

Demonetization of Currency Notes

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Narendra Modi went on national television at 8 p.m. on November 8 to announce that from midnight of that very date, i.e. in a mere four hours' time, 500 and 1000 rupee notes would cease to be legal-tender. The justification advanced for this bizarre move was that it would strike at "black money". An additional argument was thrown in, to the effect that fake currency notes used by "terrorists" would now cease to be effective; and some particularly enthusiastic supporters of the government even went to the extent of calling it a "surgical strike against terrorism".

I shall come to the fake currency issue later. Let me first look at the "black money" argument which even President Pranab Mukherjee has gone out of his way to endorse. This argument, namely that the demonetization of 500 and 1000 rupee notes constitutes an attack on "black money", is based on an utter lack of understanding of the nature of "black money", a conception of it that is staggering in its simple-mindedness.

The implicit understanding is that "black money" consists of hoards of cash which are held in trunks or pillowcases or buried under the earth. With this understanding, it is then suggested that if 500 and 1000 rupee notes are demonetized, then people going to banks to exchange large amounts of old notes for the new legal tender would make the banks suspicious; and banks in turn would convey their suspicions to the tax authorities who would then catch the culprits. "Black money" would thus get exposed, and this would discourage further transgressions in future.

Now, the second part of this argument, even assuming that "black money" actually consists of cash-hoards, makes little sense. If a person possesses, say, unaccounted money of Rs.20 crores, and that too in 500 and 1000 rupee notes, then such a person will certainly not come with the entire Rs.20 crores to a bank to change it into the new legal-tender (he will not be allowed to do so anyway); he would rather send several factotums to the bank, each carrying a small amount, and would do so over a number of days prior to the December 30 deadline. In fact even this prolonged effort would be unnecessary, since all sorts of intermediaries would come up fairly soon who would do this job of exchanging old notes for new ones on behalf of customers for a consideration. With such "black operators", exchanging "black money" from the old legal tender to the new legal tender, the idea, mooted by "experts" on several TV channels, that demonetizing 500 and 1000 rupee notes would unearth illegal cash-hoards makes little sense.

More importantly, however, this very conception of "black money" is absurd. Indeed the term "black money" itself is a misnomer, since it conjures up the image of a stock of money which is supposed to be held not openly, in the form of bank deposits, but clandestinely in the form of currency notes, and that too in pillowcases or in containers buried in the earth. Actually when we talk of "black money" we have in mind a whole set of activities which are either entirely illegal, such as smuggling, or drug-running, or procuring arms for terrorist organizations, or are undertaken in excess of what is legally permitted, or are not declared at all so that taxes are not paid on them. If 100 tonnes of minerals are extracted but only 80 tonnes are declared to be

extracted, in order to reduce tax payment, then we have a case of “black money” being generated. Likewise, if \$100 of exports are undertaken but only \$80 are declared, and the remainder \$20 are kept abroad in Swiss Banks, which is against the law, then we have a case of “black money” being generated. Or if rupees are changed into foreign exchange through the hawala route and kept as deposits abroad, then we have a case of “black money” being generated. In short, “black money” refers to a whole set of undeclared activities.

“Black money”, it follows, refers not to a stock but to a flow. “Black activities”, like “white activities”, are meant to earn profits for those engaged in them; and simply keeping a hoard of money earns no profits. What Marx had said about business activities also holds about “black activities”, namely that profits are earned not by hoarding money but by throwing it into circulation; the “miser” does the former, the capitalist the latter. And those engaged in “black activities” are capitalists not misers. Of course, in any business money is also held for a shorter or longer period (e.g. during the C-M-C circuit); but this is true as much for “white activities” as for “black activities”, so that the belief that the differentia specifica of “black money” is that it is held while “white money” is used for circulation, is completely without any basis. All money circulates, with occasional pauses when it is held, whether it is employed in “black activities” or “white activities”. The essence of unearthing “black money” lies therefore in tracking down “black activities”, not in attacking money-holdings per se. And this requires honest, systematic, and painstaking investigation.

Long before the days of computers, the British Internal Revenue Service had earned the reputation that it would eventually catch up with any tax defaulter simply through a process of grinding and meticulous investigation. True, Britain is a small country compared to India, but that only means that the size of the tax administering personnel has to be larger, tailored to the needs of the country; and if this is done, then unearthing “black money”, at least in the domestic economy, is merely a matter of patient and efficient tax administration.

A sizeable portion of “black activities”, however, is operated through banks located abroad; indeed some would say that this constitutes much the larger portion. Narendra Modi himself before his election had talked of “bringing back” the “black money” stashed abroad, suggesting that the bulk of “black money” was located abroad, even though his remark displayed the same naïve understanding that “black money” referred to a hoard rather than to a range of activities. But if foreign banks constitute the predominant source of funding “black activities”, then the demonetization of 500 and 1000 rupee notes, while causing much hardship to ordinary people, will do little to eliminate such activities.

This is not the first time that such demonetization of currency notes has occurred in India. In January 1946, the 1000 and 10000 rupee notes were demonetized; and in 1978 the Morarji Desai government had demonetized 1000, 5000 and 10000 rupee notes from the midnight of January 16. But even in 1978, let alone in 1946, this had caused no hardships for the ordinary people, since most of them had scarcely ever seen such a note, let alone possess one. (Even in 1978 Rs.1000 was a lot of money and common people hardly saw notes of 1000-rupee denomination). But that move of the Morarji Desai government, even though it did not impinge on common people, did not end the scourge of “black money” either. The Modi government’s move, while

equally ineffective in countering “black money”, has the added flaw of impinging severely on common people.

Some have argued that, whether or not the demonetization of 500 and 1000 rupee notes itself has the effect of countering “black money”, it represents a long-term move away from a cash-using economy, and amounts in that sense to a restraint on unaccounted activities that are typically not financed through recognized institutional channels. But quite apart from the fact that “black activities” financed through foreign banks will still escape detection in a cashless India, the very idea of a cashless India represents a pipedream of a segment of the elite, which is totally unaware of the difficulty that a common person faces in obtaining a credit card, or even opening a bank account (despite Modi’s loud boasts about expanding people’s bankability). The move towards a cashless economy, while not being realized, will simply become an additional means through which the common people will get squeezed.

But, what about the other argument that such demonetization acts against terrorism by preventing the circulation of fake currency notes printed “across the border”? This argument hinges crucially on the assumption that the technology employed in printing the new legal tender will prevent any possibility of faking it. Let us accept that assumption. Even so, the introduction of such new legal tender which cannot be faked, at the expense of the existing legal tender, could have been effected in a gradual and altogether unobtrusive manner, exactly as the introduction of new currency notes in lieu of the old ones is routinely effected. It is not as if the government was expecting an avalanche of fake notes on the night of November 8; why could it not have avoided the sudden, surprising, and massive attack on the security and convenience of the people that it launched on the night of November 8?

What the Modi government has done is unprecedented in the history of modern India. Even the colonial government had shown greater sensitivity to the convenience of the people than the Modi government has done by demonetizing only those notes which were possessed by the super-rich and not those possessed by the people at large. This “emergency measure”, however, is in line with the numerous other measures being currently pursued by the Modi government which has embarked on an undeclared “Emergency”: it is as fatuous as it is against the people.