Impact of Demonetization on Political Parties in India: A Case Study of Punjab and Uttar Pradesh 2017 Legislative Election

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Abstract: The Government of India announced that the Rs 500 and Rs. 1000 denominated currency notes will cease to be legal tender. The move was targeted towards tackling black money, corruption and terrorism. After initial euphoria, questions began to emerge. What are the costs of this demonetization? Will it be effective if people can still create new black money thereafter? Will it increase the GDP? Will it increase inflation? What about tax revenues? We look for answers. The political impact of the move is huge across the whole country with majority of the educated people offering support to the demonetization. The sentimental speeches against black money made by Prime Minister Modi are drawing huge crowds turning into vote banks for BJP. There is a growing support for BJP from the country with majority of the educated people offering support to the demonetization. Will it increase the GDP? What will be the costs of this demonetization? Will it be effective if people can still create new black money thereafter? Will it increase the GDP?

Keywords: Demonetization, Black money, shadow economy, underground economy, Political Parties

1. Introduction

On 8th November 2016 evening, Our Prime Minister Narendra Modi announced the demonetization of existing notes of Rs. 500 and Rs. 1000 notes. That is, 86 percent of the Indian currency was to be demonetized, turned into useless tokens. The aim behind this bold decision of PM Modi is to get a corruption free India, along with destroying counterfeit currency. It is harder to hide large amount of cash by eliminating large denomination which in turn help in eradicating black money. It was a sudden move which created a chaos everywhere. Politically, this decision has reinforced Modi’s image as strong and decisive leader, who can take bold decisions for the welfare of the country. The Prime Minister has explained why this is a financial surgical strike. It was meant to be suddenly implemented. In the past, demonetization has taken place twice but it fails because the idea is to tackle the black money existing in circulation.

2. Black Money and Political Parties

It’s not a secret that cash drives the Indian political system and no politician can hope to be a serious player without utilizing some in the elections. Hence, demonetization is bound to have a serious impact on the way India polity is structured. There are mainly two models of political parties in India. The first is the cadre-based ideologically-driven parties — this club is almost exclusively composed of the BJP, CPM and CPI. These parties are less dependent upon monetary patronage and cash dealings, although not fully immune to them. BJP has recently topped the dubious list of being the richest party with funds coming from "unknown" sources. Many of these park illicit wealth in Indian and overseas real estate, shell companies, shares, gold and overseas bank accounts. Therefore, it can be asserted that these parties, ideally should be least affected by demonetization. On the other side, there’s the “enterprise” model of political parties. These parties that derive their relevance from pecuniary patronage predicated on caste, personal charisma, community or regional identity are the ones hit hardest. In the short term, it will be tough for such political parties to sustain their patronage power and in the long term a lot will depend upon their ability to rebuild their monetary reserves.

Looking from the electoral point, most of the funding of national political parties is done in cash. With nearly five state elections in 2017, demonetization has stunned political parties. Especially, in large states like Punjab and Uttar Pradesh, cash donations are a huge part of “election management”. In one stroke, big parties will find themselves hamstrung. Parties would have to completely rebuild campaign strategies considering cash crunch.

2.1 Opposition Parties United

The latter parties that I discussed before are in turmoil now. These mostly comprise of the opposition parties. These parties are united to oppose demonetization as their black fund will be wasted. Congress which, along with opposition parties including TMC, CPI(M), DMK, is actively campaigning against the note ban. Considering the example of elections in Uttar Pradesh, the more news filters out about the cash-discomfort of Mayawati, the better are the chances for the BJP. So, the political impact of demonetisation will
still be state-specific, depending on who is perceived to be more corrupt. And who is more corrupt, to be precise.

2.2 Relationship with Common People

Indian citizens struggle to get their hands on new bills, hindered by a limited stock of freshly-printed notes, daily account withdrawal restrictions, long queues at banks and empty ATM machines. The frustration over the disorderly change may not bode well for the BJP, who rode to power in a landslide election victory two years ago. The sudden withdrawal of existing notes from circulation had sparked a loss of trust in government, former U.S. Treasury Secretary Larry Summers commented in a blog post on his website. This is politically a moment fraught with great risk for the BJP. If people's livelihoods continue to suffer over the next few weeks, that could be a major rallying point for the opposition to revive their fortunes, and hurt the BJP badly in upcoming state polls in Uttar Pradesh and other states. BJP Officials hence were also racing to re-calibrate ATMs, allow cashback-style withdrawals on some debit card transactions. Such responsive measures would mitigate the short-term pain and boost public perception of the currency ban, thus boosting the BJP's popularity in the longer term.

