

Demonetization (8th November 2016): It's Impact without any Prejudice

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Abstract

The RBI Act empowers the central government to demonetise any series of bank notes, but the government can take this decision only on the recommendation of the RBI (monetary authority of the country). The government and RBI in consultation took the decision to demonetise 86 percent of India's cash in circulation (500 and 1000 rupee bank notes) to tackle endemic corruption and counterfeits used by terrorist and other anti social groups. Parallel economy could be named as black, unaccounted, illegal, unsanctioned economy and its impact are loss of revenue to the state exchequer, consumption of non essential items, investments in unproductive channels like jewellery, bullion, real estate, luxury housing and transfer of funds from India through violation of foreign exchange rules and regulations is an outcome of corruption. The main objective of this paper is to examine the impact of recent demonetisation on the nation's economy through the analysis of secondary data. Normalcy has returned to the currency system post demonetisation on the pace of cash withdrawals has come down. The success of demonetisation is not known to the monetary authority of the country, but it claims that the move of demonetisation was well planned.

Keywords: Sectoral cleanup, wider tax net, Stemming Illicit outflows, Cashless society, Curb Counterfeiting.

Introduction

There are two schools of thought – one given by the Classical Economist and Father of Economics in his masterpiece contribution 'Wealth of Nations' published in the year 1776 – there should be no intervention of any kind by the government in the economic affairs of an economy for its smooth functioning. There was an automatic system of built in flexibility to maintain the equilibrium at the point of full employment in the economy. The basic objective was wealth, more wealth and still more wealth (maximization of wealth). As a result, the working hours of labour were raised without a corresponding increase in their wages, the logic behind the idea was that if workers were paid above the subsistence level, they would multiply and ultimately their wages would be settled at the subsistence level. Under this system, all the resources of the economy are owned, directed, and managed by the private enterprises in order to maximise their profits. Market functioning is based on price mechanism and all economic decisions are taken in accordance with the price mechanism. Private property and law of inheritance are the two key features of this system. However, this system leads to the inequalities in the distribution of economic power because of exploitation of labour in the hands of capitalists. A surplus is generated by the labour and it is appropriated by the capitalists. Society is divided into two groups: haves and have-nots. Trade unions are the product of the system leading to industrial revolution.

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Socialistic system is an outcome of the consequences of the capitalistic mode of system. Under this system all the resources of the economy are owned, directed, and managed by the government under the guidance of the plan authority. The government for the maximization of social welfare of the society takes all the economic decisions. Private property and law of inheritance both are missing in this system. The system does not operate on the basis of price mechanism, there are controls and regulations. Resources are channelized in different directions under the guidance of a public authority as per the priorities set under the plan. Both the systems have their own merits and demerits.

After the dawn of independence in the year 1947, the basic problem was the rehabilitation of refugees and breaking the vicious circle of poverty in order to put the economy on the road leading to growth and development. In 1948, Dr. SP Mukerjee (the then Industrial Minister) gave a model of mixed economy that is co existence of both private and public sectors under a common economic plan. The idea was to gain the merits of both the systems of capitalistic as well as socialistic models. With the success story of economic planning in USSR, India also moved on the path of programme of development by launching a series of five year plans and the objectives were to establish a socialistic pattern of society, removal of disparities of income and wealth, eradication of poverty and unemployment, maximization of social welfare and social security to the most disadvantageous section of the society and the most backward regions/areas. Social and economic overheads were created in the public sector in order to motivate direct productive activities. Private sector was neither willing nor capable to carry out the basic infrastructural facilities because of the requirements of huge amount of capital and a sophisticated technology and above all a long gestation period of such projects.

As a result, public sector gained the commanding height in the economy without proving accountability and transparency in the system. The magnitude of black sector in the form of a parallel economy developed with the objectives entirely different from the social and economic objectives. With the expansion of economic activities, magnitude of black sector has grown and it has become a source of power and prestige linked with conspicuous consumption.

Literature Review

“The conspicuous consumption of new black rich, their vulgar display of pomp and opulence, their unlimited accessibility to finance, their nest eggs in various places and countries, their influence in important places, all these are new common knowledge”.¹ To understand the impact of black economy, it is essential to have an estimate of black income over a period of time. Several attempts have been made to quantify black incomes in India based on two approaches:

- Kaldor’s approach of quantifying non salary incomes above the exemption limit of income tax and
- Edgar L. Feige method of working out transaction income on the basis of currency deposit ratio and from it deriving the black income of the economy

(i) Kaldor’s Estimate: N. Kaldor in his report on Indian Tax Reform estimated the non-salary income based on the breakup of national income into (a) wages (b) income of self-employed (c) profit, interest, rent etc.

