

## Narendra Modi govt's intent to curb black money laudable, but demonetisation has hit RBI image

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***The year 2016 will undoubtedly be commemorated for tectonic changes in the global and domestic environment, including Brexit, election of Donald Trump as the US president, and closer home.***

On November 8, Indian consumers were hit by a financial tsunami of sorts in the garb of demonetisation. The notable objective to clamp down on unaccounted cash, however, has given a liquidity jolt and initiated a massive currency crunch. Historically, demonetisation has been used only in extreme circumstances to control income, consumption and circulation of currency. Most governments avoid taking such dire steps as it puts the whole economy under inconvenience. Countries that have experimented with demonetisation, including Ghana, Nigeria, Myanmar, the erstwhile Soviet Union, Zaire and North Korea, in a bid to regulate their currencies, have not had much success. Instead, the outcomes have been loss of faith in the banking system and increased disruption.

In India, analysts are scrambling to figure out the extent of 'black' economy—with many highlighting that the government miscalculated its scale. Many have hypothesised that the cash crunch will put the brakes on the growth story as it will hit consumption, investment, production and employment. However, these theories are yet to be tested. It remains to be seen whether the government will be able to mitigate the impact of demonetisation.

Since economic growth is closely linked to consumption, it would perhaps be relevant to take a closer look at the latest data on consumption patterns. Data from the 'Household Survey on India's Citizen Environment & Consumer Economy' ICE 360° survey, (2016) which covered 60,360 households (after putting together a household listing of 300,000 households), reveals that households' share of expenditure constitutes an overwhelming 74% of India's household disposable income.

It takes a deeper look at the economic and social well-being of households, provides normative measures of social, political and financial inclusion, degree of access to public goods, infrastructure and welfare measures.

Nearly 80% goes towards consumption of groceries and utilities (including electricity, gas, communications, etc.) Vehicle fuel (7%) and clothes and accessories (6.3%) are the other items that constitute a high share. The liquidity crunch faced by consumers is unlikely to have a major impact on demand for these products. At best, it may force households to opt for lower value items and smaller pack sizes in the short-run. Discretionary spending, however, will be hit more severely, and this is expected to impact spending on durables, entertainment, and recreation.

The impact of demonetisation is also bound to be felt on payment modes. Cashless payments—via credit/debit cards, net-banking or e-wallets—have until now not figured prominently for groceries (7.7%),

utilities (7.8%) and clothing, footwear and accessories (5.8%). On the other hand, share of transactions for fuel and travel is higher at 30.2% and 15.5%, respectively. Until now, a majority of consumers have cited ease of use and convenience (68%) as the main reason for using cash, compared to 48% who feel the same way about cashless. Bargaining, or price negotiation, is also among the top reasons for use of cash (11%). On the flip side, many use cashless options to avail of discounts (10%) and credit with zero interest (10%).

For a consumption-based society like India, that's cash dependent, it would be unrealistic to expect a swift change to cashless. Pre-dominance of cash, even among urban, credit and debit card savvy users, is a result of basic ground realities. Tax avoidance is only one small reason. The bigger challenge is last-mile connectivity, which ensures these transactions happen seamlessly and are glitch-free. Poor internet connectivity and lack of PoS machines are the biggest barriers to cashless transactions. Many a times PoS devices are not in working condition which leaves shoppers frustrated. A multi-pronged approach is needed to deal with these issues.

Realistically speaking, the switch to cashless transactions by small mom-and-pop stores can happen in the medium- and long-term. On the flip side, cash-strapped rural consumers, especially those belonging to the bottom of income pyramid, are likely to get even more marginalised. With income opportunities dwindling, particularly in the unorganised employment sector, daily wage workers will turn to informal sources of borrowing to meet their daily consumption needs. This poses a tremendous threat as unscrupulous and exploitative element can come into play. Consumption is, thus, impacted in an unbalanced manner.

While the government's intent and actions to curb black money are laudable, the fact remains that demonetisation has somewhat dented people's confidence in banking institutions. The government, therefore, needs to follow up its bold initiative of flushing out black money by putting in place processes and systems that can provide immediate relief to consumers. Since the government has advocated that the move is a bitter pill meant for the larger good of the nation, its stance can only be justified if it takes timely and effective actions to put the Indian economy back on the consumption track.

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