

## **Demonetisation: All pain for the majority\***

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At the time of writing, chaos continues to prevail at bank branches and ATMs across India, reflecting the larger truth that the government has for no sensible reason frozen a major part of India's payments and settlements system. The government did this by declaring, for reasons wrong and indefensible, that currency notes of Rs. 500 and Rs. 1000 denomination which accounted for more than 85 per cent of the value of notes in circulation (and around 25 per cent in terms of sheer numbers) would not be legal tender within four hours of a dramatic speech by the Prime Minister Narendra Modi on the evening of the 8th of November. That speech was filled with threat and promise: once again the Prime Minister declared that 'black money' would be sucked out of the system and trashed, that those earning black incomes, holding black wealth and involved in counterfeiting currency would be pursued and incarcerated for ruining the economy and oppressing India's poor, and that the flow of counterfeit notes from across the border that fed domestic terrorism would be stopped. In a turn of phrase that began life under Modi as the label for a secret military operation but has become a way to describe his aggressive form of governance, politicians and the media began describing the policy as a 'surgical strike' on the black economy.

Those who were not the target of this strike were, however, given limited options. They could exchange the demonetised notes for new ones up to a maximum of Rs. 4,000 (Rs. 4,500 subsequently), deposit the rest of their holdings of such notes in their bank accounts, access limited amounts of cash through ATMs or bank withdrawals, and use debit cards, credit cards and electronic banking facilities wherever possible, so as not to put too much pressure on the available supply of notes. These, of course, were options available to those having access to electronic banking facilities, an adequate number of banks and ATMs in their neighbourhood or for that matter even bank accounts that many do not still have.

But besides facilities through which currency being withdrawn could be replaced, so that citizens could execute their normal transactions, there was the sheer problem of availability of adequate amounts of currency notes. The number of notes of Rs. 500 and Rs. 1000 denomination is estimated at a combined total of around 22 billion pieces (or around 25 per cent—17.4 and 7 per cent respectively—of all notes in circulation). According to one estimate, the total capacity of all government printing presses to print notes of all denominations is 23 billion pieces a year. So even if the production of denominations other than Rs. 500 and Rs. 1,000 is stopped altogether, which is not feasible, it could take as much as a year to generate the one-time supply needed to replace the 22 billion pieces that have been withdrawn from circulation. So, even if the government had started printing new notes as far back as September, as some reports would have it, it would take some time to replace the stock of currency that has been declared illegal tender. The government has by issuing new Rs. 2000 rupee notes sought to cover a part of the gap through a value adjustment. But that creates its own problems.

Not surprisingly, it soon became clear that this so-called 'surgical strike', which was a minor nuisance for the rich who can go cashless to a substantial degree, was a major blow on India's poor and lower middle classes—its casual and self-employed

workers, peasants, petty producers, small traders and street vendors. Reports from across the country, especially interior or remote regions with limited banking reach and a substantial cash economy, make clear that the initial expectation that the ‘pain’ inflicted on them through the adoption of these measures would quickly subside, has been belied.

One section affected severely is the farming community which needs to dispose of a crop that has been recently harvested, and spend on seeds and other inputs to get the next crop growing. Much of these transactions are settled in cash, and the limited availability or non-availability of legal tender post the demonetisation has squeezed the peasantry at both ends. Moreover, cooperative banks that constitute an important source of credit and cash in many parts of the country have had to suspend operations as they have not been allowed to exchange demonetised notes, or accept deposits of such notes. Arguing that poorly organised and managed cooperative banks can be the conduit for converting black or counterfeit currency the RBI has ruled that “no exchange facility against the specified bank notes (Rs 500 and Rs 1,000) or deposit of such notes should be entertained” by district central cooperative banks. These banks are also finding it difficult to convert the reserves of demonetised notes they have into legal tender. This has added to the woes of the rural population.