= Compensation of Employees + Mixed Income + Operating Surplus

= Income from Work + Mixed Income + Income from Property and Entrepreneurship

Non salary income = NDP – Income from Work

The difference between the estimated non-salary income above the exemption limit and the actual non-salary income assessed to measures the size of black income.

(ii) Wanchoo Committee’s Estimate: Direct taxes enquiry committee (Wanchoo committee) followed the method adopted by Kaldor with suitable modification. According to Wanchoo committee estimated income on which tax have been evaded would probably Rs. 700 crore and Rs. 1000 crore for the years 1961-62 and 1965-66 respectively. Projecting this estimate future to 1968-69 on the basis of percentage increase in national income from 1961-62 to 1968-69, the income on which tax was evaded for 1968-69 can be estimated at a figure of Rs. 1800 crore.

(iii) Rangnekar’s Estimate: Dr. DK Rangnekar as member of Wanchoo committee, in his minute of dissent considers the estimate made by the Wanchoo committee as under estimates. The projection of black money for 1968-69 and 1969-

70 were Rs. 2833 crore and Rs. 3080 crore respectively. The compound rate of growth of black income was of the order of 13 percent per annum at current prices, where the compound rate of growth of national income for the same period was 11 percent per annum.

(iv) Chopra's Estimate: The crucial finding of Chopra's study is that after 1973-74, the ratio of unaccounted income to assessable non-salary has gone up, whereas the Wanchoo committee assumed this ratio to be constant. Consequently, after 1973-74, there is wide divergence between the estimates of Wanchoo committee and those of O.P Chopra.

(v) Gupta's study of black income using Feige's method of Transaction-Income ratio:

Poonam Gupta and Sanjeev Gupta have raised some fundamental objections regarding Kaldor's methodology used in estimating black income in India. Since the income generated in the illegal economy is not reported for the calculation of official GNP, the estimate of GNP, which are used as a basis for estimation of black economy are serious under estimates. Gupta made use of Feige method of estimating the magnitude and growth of the black market. Feige assumed that the ratio of total transactions to total income was relatively stable. According to this study, the absolute size of the black income in India increased from Rs. 3034 crore in 1967-68 to Rs. 46867 crore in 1978-79 that is by more than 15 times. The relative share of the black economy was 9.5 percent of GNP in 1967-68 but it has jumped to nearly 49 percent by 1978-79. The study further indicates that 1 percent increase in overall taxes leads to more than 3 percent increase in the black income relative to official economy.

(vi) NIPFP study on black economy in India:

National Institute of Public Finance and Policy conducted a study under the direction of Dr. S Acharya, formerly of the World Bank; Dr. Raja Chelliah was the overall supervisor of the study. The study defines black income as aggregate of incomes, which are taxable but are not reported to tax authorities. It is the extent to which estimates of national income and output are biased downwards because of deliberate false reporting of incomes, output and transactions for tax evasion, flouting of other economic controls and relative motives. NIPFP study concludes "A total black income generation of Rs. 36786 crore or in round number Rs. 37000 crore out of total GDP at factor cost of Rs. 173420 crore seems to be on high side, although it turn out to be less than 30 percent of

GDP as against some extravagant estimates placing it at 50 or even 100 percent of GDP".

(vii) Suraj B. Gupta study of black income:

Dr. Suraj B. Gupta made a guess estimate of black income for three selected years 1980-81, 1983-84, and 1987-88. The estimate reveals that black income was around Rs. 51000 crore in 1980-81 and it shot up to Rs. 85000 crore in 1983-84 and further skyrocketed to Rs. 149297 crore in 1987-88. It would be desirable to calculate black income as proportion of GDP of the non-agricultural sector, since there is no scope for generation of black income in the agricultural sector. The general growth rate of annual black income was somewhat higher than the annual growth rate of real GDP.

(viii) Arun Kumar (Understanding the black economy and black money in India, Aleph Book Company):

The black money in the form of cash was only about 1 percent of the black wealth held in the country and as per official estimates only 3.5 percent of the black income generated in 2016. Not only do a vast majority of Indians, rich and poor, use cash and not credit cards for making daily financial transactions but also businesses need it for working capital to buy raw materials, pay wages and other requirements for production and sales. According to research in 2015, only 22% of adults in India have access to internet. This means vast majority, who do not have access..., will be unable to use banking. Only 17% of Indian has access to mobile phone banking. In a population of 1.3 billion, there are 24.5 million credit cards and 661.8 million debit cards. A large number of Indians do not have access to credit or debit cards. Most small business does not have card readers so cashless economy cannot become a reality overnight. 80 percent of the Rs.500 and Rs.1000 notes was white money used by businesses and citizens.

