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# The principle – why, key objectives

- **Stated**

- Unaccounted Money (Black)
- Counterfeit notes
- Unaccounted money funding activities opposed to public policy

- **Unstated**

- Increased cash availability in the banking system
  - Reduction in interest rates
  - Betterment of financial profiles of banks
- Reduction in Cash in the economy, due to “extinguished liability”
  - Reduced Inflation, production being the same
- Accounted economic activity leads to more real Macroeconomic statistics
- Increased Government Revenue
- Increased tax base
- “Windfall profits” expected
- Use surplus to
  - Create demand, increase consumption, promote GDP growth
  - Spends to promote / incentivise make-in-India efforts
  - Fund capex
    - Eg replace old thermal generation capacities at 5-6 Cr per MW in place of 7-8 Cr per MW leveraging on cheaper credit (Power Minister on Television)
  - Spend on social programs

**As Forbes.com wrote:** *“All in all then a rather interesting set of effects. A lower budget deficit, lower interest rates and also lower inflation. Not bad for the one simple plan, is it?”*

# The Mechanism – Big Bang approach

- Steps should be **sudden**
- **Demonetise** high value notes
  - 86% of value – very high impact
  - Place caps on withdrawals
    - Match cash availability, prevent run on banks
    - Delay process of conversion
- **Remonetise** with the following steps
  - **New currency notes** to be introduced with lag
    - Not to match amounts deposited – replaced currency will be less than deposited currency
  - **Retain caps** for some time till clearer picture emerges
  - **Impose restrictions** on banks' ability to use deposited funds
    - Fiscal discipline, prioritisation of sectors
  - **Promote digital** transactions
- **Strengthen legislative framework**
  - Benami transactions, Tax disclosure schemes, GST push to continue, Disincentivise hoarding of old notes
  - Overall **push for digital engagement** – transparency, accounting and disclosures, eliminate corruption
  - In **subsequent phases, tax reforms, political funding reforms, etc.**
    - Hints have been dropped already

# Effects....

- Cash starvation impact
  - **Suffer**
    - Anganwadi (ICDS) programs have taken a hit
    - Jute mill closed in Bengal
  - **Improvise / work around**
    - Small traders continued with 500/1000 avoiding fractional trades
    - Bhutan currency to rescue (500=400)
    - Coupons printed
  - **Beat the system**
    - Preferential treatment
    - Conversion opportunities

# Effects - Industry impact

- **Banking**
  - Cash inflow has both woes and opportunities
    - LAP: In particular, because LAP loans are typically extended to SMEs and selfemployed individuals, a borrower's ability to repay is often based on the lender's assessment of the borrower's income (surrogate loans) rather than actual reported income (incomebased loans).
    - At the same time, the ready availability of credit has made it easy for borrowers to refinance their debt, thereby potentially masking any weakening in their ability to repay the debt.
    - In this regard, Moody's expects the withdrawal of all INR500 and INR1,000 notes in early November 2016 may further expose the weaknesses in this segment. Disruptions in the borrowers' cash flows may trigger delinquencies, while tightening underwriting practices will make it more difficult for them to take out new debt.
- **Retail / (unorganised) Traders**
  - Old notes economy
  - Cash crunch has seen kirana sales fall, is now rapidly picking up.
- **Real Estate**
  - Second sales, some primary business
  - Prices not driven down
  - Rumours
  - Stalled projects will recover, increased cash available from banks, lowered interest rates
    - Some economists believe not so. All concur that higher end property prices may decline, due tax attraction and therefore margins may get squeezed.
  - Moodys: Demonetization could weigh on sales volumes but volumes will start to pick up as interest rates decline
- **Small Enterprises**
  - Lot of job work, small purchases, "informal business"
- **Manufacturing sector** has shown marginal decline in November. Observers attribute it to slowdown due to cash crunch.
- **Lorry Transport**
  - Drivers' payments,
  - Cash business
- **Auto**
  - Moodys: Demonetization could lower near-term demand
- **Consumer Durables**
  - IDC reports double digit % fall in smartphone & PC sales apparently more than 50% of such sales were cash.
- **Tourism**
  - Down significantly – year end reports still awaited.
- **Farm produce supply chains** have seen severe disruptions – upto 50% in yards like those in Vashi, our own Yeshwantpur etc
- Centre for Asia Pac Aviation says **Aviation sector** may see decline of 3-5%
- **Technology** - Unaffected

# Effects: Impact on Industry

- Deloitte assesses that subsectoral impact will be felt in
  - Luxury cars, SUVs, gems, jewellery, gold and high-end consumer branded products – **negative impact**
  - Businesses in the **fintech sector**, including payment banks, mobile wallets, electronic transfer providers, etc., are expected to see **gains**.
  - Agriculture, Luxury goods, Real Estate, Commodities, Traditional Retail (Durables and non-durables) will all see **negative impact**

# Effects:

- **All indices have fallen** (consumer goods, production, retail, etc)
  - in spite of windfall increases in central govt salaries which was to have pushed up demand. This clearly can be attributed to cash crunch
- **Large industries relatively unaffected directly by cash crunch. No impact on hi-tech, IT.**
  - Employees were impacted, became “those poor rich folks”
- Rupee **countries like Nepal have suffered**. They have stocks of cash + lower tourist, lower trade.
- Newspaper, petrol and diesel and cooking gas **skyrocketing prices**, tea garden payments affected **in north east**.

