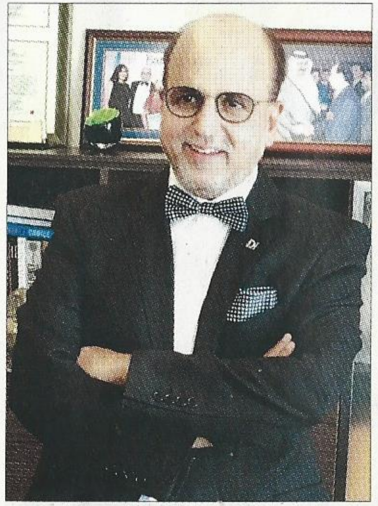
BANKING ON KNOWLEDGE

# India's government takes a bold step to curb black money

**By Dr R Seetharaman**

The Indian government announced that the existing currency notes of Rs500 and Rs1,000 will cease to be a legal tender from November 8, 2016, midnight. The move was to curb financing of terrorism through proceeds of fake Indian currency notes and the use of such funds for illegal activities. The move is also meant to tackle the parallel economy, which is impacting the real economy. As per the Reserve Bank of India (RBI), of the total Rs17tn worth of bank notes in circulation as on March 31, 2016, as much as Rs15tn (~85%) consisted of Rs500 and Rs1,000 notes.

Unaccounted wealth is mainly amassed by storing high-denomination notes, which is in the form of Rs500 and Rs1,000, facilitating the generation of black money. The government has



introduced new series of bank notes of Rs500 and Rs2,000, of which the Rs2,000 notes are being circulated from November 10.

A parallel shadow economy distorts wealth creation in the society and adversely affects inflation. Higher inflation affects the middle income and poor class people of the society. It also evades the government of its legitimate revenues, which could have been otherwise used for the welfare and development activities for the people.

The government has taken a number of steps to curb black money, including setting up of a Special Investigation Team (SIT); enacting a law pertaining to undisclosed foreign income and assets; amending the Double Taxation Avoidance Agreement between India and Mauritius, and India and Cyprus; reaching an understanding with Switzerland for getting information on bank accounts held by Indians with HSBC; encouraging the use of non-cash and digital payments;


amending the Benami Transactions Act; and implementing the Income Declaration Scheme 2016.

The new reform, initiated by the Indian government, will negatively impact the real estate, gold, and luxury apparels segment directly – which is due to high cash component transactions. The real estate and land prices may witness a correction in the cities, where the black component could be at least 20% higher than the agreement value. With this reform, the prices may witness a slowdown, as new notes will only be used for payments.

We expect a mixed impact on the banking sector as submission of old notes may result in current and savings accounts accretion, whereas cash-based EMI collections may get impacted, coupled with loan against property facing near-term stress. Few consumption sectors like jewellery, footwear, and unorganised chemical/agro-chemical sectors may be affected.

India has, however, taken a structurally positive step to focus more on the organised sector, rather than unorganised. The parallel unaccounted economy will come in the reporting domain, which is a boost to the real GDP.

The step will also encourage digitisation and cashless banking in the longer run. The honest tax payer may not worry, since they can deposit all officially owned cash into their bank accounts up to December 30, 2016. The government's intent of increasing tax compliance now gets a direct boost (in addition to the indirect boost that GST promises).

The government has not touched Rs100 rupee notes, which takes care of Medium and Small Enterprises and self-employed sectors. The curb on black money will make the real estate sector more transparent for genuine buyers.

The reform is a long-term positive for the Indian economy. It is a step in the right direction towards more transparency, governance and ease of doing business. The decision by the Indian government is indeed a bold step to curb black money.

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