The creation of a parallel economy as a consequence of the growing proliferation of black money in every sector of economy has been very serious and in number of ways pernicious influences on the working of the Indian economy. The impact of black income could be seen with loss of revenue, consumption of non-essential articles, investment in jewellery and luxury housing, black liquidity and the transfer of funds from India through tax heavens.

It is the parallel economy, which does the backseat driving, while the political leadership acts as the mouthpiece of big business to justify the abolition of controls or introduction of a dual system of

prices in the name of productivity or national interests. It was due to the pernicious impact of black money on Indian economy and polity that the Wanchoo committee concluded, "It is therefore no exaggeration to say that black money is like a cancerous growth in the country's economy, which if not checked in time, is sure to lead to its ruination".²

Objectives

The main objectives of this paper are as follows:

1. To examine the meaning of demonetisation as a measure to curb black money
2. To examine the history of Indian Economy (post independence) in relation to step of demonetisation
3. To examine the impact on the national economy and recent demonetisation dated 8.11.2016
4. To analyse the management aspect of demonetisation

Research Methodology

This paper is based on secondary data taken from authentic and standard sources like various issues of Economic surveys, research papers published in standard national and international journals of report, daily newspapers and reports like direct taxation enquiry committee etc. simple statistical tools have been applied for the analysis of different objectives.

Main Theme

Corruption appears as a factor reflecting deviation from the avowed objectives of the state. According to Rose Ackerman "institution designed to govern the inter-relationships between the citizens and the state are used instead for personal enrichment and the provision of benefits to the corrupt".³

Corruption raises the cost of development; it breeds inefficiency in departments to produce inferior quality goods. Corruption creates black or parallel economy and thus a vicious circle. It is virtually important that corruption should be eliminated or considerably reduced, so that the phenomenon of black economy does not destroy the vitals of the society.

In 2014, the Lok Sabha election was fought mainly on the issue of corruption and development. After coal, 2G Spectrum, common wealth games exposed by CAG and other agencies, the people of India voted for the new government. Under the

stewardship of Prime Minister Narendra Modi, who promised that black money slashed abroad, would be bought back within 100 days of coming to power, but this did not happen due to a number of reasons. If a survey is made for the measures undertaken to unearth black incomes since independence, the principal measures were:

- To check tax evasion (based on the recommendation of various committees and commissions set up by the government in different years)
- Voluntary Disclosure Schemes floated by the government (for converting black money into white on payment of what turned out to be in most cases, a small amount of conscience money)
- Special Bearer Bond Scheme (such efforts as the bearer bond scheme to tackle the problem are only half hearted measures)
- Demonetisation (RBI Act empowers the central government to demonetise any series of bank notes.

However, the government cannot take this decision on its own. The RBI needs to recommend it first. The law provides for a 21 member board including 14 non-official members, but the bank has been operating with less than half the prescribed strength. There are 10 board members at present on the board of RBI).

The basic philosophy of demonetisation is based on the assumption that all black incomes are held in cash, but that is only a small part of the total black incomes, which is held in liquid form. In 1946, demonetisation was resorted to but the direct tax enquiry committee admitted, "Demonetisation was not successful then, because only a very small proportion of total notes in circulation was demonetised (that is 11 percent)". Another demonetisation was attempted in 1978 of high demonetisation notes (Rs. 1000, Rs. 5000 and Rs. 10000 notes) and these notes as on that aggregated to Rs. 146 crore. Notes tendered to RBI amounted to Rs. 125 crore as per data available until August 1981. Demonetisation thus again failed because it could not make a dent on unearthing black money.

Indian economy and its tax base have long been hobbled by a parallel economy running on cash hoarded by people avoiding paying taxes. Use of illicit money is so prevalent that raids on dishonest politicians and businesses regularly turn up people holding crore of rupees in cash, sometimes stashed away in false ceilings and walls. Much of the illicit

money in India is believed to be used in real estate purchases, which make up more than 6 percent of India's 2.3 trillion dollar economy. According to Mumbai based consultants, it has been estimated that 30 percent of these transactions are done with untaxed funds or black money. Successive governments have struggled with under reporting of taxes, seen as a major hurdle in expanding state revenues, as well as growing undisclosed incomes to avoid taxation. A substantial amount of black money is secreted away to account overseas. Moreover, fake bank notes have been a major concern for India, because 250 of every one million bank notes in circulation were fake. The government in consultation process with RBI, as per rules, took a decision on 8th November 2016 to demonetise 86 percent of India's cash circulation

(Rs. 14.2 trillion in currency notes of Rs. 500 and Rs. 1000 was in circulation as on 31st March 2016, according to RBI data).

