make payments electronically on their bank account costs. In this way major money payments can be traced (in their source and destination) and white money will be circulating in the economy. As in Argentina since 2012, banks can be mandated to report client's e-payments (via credit/debit cards/net banking/e-wallets) to the tax authorities to combat tax evasion. Experience from other nations suggests demonetisation is a precursor to a cashless economy and offers a huge increase in governments' ability to pry and trace movement of money.

GAINS FROM GOING CASHLESS

In India, at the moment, the idea of cashlessness has evolved less from strategy and more by accident. There is nothing wrong with that, almost all great discoveries have happened that way. The United States and Oxygen are 2 great examples. Even when there was a strategy (aviation and cars, for example), the road to success was ridden with many disastrous failures.

The current predicament of the Govt is not really unexpected, just a battle and not the war has been lost, if that. Why would anyone have expected that a nation with a culture of "something for nothing", would quickly surrender its ill-gotten gains to a Govt fiat? The hydra-headed (Black Money) monster has recovered quickly, and the nation's well-oiled money-laundering networks have recovered from the initial shock to dump the entire money back into the banking system, for at least this instant.

But there have been many invisible gains. For one, the credibility of cash as a store of ill-gotten wealth, has been immutably destroyed. While cash was never a long-term store of value for Black Money (more likely gold and real estate), it is unclear what, if anything, will now

take its place. Two, the cost of tax evasion will go up, for sure. And many smaller evaders will come round to the view that it is cheaper to pay taxes, just makes commercial sense. Three, the other store of Black Money, real estate, can be closed off with digitisation (and biometric linkage) of land & property records, backed by a decent Wealth Tax on excessive land holdings. Four, gold can be squeezed by a Gold Registry and stringent holding norms (500 gms is enough). Five, new reforms like GST and digital (Govt) sourcing will cut the flow of Black Money at source. Six, it is possible to step up e-monitoring of financial transactions, once the share of digital transactions goes up. A whole cottage industry of algorithm-writers will spring up with the right incentives. Seven, just create a shortage of BCNs, so that they command a premium. This will push all the innocents into the digital economy, leaving the big fish (especially the corrupt) exposed to the next moves to squeeze out cash. Back it up with a steep Cash Withdrawal Tax, which disincentivises the movement into the cash economy. Periodically demonetise BCNs, and remove their anonymous character. Technology can help. Even rumours floated (about secret tracking chips or self-destructing chemicals) will create enough fear to ensure that demand for BCNs from the Black Money market will drop precipitously.

Of the above measures, most of them are within the realm of possibility, the Gold Registry being the most difficult. Legal holdings of gold are easy to dematerialise, through Gold ETFs, which can be excluded from the purview of the Gold Holdings Control Order. Illegal holdings and gold ornaments going back into antiquity, will be more difficult. Eventually, the incentive to hold gold will reduce when there appears a real return from financial assets. To ensure this, the Govt/RBI needs to keep the real interest rate positive, or even at zero. Otherwise, the tax saved on illegal gold holdings will by itself, become the biggest motivator.

Politically, the screaming and shouting will continue, including the yelling of innocent people, amplified by the politicians who really are hurting

in the place where the sun doesn't shine...but the Govt should now be reconciled that there is no going back. The political cost has already been paid, now the effort should be increased to extract maximum benefits from this exercise.

CONCLUSION

Though the economic clout is divided on the recent demonetisation promulgated by our PM, but the course of action for now is to just sit and wait for the economy to settle. Undeniably the nation has suffered on pretext of this demonetisation but the larger picture seems bright. With the Govt. all set to crackdown on the black economy, cash payments can be restricted to 2k, payments above the aforementioned amount to be made electronically, the efforts can be bolstered by Gold Registry norms, periodic bans on BCNs and tracking of financial transactions with higher digitisation. The signals at present are amply apparent - cashless India. An

ideal India now does not seem a far dream.

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