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INSTITUTE *of* TECHNOLOGY
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Demonetization In India

SYS 660 - Decision & Risk Analysis

Vinay Rajesh Gor

Introduction

On November 8th 2016, The Honourable Prime Minister of India, Mr. Narendra Modi announced Demonetization (Scrapping) in India of all (Indian National Rupee - Rs.) Rs.500 (\$7) and Rs.1,000 (\$14) notes accounting 86% of the country's currency which were ineffective & invalid immediately. This decision was backed up by introducing new currencies of Rs. 500 and Rs. 2000. According to the Prime Minister of India the decision made served many purposes, first to combat Black money giving a huge blow to all corrupted politicians, government servants, business owners, common people etc. Second to counterfeit terrorism activities and finally to increase tax revenue collections. Even though depositing/exchanging new currencies for old currencies were allowed there was chaos amongst everyone including common people as most of the transactions carried out across the country use cash as a payment option. This caused prolonged shortages of cash for several days. There were many disruptions due to the demonetization including the disruption of the economy. It is still a debate whether the decision made by the Prime Minister was correct or not. Supporters would argue that the decision made was correct whereas opposition considers it as an incorrect decision.

Decision Background

Right after India got Independence in 1947 the central government was held by Indian National Congress (INC) for more than 50 years. In early 2010's many scams involving black money were revealed against the government which held the ruling party INC to be involved in corruption & black money including many politicians, government servants, mafias, terrorist organizations etc. The opposition Bharatiya Janata Party (BJP) led by Mr. Narendra Modi campaigned in 2014 elections having a manifesto focusing on curbing Black money, corruption and tax invasions speculating trillions of rupees. Mr. Modi got immense support to be elected as the 15th Prime Minister of India. Right after completing half tenure in order to curb Black money, corruption and terrorism, Mr. Narendra Modi decided to demonetize the highest currencies.

Key Individuals

Along with the Prime Minister of India the decision was backed up, planned and implemented with the help of the Former Finance Minister of India Late. Mr. Arun Jaitley. Although the Reserve Bank of India started printing new notes of Rs. 2000 from August 2016 many articles & reports were published which claimed many alternatives ranging from introducing new currency, leveraging higher currencies, banning old currencies across the country but no one imagined major currencies would be invalid & ineffective.

On November 8th, Mr. Modi called an unscheduled meeting and discussed the decision with the Union Cabinet. Just after the meeting on an unscheduled national television Mr. Modi announced the decision.

Objectives

Objective is the main key for a decision making process. Objective serves the purpose behind the decision analysis. Bharatiya Janata Party always had good intentions right from the manifesto to do good for the country which made Mr. Modi and Mr. Jaitley to take this decision.

The main objective of Demonetization was to combat Black money which accounted for trillions of rupees. There was a huge amount of cash available in the economy with anonymity which involved bribes, money from corruptions, tax invasions etc. Also several scams happened in India prior to 2016 which involved politicians, Businessmens, Government servants. Therefore it was much required to stop the parallel economy running on cash.

Second purpose of demonetization served to reduce or demolish terrorist activities which involved cash availability with the terrorist organizations, radical groups such as naxalites, mafias and maoists. The main target was to suppress recent terrorist activities happening in India including attacks. By demonetizing terrorist organizations & groups will have shortage of cash hence limited resources to fund any activities for several months or years.

The third purpose was to increase the base of tax collection through undeclared finances from companies & employees. This was decided by giving everyone a last fair chance, increasing awareness about taxes & systematic salary transactions and finally increasing funds for the government. Prior to demonetization the number of taxpayers

across the country was 43.3 million which was comparatively less with respect to the number of people working across the country accounting for huge undeclared funds.

Decision Alternatives

Bringing Black money back

The first option which The Prime Minister of India & Finance Minister of India implemented was to bring black money. This was carried out by prosecuting the names of the people in public based on evidence available in the form of Swiss bank accounts, Real estate etc. For this black money law was enacted. Also people having black money were given a fair chance to deposit the black money available. Enormous Income tax raids were also carried out on a large scale.

Declare undeclared funds

In public announcements prior to demonetization several times everyone in the country was informed about tax invasions which were carried out for several years. Thus warnings were given to declare the undeclared funds and pay taxes which included common public & companies. Out of 1.3 billion people only 30 million people filed for taxes every year. The number of people paying taxes was even less. These taxes are major sources of income to run the economy hence declaring undeclared funds and paying taxes was also an alternative which the government implemented.

Use of Technology

Taxation systems of India were moved from traditional paper based systems to digital online based systems which used softwares to file tax systems hence enabling entire online taxations with no intermediate corruptions. This softwares detected anomalies and thus helped the government to trace any illegal activities to confiscate illegal funds.

Online payment & Banking Systems

Only 58% of the people in India had bank accounts. The Government of India through various campaigns and advertisements advised people to have access to bank accounts and moving transactions to online payments such as by credit cards, debit cards, UPI's etc. which will enable tax evasion and thus moving the systems from cash economy to cashless economy. This will also enable the government to know the owner and seller of the transactions thus increasing taxes and funds to the government instead of cash transactions which avoids taxes. This was valid for small to big product purchasing.

Executing terrorists activities

Several executions, encounters, surgical strikes and raids were carried out by Indian army in order to stop terrorism and involvement of illegal cash.

As all the alternatives provided were implemented for 2 years under different acts, laws and names by the government of India was quite successful to an extent still the desired results were not as expected. The government was still facing challenges to curb black money, counterfeit terrorism and to increase base of tax to fund government. Finally The Prime Minister of India and Finance Minister of India decided to implement Demonetization and according to them these alternatives served as the baseline for the stronger outcomes for demonetization.