There are divergent estimates about the black money stashed abroad; some place it is at 10 percent of GDP, some others say that it is equal to 100 percent of GDP (nearly 2 trillion US dollar). CBI places this figure at \$ 500 billion; the US based global financial integrity estimates this to be \$ 440 billion. BJP made the estimates if all that black money stashed returns, and then all Indian would get 15 lakh each.⁴ (That was dubbed to be merely an electoral phrase). Some person blames the rate of taxation for the exponential growth of black money. However, the table given below does not prove this fact.

Table 1: Maximum Marginal Rate of Personal Income Tax-1994

Country	Percent	Country	Percent
India	30.0*	China	45.0
Denmark	65.0	South Korea	45.0
France	56.8	UK	40.0
Germany	53.0	Indonesia	35.0
Sweden	50.0	Brazil	35.0
Japan	50.0	Mexico	30.0
Egypt	48.0	Russia	30.0
USA	47.5	Singapore	30.0

*For 1997-98 onwards

Source: Tata services Ltd., Statistical outlines of India (1996-97)

If we examine the measures (other than demonetisation), taken so far reveals that the government has miserably failed to tackle the problem created by black money. That is why this move of demonetization was a welcome step to eradicate the evil of parallel economy. The ban will help to choke the flow of counterfeit high value bank notes militant groups use to fund their attacks against the country enemies from across the border have run their operations using fake currency notes. The government on 19.12.2016 allowed the use of junked Rs. 500 and Rs. 1000 currency notes until Dec. 30, 2016 for paying tax on disclosures made under the tax evasion amnesty scheme. A holder of unaccounted cash in Rs. 500/1000 notes could deposit half of it (50 percent) in any of the 29

scheduled bank can accept income tax. A quarter of the amount (25 percent) could be deposited in cash in the non-interest rate bearing PMDK Deposit scheme 2016. The remaining 25 percent could be deposited in individual account.

Facts to be Highlighted

1. Total Value of currency notes in circulation in March 2016 = Rs. 16,415 billion

$$= (47.8\% \text{ of Rs. } 500 + 38.6\% \text{ of Rs. } 1000 + 9.6\% \text{ of Rs. } 100 + 1.2\% \text{ of Rs. } 50 + 0.6\% \text{ of Rs. } 20 + 1.9\% \text{ of Rs. } 10 + 0.3\% \text{ of Rs. } 2 \text{ and } 5) = 86.4\% (\text{Rs. } 500 + \text{Rs. } 1000) + \text{Rs. } 218 \text{ billion value of coins in circulation in March 2016}$$

Source: Daily HT 10.11.2016, P-8

2. Black Money Hardly Liquid

Table 2: Black Money Hardly Liquid (All figures in Rs. Crore)

Year	Total Hidden Wealth Seized	Cash Component in hidden wealth	Cash component in percentage
2012-13	10291	465	5
2013-14	10791	607	6
2014-15	10288	586	6
2015-16	11066	532	5
2016-17(31.10.2016)	7700	408	5

Source: Daily HT 12.11.2016, p-6

3. Cash is still king in India

Table 3: Cashless Around the Globe

Name of the Country	Percentage (cashless transactions)
Singapore	61
Netherlands	60
France	59
Sweden	59
Canada	57
Belgium	56
UK	52
USA	45
Australia	35
South Korea	29
Spain	16
Brazil	15
Japan	14
China	10
India	02

Source: Master Card Advisors

4. Report Card

- ✓ 86% of currency was sucked out of circulation by note ban
- ✓ 104 deaths (linked to demonetisation)
- ✓ 60 order related to demonetisation had been issued by 19 December, 2016
- ✓ Rs. 14.2 trillion currency notes of demonetisation of Rs. 500 and Rs 1000 as on 31 March, 2016
- ✓ Rs. 12.4 trillion is the amount banks had received since demonetisation as deposit till 10 December, 2016 (about 87% returned)

Source: Daily HT 26 December, 2016 p-13

Impact of Demonetisation (8.11.2016):