Overall, it is clear that the extent to which the measures would inflict pain on these sections was hugely underestimated by the political establishment, sundry pundits, the media and a large section of the untutored or sycophantic elite of the country. This points to their disconnect from a reality which bears little resemblance to the vision of a dynamic market economy they presume they inhabit. In that vision India is a developed country with a digitally savvy and empowered population that does not depend on cash to make payments and settle transactions. In fact, many implicitly assumed or explicitly argued that, since Modi came to power and leveraged the Aadhar programme that the UPA handed his government and introduced the Jan Dhan Yojana that offered the poor no-frills bank accounts, India had become a truly modern, near-cashless economy. A small push would see electronic transactions, mediated by ATMs, gateways, and internet and mobile banking, replace cash transactions. Even at the ostensibly ubiquitous PoSs (points of sale) plastic would displace cash.

The belief of an elite overcome by hubris was that, since in modern economies (including India) payments and settlements are supposed to occur largely behind the backs of people in a banking system increasingly located in secured cyber-spaces rather than brick-and-mortar facilities, cash was, literally speaking, dispensable. So if anybody needs cash in substantial quantities it must be those who inhabit the underworld of black incomes and wealth, counterfeiting and terrorism. This they seem to believe as true even of the Rs. 500 note that can get you at most 3 kilos of urad dal, or 10 kilos of raw rice, or a portion of tandoori chicken at Karim’s or a plate of Vada and a Masala Dosa each for two at Saravana Bhavan in the capital city.

Unfortunately for the Prime Minister, his government and India’s disconnected elite, they have had to come to terms with reality the hard way. For India’s poor and lower middle classes economic life seems to centre around the cash economy. When a misinformed government chose to freeze that economy, their lives froze as well, in queues that enticed them with access to small doses of legal tender, at shops that

rejected the notes they had legally earned and even in hospitals that refused to treat those ill, because they had been economically disenfranchised. Soon patience gave way to frustration and anger and occasionally to physical violence, even as the PM in far away Japan exhorted Indians to suffer short term pain for the greater good of a nation that did not seem to be theirs, displaying the fortitude that those Japanese devastated by the post-tsunami accident at the Fukushima nuclear plant had shown.

Hopefully, rather than feed the belief that this is the result of their karma, the experience has taught many ordinary Indians lessons that India's ruling politicians and bureaucrats had either not learnt or chose to ignore in the face of the Prime Minister's erroneous, misdirected and combined strike on the black economy, counterfeit currency and terrorism. Prime Minister Modi, after all, does not suffer those who are not carried away by his hype and hubris. So none of his advisors were willing to suggest that the presumptions underlying the demonetisation initiative designed by the PM and his team were wrong.

The first of these presumptions was that the black economy consists of black wealth held and hoarded as black money, that would lose all value and disappear after demonetisation. The fact of the matter is that black wealth, either flows out of the country only to return through transit routes like the stock market and conduits like participatory notes, the ownership of which is difficult to fathom, or is soon converted into assets like gold, real estate and financial instruments, or is just spent and transformed into money circulating in the 'white' economy. Only a small component that has either been generated in recent transactions and has as yet not been converted, or is held by those who expect to make a transaction that needs a large hoard of black money remains in the form of currency.

The second presumption is that the cash economy, in which incomes are earned in cash and spent without being deposited in a bank, where sales in cash are based on purchases made in cash (as is true of fruit and vegetable vendors, for example), where purchases and payments are made in cash even if the flow of that cash is mediated by the banking system and where electronic transactions are unknown or absent, is a small part of the overall economy in current day India.

The third is that at today's prices Rs. 500 (or for that matter even Rs.1000) is a sum that is not required in routine transactions so that impounding notes of that denomination and withdrawing them from circulation would not affect the cash economy described earlier.

The fourth is that for a considerable period of time those requiring cash for transactions would be able manage with a small volume of 2000-rupee notes and 100-rupee notes, even when more of the latter would be needed to provide the change in transactions that lie in between 100 and 2000 in terms of value.

And, finally, that forcing out counterfeit notes in circulation at present, would address the problem of counterfeiting whether resorted to for profit or to wage war on India. Rumours of the counterfeiting of the new Rs. 2000 notes are already circulating.