# Voices in support

- Moodys
  - **sees no additional risks** or reasons to change its outlook for sovereign rating
  - "Although the measures in the near term will pressure consumption, GDP growth and thereby government revenues, in the longer term they should boost tax revenues and translate into higher government capital expenditure and/or faster fiscal consolidation,
    - *"Households and businesses will experience liquidity shortages, there will be a loss of wealth for individuals and corporates with unreported income, as some will choose not to deposit funds back into the formal financial system to avoid disclosing the sources of these funds.*
    - However, greater formalization of economic and financial activity would ultimately help broaden the tax base and expand usage of the financial system, which would be credit positive.
  - Implementation challenges, in addition to affecting growth and government revenues, will affect corporates by lowering sales volumes and cash flows. In the medium term, the impact on the corporates will depend on how quickly liquidity returns to the system
  - The government could prevent the same amount of cash returning into the system, in an effort to increase the use of non-cash transactions and digital payments. **This would improve the overall operating environment for doing business in India** -- by improving the ease and speed at which payments reach manufacturers and reducing corruption -- but would prolong the economic disruption.
- Forbes
  - The aim is to get unproductive and untaxed cash money into the banking and taxation system.
  - If it all pours into bank accounts where it is taxable and traceable then that's the job done.
  - Even if the news did leak and the big money all knew in advance, the aim of the bank note switch has still been achieved. Perhaps unfairly, not in the manner which we would wish, but it has still worked.
  - **It's a rather clever policy in fact--even if it fails through being leaked it still works.**



# Voices in support

- Deloitte
  - Possible appreciation of the domestic currency in the forex markets
  - Some negative impact on international trade cannot be ruled out at this point.
  - We are likely to see some decline in inflationary pressures
  - Domestically, there could be some turmoil but Internationally, the government is likely to get a thumbs up for the move and more countries could potentially see this as a viable option to curb black money and stem illegal financial activity.
  - Last, **such action achieves larger significance for a globally connected India as it shows boldness in tackling an issue** which has remained a thorn in the growth success story of this generation.
- E&Y
  - says **automation will support GST to continue with the good work of demonetization**

# Detractors

- Harvard Business Review has labelled it as “**botched war on cash**”
  - Digital payments far away, Cites low technology penetration, High cost of cash, Social comfort with cash, Low infrastructure support
- Fitch
  - **Cuts current fiscal growth** by 0.5% (7.4 cut to 6.9)
  - **Negative outlook for next two fiscals**, sees lowered growth rates
  - **Not optimistic about** success with **digital economy**, feels lack of incentives to drop cash transactions could trigger business as usual again.
  - Additional tax revenues even if achieved could be **offset by lower GDP** growth at least in the short term
- Question mark on GST :
  - **Issues of**
    - All states being on board with the Govt with respect to impact of demonetisation on the economy of their respective states, fears of slowdown
    - Ability of Centre to keep up its commitments under law in case of slowdown, eg compensating states for revenue loss

# Detractors

- Legal base
  - Legal tender in its entirety has been negated
    - Selective usage (petrol yes, food no)
    - Negotiable Instruments act thrown to winds
- **Infringes on RBI sovereignty**
  - FM shoots on the shoulder of RBI
  - RBI does what Govt. wants
- Crippling cash crunch **drives down consumption**
- **White economy becomes black sheep** for black economy
- **Lot of suffering**, especially for working class, poor, rural
- May lead to a slew of litigation

# Other voices

- Dr. Manmohan Singh has called demonetisation an **“organised loot”, “legalised plunder” and a “monumental mismanagement”**. He even said that the **National income would fall by 2 per cent**, which in his mind was “an underestimate”.
- Amartya Sen – “Only an authoritarian government can calmly cause such misery, assumes unless proven otherwise, all having cash are black money hoarders”; **move will fail**
- Kaushik Basu – Chief Economist World bank – “move has unintended consequences”, **will not work**

# Cashless economy – Answer or Questions?

- A **great concept, great opportunity**
  - 2% by volume, 20% by value of transactions are currently digital
  - Cost of cash is huge (for banks, fulfillment agencies)
  - Vulnerabilities of economy is huge
  - No one knows what the real macroeconomic figures are
- But **are we ready?**
  - Infrastructure
  - Penetration
  - Literacy
  - Cost of digital transactions
  - Cost of failures and back up plans
  - How sound is the strategy of relying on private and commercial e-wallets to be part of main backbone for monetary flow? And have we identified all the issues involved and considered them to depth?
  - Legal issues of privacy, security, etc.

