

## Many Maladies and One Remedy: Indian Economy and Demonetization

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**Abstract:** Indian economy, though plagued by many maladies, is poised to project rosy figures of impressive GDP. The 'young' nation with equanimous population demographic advantage with vast agrarian land tracts and fishing seashore is in the threshold of development. However, She faces a plethora of syndromes domestically such as poor-quality education right from to primary to tertiary levels; lesser job-creation to the rapidly rising population; garnering of resources by a few and hoarding the same; mind-less corruptive practices to destroy the tap-root of the societal fabric; under-developed infrastructural facilities such as rural connectivity and warehousing facility for the fragmented farming community; untouched rural poverty forcing migration thus exuding urbanizing menace – seemingly an endless list. The reasons could be: the myopic political policies; nexus between *netas* [political leadership] and *babus* [bureaucratic officialdom]; rise of regional political outfits with confronting federal structure; higher tax regime forcing many to keep away from the tax-bracket – again an endless list. The semblance that has recently been created is that all such economic ill-effects shall be addressed by the magical surgical strike on the black economy by means of demonetizing the highest legal currency notes i.e. `500 and `1000 from the circulation. The short-term pain borne mostly by low and middle income groups need to be translated into long-term gain to the economy. The pertinent question is when will the wait be over and what benefits will accrue to the nation? This article, from the perception of the author, throws some insightful lights into the vexatious issue.

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### I. Problems facing Indian Economy

Though the international institutions like World Bank, International Monetary Fund and World Economic Forum had placed on record about India's enviable growth statistics by spotting of the *bright-spot* in the slowing global economy, India has *black-spots* such as black money, fake money, corruptive practices, tax evasive procedures, financing of illegal activities, money laundering and counterfeit currency in day-to-day circulation. The cascading effects reflect in poor quality in services like provisioning of education and health. We – the citizen of this country has a right to lead a decent life. The minimum needs such as food, health care, housing, basic education of everybody must be fulfilled. However, in India a large section of the population cannot afford all these owing to the poorness of the populace. Our economy, in addition, does not provide adequate employment opportunities so that poor people can get jobs and earn income. Hence eradication of poverty and unemployment is a major challenge before the economy.

Similarly higher quality of life is achieved by getting proper education and health care facilities. Since India is a very large country in terms of population, provision of education and health care by the government to all its citizens is also a major challenge. Rise in prices hit the poor and middle class people very badly. So controlling the price level is a major problem to be dealt with whenever it occurs. Finally, the income of the nation must also grow with rise in population and their wants so that the development process continues. So achieving economic growth every year is also a major challenge before the economy.

Also our agriculture is already over burdened with population and employment is seasonal there. The vagaries of monsoon and unremunerative prices of agri-produces also joined hands in flushing out the labour of this sector. The only solace at present is the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), which aims at providing at least unskilled manual work. The minimum energy required by a person for doing such work is 2400 k cal in rural area and 2100 k cal in urban area. To get this energy a person requires some amount of food in the form of cereals, pulses, vegetables etc. To buy these food items the person must have some amount of money. This implies that if the person is not able to earn this money to buy the food needed in order to get the required energy to do work, then the person is said to be below poverty line (BPL) or simply poor. Rural poverty is a perennial issue and successive governments have not addressed this effectively. In our system, corruption has prevailed from time immemorial in one form or the other. The basic inception of corruption started with our opportunistic leaders who have already done greater damage to our nation. The democratic ideals with which the Indian state was formed in 1947 are all too often subverted by the self-interest of public servants. People who work on right principles are unrecognized and considered to be foolish in the modern society. Corruption in India is a result of the nexus between bureaucrats (*babus*), politicians (*netas*) and

criminals. Earlier, bribes were paid for getting wrong things done, but now bribe is paid for getting right things done at right time. Further, corruption has become something respectable in India, because respectable people are involved in it. ‘Can the ban on these notes going to arrest these deep-rooted practices?’ is a million-dollar question to be answered. The will to restrict the entry of criminals into politics has to date not been present in any Indian government, and it is sensible to question the likely effectiveness of a corruption ombudsman whose architects are a parliament composed of such a high number of suspected criminals. India's decision to demonetize two high denominated currency notes was "bold and decisive" but the "risky" move is far from delivering a corruption-free country, the Chinese media said today. Corruption in India is like water, it shall find a way in its course – it percolates, permeates, evaporates, advects, precipitates and transpires!