(i) Growth and Employment: Milton Friedman, the great Chicago economist, argued that the great depression happened because of shortage of money. Milton had a strong faith in free markets but he did not believe that a market economy could function, when there is an acute shortage of money. One man's expenditure is other's income and so on the process goes on. There is a cascading effect on transactions, with the result that GDP shrinks by much more than the original short fall in liquidity. Economists often head where angels fear

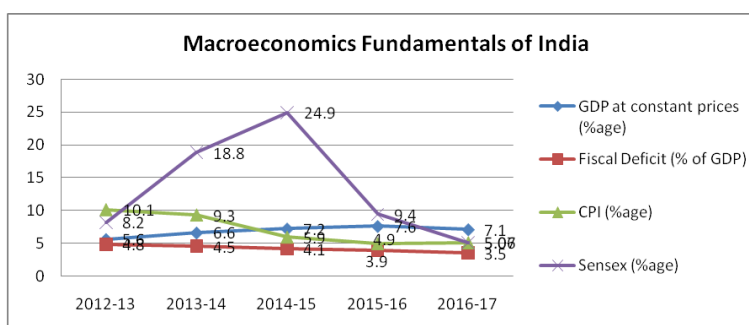
to tread to quantify the unquantifiable and put out a precise number that a 1-2 percentage point decline is likely in the growth rate due to demonetisation. If the economy has been expanding by 7.1%, the prospect is for it to slow down to 6.1% or worse to 5.1%. 2 percent cashless economy cannot be built up as a 50 percent cashless economy in short period. As a result:

Cash Crunch in an economy \Rightarrow Aggregate Demand $\downarrow \Rightarrow$ Investment $\downarrow \Rightarrow$ Employment Volume $\downarrow \Rightarrow$ Income and Output $\downarrow \Rightarrow$ Growth Rate \downarrow

Table 4: Macroeconomics Fundamentals of India

Year	GDP at Constant Prices (%age)	Fiscal Deficit (% of GDP)	CPI (% age)	Sensex (% age)
2012-13	5.6	4.8	10.1	8.2
2013-14	6.6	4.5	9.3	18.8
2014-15	7.2	4.1	5.9	24.9
2015-16	7.6	3.9	4.9	9.4
2016-17	7.1	3.5	5.06	5.07
(Estimates)	(RBF)	(Budget Estimates)	(April-Nov. 2016)	(till 30.12.2016)

Source: Daily HT, 31.12.2016, p-19 (The year in Review)



Analyst polled by Reuters had expected a 6.4% growth rate in the quarter to Dec. 2016. The pace of growth did, however slow from 7.4% logged in the second quarter of the fiscal year. The Centre Statistics Office (CSO) retained its projection that the economy will grow 7.1% in 2016-17 slowing down from 7.6% in the previous financial year. On 1.2.2017, CSO revised the 2015-16 GDP growth number to 7.9 percent from 7.6 percent estimated earlier except construction (2.7%) and financial & real estate (3.1%) sectors, all other sectors grew at a faster pace in the third quarter compared with the preceding quarter. The first and second quarter GDP growth estimates were also revised upward by 10 basis points to 7.2% and 7.4% respectively. Private final consumption picked up in the third quarter to grow 10.1% against 5.1% in the second quarter. Manufacturing was expected

to be hit due to falling consumption demand; it grew 8.3% in Q3 against 6.9% in Q2.

India's factory output as measured by the index of industrial production rose 2.7% in Jan. 2017, apparently shrugging off the impact of demonetisation. Data released by CSO showed that in Jan. 2017, mining, manufacturing, and electricity output increased at the rate of 5.3%, 2.3%, and 3.9% respectively. Capital good production, a key indicator of investment demand in the economy also rebounded, growing by 10.7% in the month of Jan. 2017. Consumer demand is yet to be picked up, consumer goods production contracted by 1% mainly because of a sharp fall in consumer non-durable goods production. However, the impact of demonetisation is not fully captured, as IIP numbers do not factor in unorganised sector data India's economy 7% in the third quarter⁵.

World Bank CEO, Kristalina Georgieva, “To ban high value bank notes as part of efforts to stamp out corruption will have a profound and positive impact on India’s economy. Demonetisation may have caused some hardship to people living in the cash economy but in long run the move will help to foster clean and digitalised economy.”⁶

Today, India stands before a unique moment in history. It could choose to squander its immense potential with its antiquated socio-political system,

heritage, democratic values, and a young demography to transform the lives of its 1.3 billion citizens. According to a study made by Pricewaterhouse coopers, “It will have to create jobs on a scale that can absorb 10-12 million people, who join the workforce every year, including members of the emerging middle class- a billion strong by 2034. Only 1,35,000 jobs were created in 2015, the lowest in seven years and 67% lower than the number created in the last year of the UPA government.