# Outcome..

- Planned / Expected
  - **3 Lakh Cr** of the 14-16 Lakh cr will not come in and **will be extinguished**
  - **Potential of Taxes** from disclosed deposits (un-estimated)
- Current
  - Tax raids have **resulted in 4000 Cr** – needs investigation
  - **4 L Cr is expected to be suspect** (deposits over 80L) is being investigated
  - **Tax** collections **up by 14%** says FM.
  - **Digital transactions up**, great fillip being given
    - Impact yet to be assessed

# Outcome challenged ...

- Compression of economy
  - Some economists like Dr Kavita Rao, professor, NIPFP caution against optimism behind demonitisation outcomes:
    - Assuming Rs three lakh crore is extinguished, as is quoted in media reports, and assuming half of it is used for transactions, then the **GDP loss to the economy would be Rs 12 lakh crore**, since the GDP is about eight times the currency in circulation. This amounts to **about 8% of GDP**. This is without factoring in the effect of the compression in demand in the economy.
  - Continuing impact
    - While the initial impact is on account of currency being wiped out – resulting in compression and affecting nearly every sector, the **impact would continue depending on the speed** with which new currency (or alternatives) is infused / alternatives adopted.
  - Even if credit is generated, the question would be whether there is demand for such credit
    - The opinion here seems to be: at the present, not much. “Remember the demonetisation drive is happening in a year when there has been low credit offtake. If there is a compression in demand after demonetisation, there might not be any takers for credit. Even if banks want to give credit, they will have to push for risky assets.”

# Implementation & Learnings

- From what is observed as the aftermath, it does seem
  - Lack of planning for the scale and complexity required
  - Knee jerk
    - Flip flops
  - No clear communication
    - Everyone communicates
  - Lack of role clarity
  - Lack of understanding (or perhaps agreement) among key stakeholders on why this is being done
- **Learnings for Govt**
  - **Plan, plan, plan, plan, plan.....**
  - Discuss with experts, eg is secrecy really key?
  - Create enablers – policy/ies on taxation, infrastructure for sectoral reforms, education / awareness / specialised literacy, etc.
  - Depending on support of majority of such a huge and diverse population is very very risky.
  - Forbes wishes more attention to
    - Reach for the root of corruption: government's extensive presence in the economy as business owner, major employer, manager, and gatekeeper. This is what breeds and nurtures corruption and cronyism



# Learnings for others

- Industry
  - Go cashless, promote cashless
  - Increased Focus on accounting
  - Increased Focus on risk management
- Professionals
  - Increased consulting on **risk management** and accounting
    - **Compliance pays** in the long run
    - Focus on **internal efficiencies and increased competitiveness** rather than tax workarounds
  - Rockstar tax “planners” may see some decline
- Aam aadmi
  - Mattress is best used for a good nights sleep
  - Limit cash use

# Questions

- If the objective was to weed out dirty money and bring it into mainstream, **why the secrecy, alacrity and widespread chaos** and negative impact on economy even if short term?
  - People who want to convert are doing so even now, and IT is tracking them. This could have been done over a longer period of time too, and with more transparency (eg money printed etc.)
- **Will digital really take off within a shorter span?**  
Will daily wage earner get paid on an e-wallet and he spends for his *bidi* and *chai* to school fees and *kholi* / *barsaati* rent on the same e-wallet?
  - Do we have all the pre-requisites in place?
- Has the move **achieved, even** if **partially**, desired outcomes?
- With hindsight, **was there a better way of doing it**, if yes, will we ever admit it?

# So in summary..

- A **big, bold, unprecedented gamble?**
- Maybe, but...
  - Most of us are **still guessing**.....
  - Probably this was **inevitable**...
  - Lets remember, this is **just one** of a **series of steps required** to unearth black or unaccounted money / assets in and out of the country, and to curb corruption. The next steps would include structural reforms, electoral reforms, fiscal reforms, legislative reforms, and finally, social reforms, followed by implementation of a strong regime focused on control systems, monitoring, detection and identification, and prosecution of unlawful acts.
  - At some level, all economics and mathematics are beyond complex mathematical models – they are **subservient to public actions / reactions**
    - A **big +** for the government **is the collective positive** mindset of the **masses**
- **Political gains** – arguably - matter as much as **Economic gains**

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