In common parlance, black money is a term used to refer to money that is not fully legitimate in the hands of the owner. The illegitimacy could be for two possible reasons: i) The first is that the money may have been generated through illegitimate activities like crime, smuggling, illicit trade, illegal mining, illegal felling of forests, illicit liquor trade arms trafficking and corruption, all of which are punishable; and ii) the second and perhaps more likely reason is that the wealth may have been generated and accumulated by failing to pay the dues to the public exchequer in one form or other. In the later, the activities undertaken by the perpetrator could be legitimate but s/he has failed to report the income so generated, comply with the tax requirements, or pay the dues to the public exchequer, leading to the generation of this wealth. One of the reasons for the complexity of the problem of black money is the differences in perceived interests and objectives of taxpayers and the tax authority. However, in practice it may be difficult to bring about the balance and convergence in the interests of all the connected stakeholders. The quantum of money with the public by evading payment of other statutory contributions such as taxes and [excise, stamp] duties is sizeable. Generally, a high burden of taxation, either actual or perceived, provides a strong temptation to evade taxes and generate black money.

Similarly on the employment front India is not doing up to the mark. The abject poverty is linked to unemployment among the population who are willing to work. Slow growth of industries, poor education and training are main reasons for unemployment in India. The major sector that employs unskilled and semi-skilled people is the unorganized sector – who happens to be the victim of this surgical strike. Hence, employment to population ratio, which was heading southwards, had again dipped to newer nadir.

| Year | Employment to population ratio <sup>#</sup> |
|------|---|
| 1992 | 58.3  |
| 1993 | 58.3  |
| 1994 | 58.6  |
| 1995 | 58.1  |
| 1996 | 57.9  |
| 1997 | 57.5  |
| 1998 | 57.3  |
| 1999 | 56.8  |
| 2000 | 56.6  |
| 2001 | 57.1  |
| 2002 | 57.2  |
| 2003 | 57.8  |
| 2004 | 58.1  |
| 2005 | 58.1  |
| 2006 | 57.1  |
| 2007 | 56.4  |
| 2008 | 55.1  |
| 2009 | 54.2  |
| 2010 | 53.5  |
| 2011 | 52.8  |
| 2012 | 52.2  |
| 2013 | 52.2  |
| 2014 | 52.2  |

<sup>#</sup> Source: International Labour Organization, Key Indicators of the Labour Market database. Employment to population ratio is the proportion of a country's population that is employed. Ages 15 and older are generally considered as the working-age population.

Public funded education is not producing the desired quality owing to different perceptions of different stake-holders. This service sector has grown considerably since the 1990s and educational services are now playing an increasingly important role in the growing economy like ours. In conjunction to this trend, the

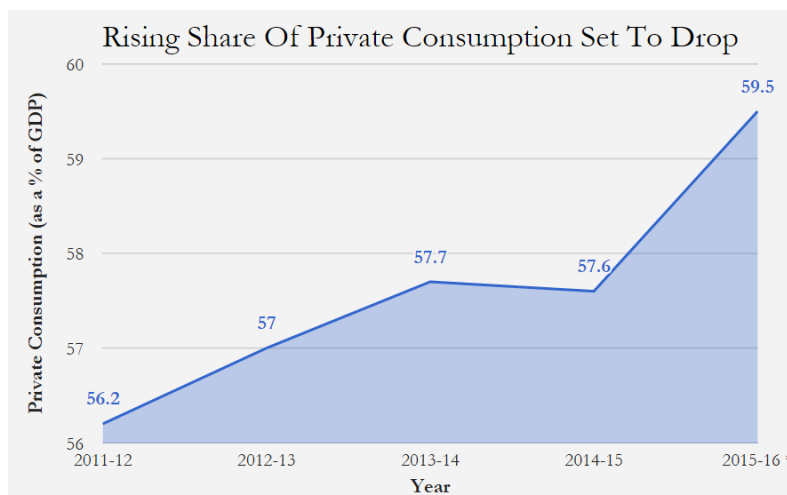
construct of service quality has become an extremely topical issue within the services literature. The provision of good service quality is commonly associated with increased profitability, customer satisfaction, customer loyalty, customer retention, customer attraction and positive word of mouth. In consideration of these apparent relationships, it is no surprise that there is great interest in the measurement of service quality. ASER reports fulfilled the urgent need to take stock of the status of the quality of elementary education and helped in understanding the nature of progress over a period of time. Based on these, the country's education system needs a complete overhaul to tune with the current needs.