Table 5: Volume of New Jobs

Year	New Jobs Creation
2009	12,80,000
2010	8,70,000
2011	9,29,000
2012	3,21,000
2013	4,19,000
2014	4,21,000
2015	1,35,000

In one quarter of 2016-17, for which official data is available 77,000 jobs were created, of which 50,000 were government jobs. In 2016, the employment survey methodology was changed, expanding it to all the states, unemployment rate as of Feb. 3, 2017 was 6% (+1% higher in respect to base Sept. Dec 2015). However, demonetisation has adversely affected the unorganised sector and casual daily wage labour. Negative perception about employment is the highest since Modi government took over. Data on rural wages, released by RBF, shows that non-agricultural wages have done much worse in comparison to agriculture wages in the month of Nov. and Dec. 2016.⁷

(ii) Medical Tourists: Demonetisation of high value currency notes has added to the problems of several foreign nationals, who are in India for medical treatment. They were facing in difficulties in getting exchange for foreign currency and paying hospital, food and accommodation bills. India has become a hub of medical tourists because of the factors namely: 1. Cost is a major driver for nearly 80% of medical tourists across the globe 2. Availability of accredited medical facilities 3. Among medical tourism corridors of Singapore, Thailand, Malaysia, Taiwan, etc. India has the second largest number of accredited facilities and 4. Chennai, Mumbai, Andhra Pradesh and Delhi NCR are the most favoured medical tourism destinations. The medical tourism industry in India is valued at USD 2 billion in 2015, with India

issuing 1.3 lakh medical visas that year. Africa account for more than half the overseas patients (51.1%) followed by Asia and the Pacific (22.5%) and the America (15.7%), shows- Ministry of tourism data. This problem was an outcome of the immediate effect of demonetisation.

(iii) Farmer’s Plight and Farmers Loan Waiver: In chasing higher and higher GDP growth rates, India tends to gloss over two facts (farm growth cut poverty twice as fast as industrial growth and a one percent rise in agricultural output raises industrial production by 0.5% and national income by 0.7%.in other words, the country’s fortunes are structurally tied to its farmers. Two-third of Indians relies on a farm-based income. Policy makers celebrated the green revolution for too long without realising it had run its course. Delinking farms and rains still remains a challenge. The rate of investment in agriculture in the 80s and 90s was between 8-12 % with such a low spending in agriculture, farm growth hobbled at 2.4 % or so. Even today, irrigated lands make up only 40% of the country’s arable land, making 60% of the net sown area vulnerable to monsoon failure. Therefore, area cannot be expanded but only way to go to raise productivity. Input subsidies cannot help as per our expectations.

Investment → ↓ Rate of Growth ↓ farm incomes ↓
(farmers are disillusioned to abandon farming → where do they go

Share of agriculture in GDP (percent points) has gone down from 38.6% in 1972-73 to about 14% in 2012-13 and then marginally up to 17% in 2015-16. There is a leakage between GDP growth rate and change in the sales of passenger vehicles, two

wheelers, TV sets, and refrigerators (consumer durables). Farm investment has now reached 20% or so of the GDP but most of it comes from the private sector. Experts recommend that public investment must also go up.

Table 6: Trends in Agricultural Growth Rate

Year	Growth Rate (%age points)
2012-13	1.5
2013-14	4.2
2014-15	-0.2
2015-16	1.2
2016-17	4.1 (Year after demonetisation but of good monsoon after two consecutive droughts)

A UN report said one farmer commit suicide every 32 minutes between 1997 to 2005. So far, the centre has waived farm loans twice in 1990 and 2008. Under the agriculture debt waiver and debt relief scheme of 2008, the government waived entire loan to marginal and small farmers (up to 2 hectares land holding) and offered one time relief of 25% to other farmers. A 2015 International

Council for Research and International Economics Relations (ICRIER) paper says that massive write off loans in 2008 took its toll on the banks; increasing the non-performing assets of commercial banks, three fold between 2009-10 and 2012-13. Despite government efforts to increase institutional lending in rural areas, many still borrow from moneylenders.