These presumptions are possibly not held with confidence even by the Prime Minister. The government's decision to go ahead with this exercise seems to be motivated more by the need to convey the impression of uncompromising action on

promises to eradicate corruption and abolish black money that Modi and the BJP has been making but not delivering on, rather than actual conviction that this would achieve objectives such as flushing out black wealth, ending corruption or closing down terrorist financing.

But in this attempt at drama, which resulted in a decision announced at 8 pm to demonetise Rs.500 and Rs. 1000 notes becoming effective four hours later, the government seems to have forgotten to assess the near term consequences of its move. The result is an impression of poor judgement and incompetence. It is clear that too much currency was taken out of circulation, and that the rate at which it could be replaced was hugely underestimated. Ceilings set on amounts of the demonetised currency that can be exchanged for legal tender at bank branches and other designated locations and on sums that can be withdrawn from bank accounts have proved far too low. All this has resulted in huge queues in front of banks, as people attempted to exchange the demonetised notes for valid currency and deposit the balance into their accounts, not to meet the end-December deadline for getting rid of the old notes, but because that is the only way they could obtain their currency that can be used to defray immediate expenses.

What followed was chaos for a number of reasons. It soon became clear that ATMs were not the best way to access money lying in bank accounts. Since the physical dimensions of the 2000-rupee notes are different from those of the now withdrawn 500- and 1000-rupee notes, ATMs had to be recalibrated to dispense the new Rs. 2000 notes. Whatever planning was done before the measure was announced, it does not seem to have taken this issue seriously. This meant that only one tray that could accommodate notes of Rs. 100 could be used to distribute cash through ATMs. That severely limited the contribution this channel could make to the task of putting enough cash into circulation. It also meant that a substantial amount of available Rs. 100 notes had to be diverted to the ATMs, so that those approaching the banks had to accept more than the desired number of notes of Rs. 2,000 denomination. Using that in transactions of lower value and getting change has proved a headache for many. Moreover, limits on cash that could be accessed, created a host of difficulties among those needing currency for day-to-day transactions and those needing to make lump-sum expenditures in hospitals or for marriages and other ceremonies. Not surprisingly, patience is wearing thin even among those who believe that this is a worthwhile exercise; frayed nerves are leading to scuffles; and some most adversely affected have turned violent against others or even themselves.

Meanwhile, as was to be expected, some of the powerful are using a few of the poor, such as their workers, to exchange old notes for new ones or to deposit the notes that are being demonetised into the accounts of the latter. To prevent this from resulting in a situation where notes belonging to the same individual are exchanged to the extent of Rs. 4,500 each in multiple banks, the government has instituted a system of marking those exchanging currency with indelible ink. This has meant that those without a bank account and savings of more than Rs. 4,500 held in the form of the demonetised notes, will see a part of their hard earned and kept savings vanish. Jan Dhan accounts have also been put on watch for 'suspicious' deposits. The poor have in these ways too been made victims of the government's 'strike'. Even if one, without adequate reason, believed that the measures announced on 8 November will badly hit the rich and the corrupt, the fact that the poor would also be hit or, as the

evidence pouring in suggests, even devastated would have called for caution in proceeding with an exercise of this kind. As the Supreme Court bench looking into the issue pointed out using the military terminology favoured by the government and the Sangh Parivar, this was not a surgical strike but akin to carpet bombing.

But all this is not forcing the government to rethink, with the Prime Minister, the President of the BJP and the supporters they have accumulated trying to brazen it out saying that some short term pain is needed to cleanse the nation of the evils of black money, corruption and terrorist financing. In fact, the claim is that anyone criticising or opposing these ruinous measures is supporting corruption, terrorism and the black economy. But as the period over which this pain has to be suffered extends and the conviction that the evils being targeted are being hit wanes because of evidence to the contrary, there is every likelihood that much of the population would see this policy for what it is. Hopefully, that would reflect itself in how they vote as well in the many elections to come.

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