## II. Can Demonetization be a Panacea

Demonetization as introduced and the steadfast implementation of the same have to be viewed in the light of the aforementioned illnesses facing the fast-developing Indian economy. There is neither a universal cure nor a unique method for any illness and it is true to the economic maladies facing the nation too. The existing negative employment generation had deteriorated further after demonetization by infusing liquidity crunch in the informal sector – the major source of employment generation. The informal financial sector accounts for a 26 percent of GDP. The demonetization of Rs 500 and Rs 1,000 notes hurt agriculture, informal sector workers — about 482 million people who earn cash incomes – and disrupt India's consumption patterns for at least the next quarter, according to an assessment released last week by Deloitte, an international consulting firm. Demonetization has perhaps penalized the entire informal sector and damaged it permanently. The informal economy – which presently employs more than 80 percent of India's workforce, includes workers in small and medium industries, grocers, barbers, maids and others. People who do not use debit or credit cards, access the internet or use mobile banking and e-wallets will be the worst hit, said the Deloitte report.

The rural economy – on which 800 million people or 65 percent of India's population depend, is largely driven by cash. Agricultural growth in India contracted 0.2 percent in 2014-15 and grew no more than 1.2 percent in 2015-16, largely because of back-to-back droughts. Agriculture was expected to grow at 4 percent this year according to this October 2016 CRISIL report, but demonetization is likely to dent that forecast. India is currently in the midst of the winter sowing season, but farmers are reported to be running out of cash to buy seeds. Farmers buy seeds, fertilizers and farm equipment in cash, pay their workers in cash, and traders and commission agents pay farmers in cash. Rural penetration of banking and ATMs too were sparse and demonetization had hit them worse.

Agriculture and informal sector spending shall affect the rising share of private consumption which was hovering around 60 percent of GDP, provisional estimates from the office of the Economic Advisor indicates as depicted in the following graph.



Note: \*Provisional estimates

Source: Key Economic Indicators, Office of the Economic Advisor

This slow-down due to demonetization can be set right only after remodeling of the informal sector and doing so with the poor connectivity with the vast spread of the nation is going to be a daunting task. There could be some turmoil as the effect will be disproportionately felt by the lower and middle income classes. Today many small scale businesses in informal sector are neither paying service/sales tax nor any income tax despite some of them having incomes well above the taxable limits. This can happen as they pick material on cash from small scale industries, who in-turn do not report this manufacturing and related income. It is a chain that starts at point of production. In the competitive business scenario, it appears to be a boon to some businesses who use tax

evasion to keep price of goods low. It may seem as a benefit to consumer but further revelations can show that it is also a cause of poor quality goods and services which benefits neither government nor consumers. Some such unproductive business will for sure face impact and will try to use demonetization to pay lower wages. This kind of reverse spiraling impact may also result due to demonetization.

Black money, which accounted for sizeable amount of our GDP, is stashed in the form of realty, gold, investment in foreign banks and higher denomination currencies. Cash economy is a complex mix of black and white transactions. India's 11.8 % of economy deals in cash. India's cash-to-GDP ratio is more or less parallel to many big economies such as Japan, Germany and France. The main question is 'How much cash will come back for exchange and how much cash could disappear from the system?' Going by the history of demonetization of 1978, as much as 75 % of the money had returned in the system, while the remaining 25 % was extinguished. The exact size of extinguished money may only be available by the end of March, after the closure of the exercise. The tentative indications are not convincing that the exercise has yielded the desired result in this dimension too.

### **III. Conclusion**

Long term gain seems to be vague and little; a possible discontented revolt by the short-term pained class shall need to be faced by the ruling class. The nation would like to know the net gains of the excruciating disruption due to this surgical strike. Based on the background materials, demonetization exercise has not and will not yield desired results unless legal reforms are addressed to.