

## Op-Ed Submission Ashwinbalaji Sundaresan

Rahul returns from a toiling day in the fields. As he sits down and cools his weary limbs, something in the evening news catches his attention. Brushing aside his mental fatigue, he forces himself to concentrate on the words on screen. His wife and children seem to move in slow motion as his neurons frantically process the aural and visual data that is being played on screens throughout the country.

"Demonetization is being implemented with immediate effect." Rahul's eyes go to the strongbox in the corner holding the thousands of hours of blood and sweat spilt for his family. Now, there is only tears..

Both citizens were reeling from the effects of the demonetization policy implemented by the Indian government on Nov 20th 2016. Denominations of 500 and 1000 were replaced by a new 2000 rupee note. This surgical strike was aimed at lancing the boil of black money and corruption that was festering for so long and bringing the perpetrators to justice. Those who returned huge sums of money were taxed by the government as well. For Rahul, the common man, his fears were put to rest as banks throughout the country worked at a frantic pace to accept old notes and replace them with new ones. A grateful Rahul, returned home with a smile on his face, though the serpentine lines at ATMs and banks made it quite a wait.

The government claimed that the demonetization was an effort to stop counterfeiting of the current banknotes allegedly used for funding terrorism, as well as a crackdown on black money in the country. In the days following the demonetization, banks and ATMs across the country faced severe cash shortages which had detrimental effects on several small businesses, agriculture, and transportation. While people seeking to exchange, their notes had lengthy waits, and several deaths were linked to the rush to exchange cash. Also, following Modi's announcement, the BSE SENSEX and NIFTY 50 stock indices crashed for the next two days.

The demonetization received support from several bankers as well as from some international commentators, although it was criticized by members of the opposition parties, which led to debates in both houses of parliament.

Was it worth it?

The Idea of demonetization is long overdue. The growth of the cash economy with respect to GDP was less than 10 percent in 2001. But in 2010, it was greater than 12 percent. Even though use of technology and cashless payments has increased dramatically. This shows that the Cash economy has penetrated very deeply in the society. A study by Credit Suisse shows nearly 50 percent in India is cash economy. But this does not completely reflect an illicit economy, but genuine economy which has his roots deeply planted in employment of individuals

In the past decade, the abundance of cash, resulted in a large cash hoarding and transactions between cash to gold and real estate. This in turn caused the rise of land prices beyond the reach of the common man. This is also what many refer to as "the wealth effect". Thus, an effective decision had to be taken to change this dilapidated situation.

Nearly 87 percent of the notes in circulation was of the denominations of 500 and 1000's. One problem in this was how much of it was due to illicit means. Another curveball to consider is the fake currency in circulation.

Demonetization has been a major setback to terror funding in India. In Kashmir, extremists had issued a warning against depositing the money in banks once this policy came into effect. But to the contrary, a huge number of people turned up to do so, and there was a sudden drop in unrest in otherwise a very sensitive state.

Terror funding in India has two separate heads. The first one was from counterfeit currency flowing in from other countries. Demonetization eliminated counterfeit currency which was mostly in the 500 and the 1000 rupee notes. The second was through legal tender. The Naxalites, the Communist guerrilla extremists in India, funded their operations by cash. Now, because of demonetization, it is very difficult for them to convert the old tender by turning over to the bank. This is because their funding was designed to operate only in a stable cash economy, not a bank economy leading to a major setback to their operations.

Out of the fifteen trillion rupees in this currency, studies show that 3 trillion will not come into the banking system. Now, out of the twelve trillion that comes into the system, an average tax rate at 25 percent would generate substantial revenue for the government which will have a far-reaching consequence to India's growth story. Also, such a large amount of cash in the banking system multiplies due to fractional reserve basis which would otherwise remain the same if it were to be held in the society. A minimum of 3 to 4 times multiplier can be expected in a couple of years. This also shows that the black money economy is not an efficient use of the resources.

The money creation by banks will increase the prosperity of the economy. Another important effect of this money in the economy is the reduction of interest rates. Interest rates are currently very high in India. These high rates particularly impact the small and medium businesses which do not have access to cheap foreign funds. Another major impact is the withdrawal of cash from the real-estate economy. This leads to a moderation in land prices and a price drop of 30-40 percent can be expected in the urban areas. This is going to promote affordable housing. For consumer goods, the price depends on supply and demand of a product. For land, price depends on the amount of money chasing behind it.

Another major impact will be the reduction of ostentatious and unnecessary consumption down due to lesser availability of cash. This will in turn reduce the probability of inflationary pressures from these sources. One may argue that this reduced consumption will hold back the economy and lead to a drop in GDP. In India, the GDP numbers do not explain the growth in economy. This is because GDP doesn't represent employment. A major part of increase in GDP is due to increase in prices. A jobless growth doesn't mean that the country's economy is growing. In fact, due to demonetization, prices will come down leading to an increase in growth in terms of quantity because of increase in demand due to cheaper prices. This will in turn increase the number of jobs in the society. Thus, a moderation in prices, which will lead to a genuine increase in demand leading to an actual increase in GDP.

But measures need to be taken after this to ensure this illicit money is not generated in the economy again.

But why should the common man suffer?

Overall, the benefits far outweigh the temporary setback. What many criticize is the lack of planning by the government. But the problem with increased planning, the risk of information leak increases exponentially and the whole operation would become useless. The fact that such a secrecy was maintained for nearly nine months in a porous system like the Indian government is amazing. Some

claim that they were forced by the government into stressful situations which wasted their time and resources. But this discomfort is a small price to pay. The patience shown by most people has been extraordinary. The fact that there was no one protesting on streets show that people believe in this move and are willing to contribute to the greater good.

Currently most of the difficulties faced by common hold holds for everyday family, business and banking level operations is mostly over. The next challenge is bringing about liquidity in the production side. Historically money reached this sector only by cash. One efficient and proven way to ensure money still reaches this system is through non-banking financial institutions. These institutions can penetrate deep in to the economy making funds available for all levels of production.

One temporary measure to relieve the cash crunch is to partially pay the salary in the government institutions, and companies listed in the Bombay Stock Exchange in cash. These companies are specifically chosen as cash from these systems can easily be traced allowing for only legitimate payments. This influx of cash would aid currency note circulation and provide temporary relief.

Demonetization is a necessary evil, without which any money investment in the Indian economy would not be efficiently utilized due to corruption, kickbacks etc. The next few quarters are the correction phase which might see a drop in financial value. But post the correction phase, India will be set on a whole new road to development.