

## **Demonetisation was Primarily a Political Act\***

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Two weeks into the surprise announcement of by Prime Minister Modi of the demonetisation of “high value” notes, it is becoming more evident by the day that the primary purpose was political rather than economic, and that this political purpose was specifically directed towards ensuring the fortunes of the ruling party vis-à-vis its rivals. Nothing else can explain the abrupt nature of the announcement or the subsequent manner of its implementation, which has been so apparently insensitive to the specific needs of so much of India’s working population. While a lot of the criticism of this scheme has focussed on implementation problems (which are indeed rife) in fact it is elements of design, including in the periodic revisions to the policy that are being made, that make this political motivation starkly clear.

One important political motivation was obviously to indicate that the Modi government is serious about its promise to end corruption – a claim that as coming under increasing scrutiny given the apparent unwillingness to make good on the many electoral promises like cracking down on illicit funds held abroad or going after tax evaders and wilful defaulters of bank loans. This extreme gesture creates a kind of smokescreen that prevents people from continuing to ask why that has not been done, even as it creates many distractions resulting from the need to cope with this drastic move. The analogy with a war that is constantly being made by the Prime Minister and others is also designed to do this, to make people participate in a sacrifice for “cleaning up” the nation.

That the suffering of the ordinary people is immense, there is now no doubt. Hundreds of millions of honest hardworking Indians have been caught in an unnecessary nightmare of economic turmoil and probably face severe economic depression in the coming months. The removal of liquidity has drastically affected India’s informal sector, which accounts for half of the GDP and more than 85 per cent of workers. It has devastated farmers who are facing the cash shortage at the end of a harvest season and now are denied the ability to purchase crucial inputs for the current rabi sowing season. Traders at all levels – from wholesalers to petty roadside vendors – are feeling the pinch and have faced losses in perishable stocks as well as difficulties in meeting payments for new stocks. The heavily cash-dependent road transport sector is very badly affected, which in turn is affecting the supply of basic necessities, especially in far-flung areas.

Workers who have been paid in cash (more than 90 per cent of all workers in India according to NCEUS estimates) have been forced to wait for payment, or accept payments in the cancelled notes. Many of those who are lucky enough to have bank accounts have found it difficult to take time off (full days off, really) and lose wages just to stand in queues at the banks to receive cash, while those paid in the new Rs 2000 denomination notes are finding it difficult to use them, as very few people are willing to provide change for these for relatively small purchases. Migrant and daily wage workers are not finding work and are denied the ability to translate their meagre cash holdings into necessary consumption. Housewives who had struggled to save small nest eggs in cash on their own are now being forced to reveal them, at risk of

losing control over these precious funds to husbands and other male family members who may not take their or children's requirements into consideration.

The negative multiplier effects of all these forces are also already evident, as the immediate effects of the cash crunch work their way into reduced consumption and therefore reduced demand, generating deflationary forces. Some observers are foolishly celebrating this as a decline in inflation, not realising that this is the outcome of contractionary economic processes, which may in any case be undone by the adverse effects on agricultural supply over the coming months.

The extraordinary thing is that none of these disastrous effects was necessary, even with the government's stated purpose of curbing corruption and reducing the spread of counterfeit money. The drastic demonetisation – at one stroke cancelling 86 per cent of the currency in circulation – could have been announced to be taking effect from a later date – say 30 December – thereby giving the population time to adjust. Meanwhile, in the intervening period the hoarders of black money who would be forced to offload their cash stocks could be identified by tracking suspicious transactions and bank entries, exactly as is being sought to do now. At the same time the government could try to ensure that enough currency notes would be printed and distributed in time to meet the continuing cash needs of the economy, especially the informal economy.

So why was this more reasonable and less damaging path not chosen? It appears that the need for secrecy was not really with respect to “black marketeers”, but vis-à-vis other political parties. The timing of the announcement would be unthinkable to anyone sensitive to farmers' needs because it is so terrible for agriculture as it comes right between a major harvesting season and a critical sowing season, when the need for and use of cash is probably the most intense of any time in the year. Yet it is a politically convenient time for the ruling party if the objective is to catch by surprise other political parties just before the important state elections in Punjab and Uttar Pradesh, which must be held before the end of March 2017. There have already been accusations that the BJP had some kinds of heads' up in this, while there has been a suspicious rise in bank deposits in the month of September, some of which is rumoured to be linked with accounts controlled by BJP members.

Similarly, the selective use of exemptions tells its own story. There have been some attempts to assuage middle class concerns, by exempting places like public hospitals and petrol pumps, allowing them to receive the cancelled notes. But obvious exemptions like agricultural co-operative credit societies or publicly run shops for inputs like seeds and fertilisers were not been allowed, despite entreaties by the Union Ministry of Agriculture and has only just been allowed after much public outcry. Why should this be the case? There is no rational argument for this – the only reason could be that these are controlled by state governments, and many of these (including in Uttar Pradesh) are controlled by non-BJP parties. Obviously, the central government controlled by the BJP does not trust them to ensure that rival party elements do not make use of this loophole – it wants to control the available loopholes through the central government.

One particular obscenity in terms of changed design is the recent reduction of the limit for exchange of demonetised cash notes from Rs 4500 to Rs 2000 per person, in

perpetuity! Ostensibly, this is because it was feared that those with large cash balances were using this method by employing others to exchange the old notes. But even one person employed, say, a hundred people to do this, they could have done this at most twice a day in most places, given the length of the queues, which meant at most Rs 450,000 per day – a relatively trivial amount in the context of the kind of illicit funds actually at large in the economy in different forms (such as property, gold and jewellery, benami accounts, stocks and shares held in the form of Participatory Notes, etc.). So the fear is not about individuals, but probably rather about other political parties, who might just be able to mobilise larger numbers of people to make such exchanges.

Meanwhile, because of this very severe limit, those who do not have bank accounts (still around two-thirds of the population) are effectively being denied access to their own small wealth held in the form of the old currency. Rs 2000 is too small an amount to provide more than a week's consumption even for a relatively poor household, so what are such people supposed to do after that? This is an abrogation of the basic contract embedded in the currency notes, of the promise to pay the bearer the stated sum. Quite apart from the questionable legality, this may also in the long run reduce faith in the currency and cause the public to shift to holding other assets like gold – a very problematic outcome for a developing country like India.

The Modi government's willingness to push for this political gain at the expense of the economy and the well-being of the mass of people is not just cynical: it is also a high-risk strategy that may just unravel.

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