Table 7: Proportion of Sources of Lending in Rural Areas

Year	Institutional Source (% age)	Non-Institutional Source (% age)
1951	7.2	92.8
1961	14.8	85.2
1971	29.2	70.8
1981	61.2	38.8
1991	64.0	36.0
2002	57.1	42.9
2013	56.0	44.0

Source: NSSO, Quoted from Daily HT (28.12.2016), p-19

According to ICRIER, generalised loan waivers should be avoided as these impair the agricultural credit channels.

(iv) Connection between high cash economy and corruption: Cash in circulation in an economy has little correlation with corruption, a comparative analysis of World Bank and transparency international data suggests, deepening suspicious that those with black money prefer to keep their ill-gotten wealth in other forms of assets. While figures show that India holds 11.8% of its

economy is ranked a poor 76th in the global corruption ranking. Germany, at the 9th in the graft ranking, has a 8.7% cash economy. Hindustan times analysed the cash in circulation and GDP of 26 countries- 12 top economies barring the US and China, 12 very corrupt countries with stable government and three mid-sized economies with varying corruption ranks. Table given below clearly establishes that there is no correlation between cash in circulation as a portion of its GDP with corruption.

Table 8: Cash in Circulation as a Portion of its GDP with Corruption

Country	GDP (in trillion dollar)	Currency in circulation (in billion dollar)	Currency in ratio to the GDP (%age)	Corruption Ranking
Japan	4.12	852	20.7	18
Germany	3.36	293	8.7	10
France	2.42	227	9.4	23
India	2.07	245	11.8	76
Italy	1.18	199	10.9	61
Brazil	1.77	68	3.8	76
Canada	1.55	59	3.8	9
Korea	1.38	77	5.6	37
Australia	1.34	54	4.0	13
Russia	1.33	139	10.5	119

The analysis of data showed up: Russia, the world's 13 largest economy and Spain, the 14th largest, shared the same proportion of cash economy. Yet, Russia is ranked 119 on the corruption index while Spain is also cleaner at 36.

(v) Tax Evasion, undisclosed income to see a decline: Demonetisation appears to have provided the impetus for the expansion of formal economy and has laid the groundwork for a corruption free India by giving authorities an insight into the income of taxpayers and the source of their earnings. Direct tax collection soared from 6% in 2015-16 to 15% this year and is expected to rise further primarily due to the government's crackdown on black money. Demonetisation is also an exercise on the part of the government to eliminate corruption, black money, counterfeit currency, and terror funding. While securing bank notes against counterfeiting was cited as the objective of the withdrawal of 17,165 million pieces of Rs 1000 notes- valued at Rs. 15.44 lakh crore, there was no official estimate of fake note in circulation. However, a study

conducted by Indian Statistical Institute, Kolkata, on statistical estimation of counterfeit notes indicated that FICN in circulation was approximately Rs. 400 crore and around Rs. 70 crore was been pumped into the system annually⁸.

The cash to GDP ratio in India is 12.2%, while in most developed and developing economies it remained between 2 to 5 %. Demonetisation has also given huge push to digital money and thrust towards a cashless economy and the thrust is now on transparency, so many people will now come under the income tax net.

Black money worth Rs. 14697.24 crore has been unearthed in the April to Feb. period of 2016-17 against Rs. 11,226 crore during the entire financial year of 2015-16. During the two months of demonetisation from Nov. 2016 to Jan. 2017, the government unearthed unaccounted cash worth Rs. 513 crore, of this Rs. 110 was in new currency. The direct tax collection has jumped from 6% in 2015-16 to 15% this year entirely on account of action against black money.

Table 9: Heightened Tax Vigil

Year	Total Undisclosed Income Admitted (Rs. Crore)	No. of Entities Raided
2012-13	10291.61	422
2013-14	10768.55	568
2014-15	10228.05	545
2015-16	11226.02	447
2016-17	14697.24	1037

Source: Daily HT, 20.03.2017, p-9

(vi) Tax collection and government’s expectations: Direct tax collections are likely to fall short of budget target in 2016-17 with the government managing to garner only 73% of the estimated collections in Feb. 2017. Data released by the finance ministry show that direct tax collections in April-Feb. 2017 amounted to Rs. 6.17 lakh crore, a 10.7% rise from a year ago. After adjusting refunds corporate tax collections grew only 2.6% while personal income tax collections were up 19.5%. Indirect tax collections until Feb. amounted to Rs. 7.72 lakh crore, a 22% rise from the year ago period.⁹

Management of the Impact of Demonetisation

The Economic survey 2016-17, acknowledged that demonetisation had influenced the economy in short run and caused inconvenience, especially to those in the informal and cash intensive sectors of the economy, which have lost income and employment. The long term benefits of reduced corruption, greater digitalisation of the economy, increased flow of financial savings and greater formalisation of the economy, this could eventually lead to higher GDP growth, better tax compliance and greater tax revenue.

