

Invalidation of Large Denomination Bills

I. Introduction

On November 8, 2016, the Modi government declared that as of the midnight that day, all the large denomination bills of 500 Rupees (approximately 1.6 yen at the time) and 1,000 Rupees, which were in circulation and covering 86% of the whole Indian bills, shall be banned from use.

The measure to invalidate the large denomination bills was for the sake of eradicating black money. However, it also brought a great inconvenience upon the people and cast a shadow, although not lasting, on Indian economic growth.

II. The purpose of invalidating the large denomination bills

The invalidation was said to be aimed at eradicating illegal money. In India, the “underground economy” that exists for tax evasion, which does not leave any official trace, amounts to be 20% to 40 % of GDP.

The large denomination bills are predominantly in the hands of wealthy people. Especially, real estate assets are sold and paid in cash off the books; and so are most of political donations. This is done so that no records are left behind. Many of large denomination bills are used for illegal transactions and then stocked. The measure to invalidate the large denomination bills was a knife stab into the black money beast.

Dr. Makoto Kojima, Professor emeritus at Takushoku University, points out two reasons for the timing (November 2016) of the invalidation¹.

¹Makoto Kojima, “*The Introduction of GST and the prospect of the Indian economy,*” *Contemporary India Forum, 2018 winter*, Japan India Association. (original title)小島眞「GSTの導入とインド経済の展望」、『現代インド・フォーラム 2018年冬季号』所収、日印協会。

Firstly, it appears that the government expected to implement the measure to invalidate large denomination bills before the introduction of Goods and Services Tax (GST) to set a better ground for the latter if the measure could contribute to eradicating the “underground economy” even if to a small degree.

Secondly, taking into account the fact that, from February to March, 2017, in India, parliamentary elections were held in five states including the state of Uttar Pradesh (UP), which accommodates more than 200 million residents, it seems that the government used the invalidation measure in order to run the elections advantageously.

A large part of revenues for Indian political parties are company or individual donations of unknown origins. The invalidation of large denomination bills would greatly damage the money sources of the parties. Actually, in the parliamentary election of the state of UP, two large local parties, having controlled the state government previously, were defeated by a big margin and the Indian People’s Party (BJP) led by the Prime Minister Modi gained 403 seats (80% of all the seats).

III. Side effects of the invalidation of large denomination bills

The invalidated bills could be changed with other legal tenders at banks by the deadline of December 30, 2016. However, drastic delay in printing new bills of 500 Rupee and 2,000 Rupee limited currency exchanges to a certain amount and imposed extreme lack of cash and inconvenience upon the majority of the people.

Since the establishment of the Modi government, the Indian economy had recorded the growth rates of 7.5% and 8.0% in 2014 and 2015 respectively, which were high enough to draw the world’s attention.

In the middle of such high growth of the Indian economy, the invalidation measure was suddenly introduced. In the situation where 80% of the whole commercial trades were paid by cash, those who suffered most were retailers of food and commodity and logistics industry. Partially because the issuance of the new bills was not sufficient until April 2017, the invalidation measure

naturally slowed down Indian economic growth, which had previously been strong. .

The invalidation measure was executed in November 2016; the GDP growth rate went down from 7.5% in Q2 (July – September) to 7.0% as early as in Q3 (October – December); it further lowered to 6.1% in Q4 (January – March) and to 5.7% in Q1 (April – June, fiscal year 2017); and at last in Q2 (July – September) it recovered a little bit up to 6.3%.

Manufacturing Purchasing Managers' Index (PMI) is an indicator of how purchase representatives of manufacturing companies feel about the economy and the number 50 is regarded as the turning point between prosperity and recession. India's PMI recorded 54.4 in October 2016 and then decreased to 49.5 in December, the month after the invalidation measure. Since then, PMI fluctuated mildly above the level of 50; it marked 52.5 in April and May, 2017, and dropped again to 47.9 in July, when GST was introduced. Thereafter, PMI recovered again the level of 50 and even went up to 52.6%.

Dr. Kojima (professor emeritus) opines that taking the growth rate of the whole manufacturing industry and the movement of PMI, as far as the middle and large size manufacturers are concerned, the negative impacts of the invalidation measure and the introduction of GST have apparently been swept away and a new process of growth seems present².

VI. Accelerating the cashless economy in India

According to Dr. Kojima (professor emeritus), although the introduction of the measure to invalidate large denomination bills in November 2016 was supported by the Indian people to a certain degree for the justification of eradicating illegal money, it also caused a great problem regarding cash payment and resulted in the rapid increase of digital payment, accelerating the cashless economy in India³.

In India, National Payments Corporation of India (NPCI) was established

² Kojima, *op. cit.*

³ Kojima, *ibid.*

in 2008; a series of non-cash payments unique to India have already been developed, making rapid progress. Countering such cards as MasterCard or VISA, the national card RuPay was released, steadily extending its share.

In December, the following month of the invalidation measure, Bharat Interface for Money (BHIM) was launched, which was an application to enable free inter-bank remittance through portable phones up to 100,000 Rupees. After that, an epoch-making application for payment through smart-phones was made public, which can be used even by people without a portable phones as long as they have a bank account linked to their identification number. Aadhaar Pay is the name for this smart-phone application.

Upon verifying the identification of a consumer by a finger print scanner set at shops, the payment to a shop can be executed on a smart phone by account transfer via NPCI.

VI. Summary

The main purpose of the measure to invalidate the large denomination bills was to eradicate illegal money; it decelerated Indian economy for a temporary period of time and accelerated cash-less economy in India.