Opportunities

Less Cash Economy - If the demonetization is successful and the country accepts it to full fletch then India will be a less cash economy and more digitally influenced economy.

Increase funds for the government - If the demonetization works effectively then the number of taxpayers filing taxes and paying will increase which will give the government more funds.

Financial Inclusion - If the demonetization works then almost everyone will be connected to banks and proper systems pushing towards an efficient financial tree.

Threats

Slow economic growth - If demonetization is not successful then all businesses, jobs, cash flow will be slow eventually leading to slow economic growth which can lead from days to months.

Panic & Confusion - If proper knowledge is not circulated amongst the public then panic & confusion can lead to chaos. This chaos can be difficult to handle because of the huge population.

Process

Mr. Modi & Mr. Jaitley followed a well planned process in order to carry out the things which would not only help the economy but also cause minimal damage to the people of the country. Starting from the alternatives to implementing the final decision of demonetization every small detail was taken care of. Even though it took its own time to work under normal circumstances, exchanging new currencies for old one with a limit was decided so that maximum people get cash. ATM's were updated and checked in a timely manner. Prior to demonetization almost all common people were connected to banks via a proper identification method which they introduced years ago Adhar system. Digitization of the Tax system was enabled so that income can be filled and taxes can be paid. All government offices and services were allowed to receive old currencies in order to avoid any overcrowding. Thus all steps taken were well planned and hence there was a proper process which was followed.

Weaknesses in the process

The decision of demonetization was implemented with true intentions to improve the economic status of the country. After thinking and implementing many alternatives which did not work out great, finally demonetization was implemented. There were several weaknesses associated with the decision making.

First was 'preparedness', the entire country was not prepared for this decision. On the other side even banks, postal services, and ATMs were all unaware and hence were

paralyzed. It took days to get on track. Banks and postal services were out of cash within a few hours of operating, ATMs were not able to dispense as it required software updates for new currencies to detect. There was a shortage of cash across the country in all sectors. Mr. Modi and Mr. Jaitley did not aware banks, postal services because this would give many a chance to arrange the funds and hence the decision would not be fruitful.

Another weakness was 'evaluation', Prior to 6 months of demonetization new currency of Rs. 2000 already started printing by the Reserve Bank of India. Several reports, articles, research papers speculated the merits and demerits of introducing new currency but nothing was expressed formally by Mr. Modi and Mr. Jaitley. This decision was planned as and when new currencies were printing in stretch but none of the ministers took advice from top financial experts. Ex Director of Reserve Bank of India, Harvard and MIT alumni Mr. Raghuram Rajan even submitted his report on speculations and impact of new currency, scrapping old currencies would cost GDP which was eventually dismissed by the government with no reasons.

From all these events appear to justify that Mr. Modi and Mr. Jaitley did not evaluate the possibility of effects but were more inclined towards implementing the decision.

Biases

Printing new notes prior to 6 months by Reserve Bank of India makes it evident that the decision was already planned ahead of time. Both the ministers already had a full proof plan to implement demonetization even though other alternatives were giving fruitful results.

“Confirmation Bias” likely affected the decision maker in a way that all misfortunes that happened in the past were aligned to past governments which were associated with corruption, terrorism, tax evasion. Eventually this had become a mindset irrespective of proofs.

“Status Quo Bias” is likely to be affecting Mr. Modi & Mr. Jaitley. From the first day of campaigning election to their manifesto there were several instances where they claimed to work upon this issue. As they were close to finishing the half term of their ministry they wanted to implement something huge related to corruption, black money and taxes and nothing worked great. Therefore deviating from the promises could have caused harm to them in future elections.

“Anchoring Bias” also affected Mr. Modi & Mr. Jaitley from a perspective that for several past years various big numbers related to corruption, black money, tax invasions from different sources were put forth. These numbers were considered as anchor point thus all further steps implemented purely relied on these figures.

Outcomes

After 4 years of implementation of demonetization in India the outcomes achieved are on both sides of the axis.

The first positive outcome is all transactions from companies to personal funds including taxation have entirely shifted to online systems. 99% of the people in India now have been connected to Banking systems which was earlier 58%. Many terrorist organizations were hit on a large scale which almost stopped all terrorist activities specially in Jammu & Kashmir which is the most terrorist prone area. Huge amounts of black money were declared which helped the government to get their share in terms of taxes. Finally the number of taxpayers increases by millions which increased funds for government accounting for billions of rupees.

Negative outcome was that for several months the GDP was reduced drastically. Huge number of people working on daily wages were affected as their main source of income was in cash. There were loss of a huge number of jobs and decline in wages because of less cash available in the market which drastically changed the economic plans of many people.

Impact

Bharatiya Janata Party led by Mr. Narendra Modi got immense response from the common public. Mr. Modi & its government were elected as Prime minister for the second term. Post demonetization 6 state elections gained favour for the Modi

government with a majority. On the other hand In 2019 still demonetization is still considered as the reason for Economic slowdown.

Conclusion

The decision of demonetization in India was carried out with a full proof plan kept as a secret just between the Prime Minister & Finance minister to combat black money, counterfeit terrorism, and increase tax revenues which I think both ministers did a good job. Although the decision had biases. Several alternatives prior to demonetization were not successful and the ultimate decision worked out in many ways. Even though the numbers for each objective did not meet as expected but still in terms of quality the objectives of the purpose were achieved.. After the 4th anniversary of the decision several opinions have been made ranging from for and against but with every decision comes its strengths, weaknesses, opportunities and threats. This is also valid for demonetization in India which can be concluded as what Malcom Gladwell refers to it as “The Right and the Wrong way”.

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