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BUSINESS

Demonetisation was good policy decision but it is not adequate to flush out black money from system

Unless preventive measures are taken to stop further generation of black money, demonetisation dose may have to be repeated once in a decade. But the economy and poor people, certainly, are not in a position to bear the pain again

Jagadish Shettigar | November 07, 2017 09:54:08 IST



Having seen how demonetisation impacted the economy during the last one year, it is time to introspect whether it has served the objective behind the move. This out-of-the-box initiative by the Narendra Modi government has been severely attacked by some people, including economic experts from the left and right. Criticism by political opponents is understandable, more so in a country like India where democracy is yet to see a matured mind-set. Similarly, criticism of demonetisation by leftist economists can be brushed way - though ideally they should have extended support to a measure meant to unearth black

money.

What is baffling is criticism by someone who claims to be an expert in black money having tried to sensitise the issue through publication of a book on black money decades ago. Surprisingly, a couple of reform-inclined economists operating at international levels and whose emotional links with India is limited to invitation from the government to take up certain assignments also attacked the move. Like any other consultant, they too return to their foreign employer the moment opportunity ceases with change in the government in India. A couple of them still continue to attack the demonetisation move without putting across any economic logic. So much for the intellectual integrity of these economists.

Often the critics ask whether the authorities have been able to identify black money as 99 percent of the demonetised currency has come back to the banking system. These people argue as if the entire money deposited in bank accounts is white money. No one suspects their intellectual calibre to understand the meaning of black money. One can dismiss ignorance of semi-illiterate people who often confuse black money for counterfeit currency.

Black money is simply that part of income which is not declared for taxation. The fact is if almost entire demonetised currency had returned to the banking system, it would have made the job of income tax (IT) department easy. Now it is for the IT department to probe where money was deposited in the banks during 8 November to 31 December 2016; and what part of it constitutes black money. Once the IT department starts investigating the source of income, they would be in a position to identify black money, provided the IT officials don't get tempted to take this opportunity to becoming rich.



File image of Prime Minister Narendra Modi. Reuters

The Narendra Modi government deserves to be congratulated for its success in achieving the objective. It is difficult to imagine any other scheme which has been equally successful in achieving its objective. If less than one percent of the demonetised currency failed to get disclosed, the reason behind it is straight and simple. In the case of those who disclosed their black money by depositing it in bank accounts, their only crime is evasion of income tax by hiding their legitimate income. Having realised that all options were closed after 8 November 2016 these persons have taken the risk of facing investigation by the IT department and pay penalty tax as per the law. In other words, they have opted to come clean. In such cases, the source of income is fair.

On the other hand, in the case of hardly one percent of the demonetised currency which failed to get disclosed, the crime is not just about evasion of income tax. More than that, the very source of income is under question. This part of the income cannot be disclosed for the simple reason that it is illicit money - most probably linked to political class and bureaucracy. They cannot get way by simply paying penalty tax. Had this part of income got disclosed, the owners of this illicit money would have been caught under the law for bigger crimes. It also would jeopardise the careers of many politicians and bureaucrats.

crises. It also would jeopardise the careers of many politicians and bureaucrats.

Another major criticism against the prime minister's out-of-box measure is about erosion in economic growth. It is a fact that at 5.7 percent growth during the first quarter of the current year, the economy experienced the lowest growth rate in the recent years. Though the economy is likely to pick up during the remaining three quarters and end up with an annual growth rate of between 6.7 to 7 percent which would be marginally lower than 7.1 percent growth achieved during the last year. There is also the possibility of India getting falling behind China from the position of the fastest growing economy. Though nobody is comfortable with slowdown in the economy, the fall in growth rate is nowhere near the two percent slip as predicted by Manmohan Singh on the floor of Parliament. This again reflects our political culture as the former Prime Minister commands respects not because of heading the government for 10 years but because of his expertise in economics.

Disruption in the economy in the short-run was very much anticipated when the bold step was initiated. The adverse impact of cash crunch on consumption expenditure and thereby, on gross domestic products [GDP] is a matter of elementary economics. The very fact that the prime minister had to address the nation before announcing the measure shows that the government was fully aware of the disruptive measure causing inconvenience to common people as well as its negative impact on economy. Otherwise, this move could have been announced through a routine gazette notification. One should appreciate the prime minister's gesture of taking ordinary citizens into confidence before initiating such a major step - that too disruptive in nature.

However, it is unfair to blame demonetisation alone [and now, adding GST along with it] for the deceleration in the overall economic growth during the first quarter of the year. If that is the case, then how did economic growth slip from 7.6 percent during 2015-16 to 7.1 percent in 2016-17, that is, prior to demonetisation? In all likelihood, expected fall in growth rate during current year may be lower than the one experienced last year -- if revival in economy since August 2017 is sustained. In this blame game, the so-called economic experts conveniently ignore the impact of two factors, namely, poor performance by our major export destinations like the United States and the Eurozone and rural crisis due to failure to extend economic reforms to agriculture.

Fortunately for us, major economies such as the US and Eurozone started performing better since the last couple of months. This is a significant development as these markets support around one-third of our exports which is crucial for around 15 percent of the domestic economy. Leapfrogging in terms of ease of doing business along with game-changers like Bankruptcy code and GST [though this needs to be fine-tuned] have already boosted business sentiments. By the end of the current year, the economy may gear up to regain the position of the fastest growing economy.

However, the prime minister should not be content with the initial success of cleaning up of governance as well as the business environment. To be blunt, these steps are just curative in nature, not preventive. Demonetization has definitely given a big blow to holders of black money. It might have closed options for tax evaders and compelled them to disclose their income. Is the government sure that black money is not getting generated in the form of new currency, especially, Rs 2000 currency note which has made the task easier? Those who have access to gossips in corridors of power, be it the Centre or state, know that corruption is very much in practice. Unless and until preventive measures are initiated to stop further generation of black money through corruption and unfair business practices and manoeuvring political process, demonetisation dose may have to be repeated once in a decade. But the economy and poor people certainly, are not in a position to bear this pain once again.

(The writer is a Professor at Birla Institute of Management Technology and a former Member of the Prime Minister's Economic Advisory Council)