But the gross non performing asset level – loans that have turned unproductive – increased to Rs. 6.3 lakh crore as on 30.9.2016 from Rs. 5.5 lakh crore as on 30.06.2016 that is an increase of Rs. 79977 crore only in quarter. This issue is a very serious issue and has to be addressed at the earliest. That is why the government is going to inject an additional Rs. 8000 crore into the cash starved public sector banks by the end of 2016-17, this is in addition to the prescribed recapitalisation amount of Rs. 25000 crore for the current financial year. New currency notes of Rs. 12 lakh have been pumped into the system since 9.11.2016 (the date of demonetisation)¹⁰. There may not be a proportional relationship between supply of money and credit money with the prices and other related variables. But these are to be managed in coordination with the monetary and fiscal authorities of the economy in an effective manner.

Despite the criticisms, quantity theory of money has its own merits. Quantity theory of money has not lost its validity in modern times, however, its assumptions may not hold good.

$$P' = \frac{MV + M 'V'}{T}$$

or $PT = MV + M 'V'$

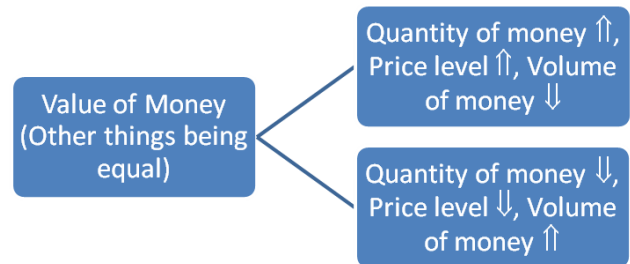
M – Quantity of Money, supplied by the government / central bank

V – Velocity (no. of transactions made by a unit of money M)

M’ – Credit Money and V’ is its velocity

T – Total volume of Trade and

P – General price level



Value of Money = Purchasing power = The no. of goods and services which can be bought by a unit of money and naturally there is an inverse relationship between general price level and value of money.

Conclusion

Many social disadvantages are associated with the use of money, because it has been responsible for large-scale corruption in modern societies. The possessor of wealth and money has certain disadvantages, which others do not have. Excessive cash boosts parallel economy and that is why it must be curbed. Demonetisation move was primarily aimed at weeding out the ills of society. Finance Minister Arun Jaitley said in the Rajya Sabha “It is no credit to any economy that you deal in cash.....cash has a lot of vices.” Counterfeiting and to curb black money were cited as the two main objectives of withdrawal of 17,165 million pieces of Rs 500 of 6,858 million pieces of Rs. 1000 notes- valued Rs 15.44 lakh crore. Demonetisation was planned, the decision was not taken in a day. According to RBI governor, “the government may be best to reply whether demonetisation would curtail black money’.¹¹ Von Mises, the German Economist remarked, “Money is regarded as the cause of theft and murder, of deception and betrayal. Money is blamed when the prostitute sells her body and when a bribed judge perverts the law”.¹² A study of economic history of the last century furnishes ample evidence to show that money does go wild and at times causes untold suffering. Thus, “money, which is a

source of so many blessings to mankind, becomes, also, unless we can control it, a source of peril and confusion".¹³ Some people manage to drink from many fountains while others go thirsty because they do not know where to look. The management aspect depends upon good governance, because the impact could be a mixed bag of pains and gains. However, let the pains be temporary and gains to be permanent.

Endnotes

1. DK Rangnekar. Minute of Dissent in Direct Taxes Enquiry Committee. Final Report, Dec. 1971. p. 249
2. Direct taxes enquiry committee, Final Report, December 1971, p. 9
3. Rock Rose Ackerman (1999) Corruption and Government: Causes, consequences and reforms, p-9
4. Dutt & sundharam. (2016). Indian Economy. p-443. S. Chand & co., New Delhi
5. Daily HT, 11 March, 2017, p-21
6. An interview given in Hindustan Times on 01.03.2017, published in Daily HT on 03.03.2017
7. Daily HT, 16, Feb. 2017, p-12
8. Daily HT, 25th April, 2017, p-6
9. Daily HT, 11 March, 2017, p-21
10. Daily Hindustan Times, 11.3.2017, p-11
11. Daily HT, 26th April 2017, p-6
12. Von Mises. The Theory of Money and Credit, p-93
13. Robertson, D.H. Money. p 15-16 (1932ed.)

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