

Remember, Remember: The 8th of November



As India marked the 3rd anniversary of Prime Minister Modi's attack on currency hoarders and tax evaders, we look back at the aftermath of one of the biggest events of demonetization the world has ever seen - leaving over a billion people cash-crunched.

Driven by the ambition to curb black money and reduce terrorist financing, the decision was well intended, but poorly researched and terribly executed. Following the announcement on the 8th of November 2016, the country witnessed one of the most chaotic periods of its modern history. Millions of people lined up outside almost every bank in India for hours and even days to get their INR 500 and INR 1000 rupee notes exchanged. The failure to meet the huge demand for new currency notes opened the Government of India and the Reserve Bank of India to huge criticism - leaving a dent in their credibility.

Strange as it may seem, this is not the first time India had chosen to demonetize its currency as a measure to curb the circulation of black money in the economy. The first ever demonetization took place in 1946, during the British Indian government, followed by the second demonetization in 1978, during the government of Prime Minister Morarji Desai - where INR

1000, INR 5000 and INR 10,000 notes were withdrawn from circulation. Even though the demonetization of 1978 was not an absolute success, it did curb the circulation of black money to some extent - due to its exposure limited to only a small percentage of the population.

Although similar in nature, the demonetization of 2016 turned out to be a disaster despite the three step approach taken by the Modi government before declaring INR 500 and INR 1000 rupee currency notes null and void. The Modi government had taken a stepwise approach by 1) opening bank accounts for all 2) linking them to unique IDs and 3) allowing voluntary declaration of black money, in hopes of formalizing the Indian economy. However, the results were not as expected, owing to the changed dynamics of the Indian economy. A few months later, approximately 99% of the currency was back into the system in different notes.



So, what really went wrong? The attack on cash was based on the faulty assumption that most cash equals black money and that demonetizing would help the government unearth it, thereby reigning in more tax collections and increasing economic activity. However, most of the black money gets converted into return-bearing assets like gold or real estate, or gets converted into a foreign currency and is transferred abroad. The sudden cash crisis had the unintended effect of disrupting the cash-dependent agricultural economy, the labor-intensive small and medium businesses and the cash-driven real estate industry and impacted a huge segment of the population who were outside of the taxable

income bracket anyway. This sudden disruption in the economy led to rising unemployment, slowing demand, a loss of business confidence and an overall credit crunch. The pain was further elevated due to a complex GST regime, leading to a slowdown in the economic growth of the country.

We are now three years past this historic demonetization of 2016 and the after-effects of the move - although not completely gone - seem to be fading away gradually. Despite the mess that the country went through, there have been improvements in various areas that lay the foundations of a stronger and more economically prosperous India. The country has seen one of the largest financial inclusions globally in recent years - adding approximately 360 million new

accounts under Modi’s “Pradhan Mantri Jan Dhan Yojana”¹ scheme. Linking “Aadhaar cards”¹ to bank accounts has increased the traceability of funds and enabled the government to ensure that the social benefits targeted to the low-income population reach them effectively. The growth of digital payments in India has also been one of the highest globally, attracting e-wallet giants like Google, Amazon and Alibaba-backed PayTM to expand their services in this industry.

India has favorable demographics for a strong growth in consumption demand in the near future, making it an epicenter of global economic growth along with a few other emerging countries. Supported by strong economic policies such as the recent corporate tax-rate cut and the increasing ease of business, our hopes for India are high.

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¹ See glossary on page 4

GLOSSARY:

“Pradhan Mantri Jan Dhan Yojana” is a financial inclusion program launched by the Government of India, under the leadership of Narendra Modi. This program is managed by the Ministry of Finance and is applicable to all citizens aged 10 to 65 - giving them affordable access to financial services such as banking, remittances, credit facility and insurance.

“Aadhaar” (foundation) is a biometric identification system launched by the government of India under the leadership of Narendra Modi in 2016. The Aadhar card saves an individual's personal details in a government database and has been linked to bank accounts, phone numbers, major purchases, etc. It is becoming the quickest way for the government to assess data and transfer public welfare services.