



AJAY CHHIBBER

# OFF THE BLACK MARK

*Demonetisation won't hurt 'kaladhani' – it will only damage economic growth*

THE MODI GOVERNMENT'S hit on black money may go down as one of India's biggest economic blunders — or greatest achievements. Whether one agrees with the move or not, its implementation has been bungled and the collateral damage is likely to be heavy. Where did this idea originate? Surely the PM's key economic advisors would not have recommended it.

Demonetisation is usually associated with decrepit economies and hyperinflation, such as Zimbabwe recently and Argentina in the past. The Argentine government demonetised several times in the last century; it even changed its currency's name from peso to austral, then back to the peso — each time, it further reduced confidence in the currency. Myanmar, Ghana, the former Soviet Union, Nigeria and Zaire also demonetised, leading to devastating economic consequences. In all cases, often done by military dictatorships, demonetisation eroded confidence in the currency. It is therefore surprising that a reform-minded, popular, democratically elected prime minister has resorted to demonetisation. Even Arthakranti, the Pune NGO from where the idea ostensibly emanated, is distancing itself from a ham-handed plan to withdraw 85 per cent of the country's currency overnight.

There is likely to be a one-time stock effect on those who held black wealth or *kala dhani* in cash. But much of it sits in gold, real estate

It might have been better to go after real estate transactions, the movie industry, gold, weddings, election financing and *benami* transactions. Without tackling the reasons for black wealth, just demonetising won't eliminate the black economy. More poorly conceptualised, badly implemented policy will only take us back to the Hindu growth rate of 3-4 per cent.

oris offshore. Estimates of *kala dhani* vary; the most commonly accepted is around 25 per cent of GDP. Demonetisation only affects black money — not *kala dhani*. Estimates from previous raids show cash is 5-6 per cent of *kala dhani*. Cash is easily transactable but because it's bulky, it's hard to hoard too much *kala dhani* in cash. So, about 1-1.5 per cent of GDP is held in black money. If the government nets half of it through demonetisation, it's around 0.5-0.75 per cent of GDP. This still leaves the bulk of *kala dhani* untouched. The flow of resources into *kala dhani* is unlikely to be affected by demonetisation. In fact, over time, even less will be held in cash, more in gold, real estate or shifted offshore.

The collateral damage from this move could be huge, economically and politically. The poor are already suffering, especially those without easy access to banks, post offices, even information on what to do. More long-lasting damage could be to trade in sectors where much business is conducted in cash — especially the informal sector and rural areas comprising about 40 per cent of GDP. The non-bank financial sector, on which many SMEs rely for short-term finance, has also been hit. As a result, the effect on economic growth in 2016-17 could be as high as one per cent of GDP — which will neutralise the one-time gain from demonetisation.

It is claimed India's cash to GDP ratio, at around 11-12 per cent of GDP, is too high. But

comparisons are made with countries at much higher levels of development, with much smaller, rural, un-banked populations. China has a cash to GDP ratio of around 9.5 per cent of GDP. Germany at 8 per cent of GDP and the US at around 7.5 per cent of GDP. There appears no correlation between corruption and the cash to GDP deposit ratio. Nigeria, widely regarded as one of the most corrupt countries, has a cash to GDP ratio of only 3 per cent of GDP as faith in the currency has eroded.

To weed out black money, more comprehensive reform is needed. It might have been better to go after real estate transactions, the movie industry, gold, weddings, election financing and *benami* transactions. Without tackling the reasons for black wealth, just demonetising won't address corruption or eliminate the black economy. The Modi government should focus on achieving genuine economic recovery and ensuring job creation. More poorly conceptualised, badly implemented and moralistic policy prescriptions will take us back to the Hindu growth rate of 3-4 per cent of the 1970s and 1980s. We thought we were done with that.

The writer is distinguished visiting professor at the National Institute of Public Finance and Policy, (NIPFP) and former DG, independent evaluation office, government of India



## NOVEMBER 28, 1976, FORTY YEARS AGO

### HUA'S BIG BATTLE

working group on national integration in kick in the pants". An average Pakistani fan-