2.3 Internal Politics

Recent news reports also tell that political parties depositing old Rs 500 and Rs 1,000 currency notes in their accounts are exempted from income tax, which is clarified by Revenue Secretary Hasmukh Adhia, even as the government levied stiff penalty on unaccounted cash in banks and came out with new disclosure scheme. Meanwhile, those who stand in queues in vain and in the hope that the black money demon has been contained and annihilated shall continue to live in a fool's paradise while all parties shall literally laugh all the way to the bank.

India is trying its best to counterfeit corruption and other such issues with its innovative policy measures. Demonetization is one such step, and therein lies the fate of the prime minister. He has taken the biggest political risk that India hasn’t seen since decades. All credit, whether it’s for success or failure would go to him. The country is still in chaos, and only time will tell how this step affects the economy in long term. As for the political effects, the politicians in lead mostly have found a way to cope with it. Others are trying hard for the same. It’s the common people who are at the suffering end now. I just hope this all ends with some positive note.

3. Black Money and Demonetization

To start off, black money is a wider societal ill and demonetization is but one step in the war against black money. Black money and black economy are also two different constructs. The terms shadow economy and underground economies are also used as synonyms for black economy. Black money is the currency of black economy. It refers to illegal money earned from illegal sources which has not been disclosed to the government. The advantage of black money is that it links into the legitimate economy, uses the advantages of the legitimate economy but does not pay the costs.

3.1 Research on Tackling Black Money

The issue of black money has been well-explored. The National Institute of Public Finance and Policy has been active in research about black money. Their 1983 survey of estimates of Black Money [http://www.nipfp.org.in/publications/working-papers/1509/] ed to a report on Aspects of Black Money [http://www.nipfp.org.in/book/927/ in 1985. The Report of 2012 titled Measures to Tackle Black Money in India and Abroad [http://director.gov.in/sites/upload_files/revenue/files/Measures_Tackle_BlackMoney.pdf] and the 2012 White Paper on Black Money by Ministry of Finance covers the various research studies and updates them. These studies however have not been able to determine a consistent estimation of the black economy. The estimates, including from other sources, vary from 15% to 45% of the total economy. The papers, however, give a broad spectrum of mechanisms to deal with black money. [http://www.nipfp.org.in/publications/working-papers/1509/] Apart from the above Indian initiatives, there have been global initiatives to tackle "underground economy‖ or "shadow economy‖. Primarily, the principles remain the same. Internationally, I find, they focus more on facilitating voluntary compliance than enforcement. Maintaining trust and confidence in tax system takes precedence [Comparing how some tax authorities tackle the hidden economy by UK National Audit Office Rand Europe 2009]. They also recommend risk based monitoring mechanisms, coordination amongst revenue departments and education among other things [Reducing opportunities for tax non-compliance in the underground economy – Information Note dated January 2012].

3.2 Principles of Tackling Black Money

The first principle is that remove the systemic pain that leads to creation of black money in the first place. Blame lies with the tax department. Black money is nothing but money generated in legitimate transactions which are hidden from government so as to avoid paying the transaction cost (usually tax) in the legitimate economy 7. This is usually done by using physical cash. This cash thereafter must be processed to convert into consumption or investment. Black economy refers to various activities, transactions etc. that help process this physical cash, create returns on this cash, facilitate consumption using this cash etc. The second principle has two parts. First, not all cash transactions are necessarily black money transaction. They become black money transactions only if they are hidden from the legitimate economy. Thus, a shop-keeper who does not give receipt but declares the sale (it’s only hypothetical) does not create black money. Conversely, a shop-keeper who gives a receipt but discloses other receipt book to the tax authorities (happens all the time) creates black money transaction. Second, the black money must at some time or other be plugged into legitimate economy.

Thus, it cannot be done using user-created currency that cannot be exchanged with local currency. So it depends on legal tender. It means somewhere down the chain there must exist a person for whom part of this black money is legal...
The third insight is that black economy is continuously fed by parts of white economy that go underground. Quite a few people who do not want to promote black money contribute to it. They are either coerced—say developer forcing buyer to pay him in cash or government officer seeking bribes in cash. Therefore, preventing white money from becoming black the starting point. The recommendations of Report titled Measures to tackle Black Money in India and Abroad describe some strategies. The core principle is to increase the cost of converting legitimate money into cash (wherein government loses ability to track it) and reducing the cost of electronic transfer also promotes electronic transactions.

Black money flows through a separate channel. Such channel has infrastructure to handle black money. The fact is black money seldom remains in cash. It moves into higher value items like real estate, diamonds, gold, films etc. The people involved in these sectors have well-evolved mechanisms to absorb black money. One way is to create entire value chains that use only cash. It is easy in sectors where workers/suppliers are unorganised, contract workers—e.g. Construction, films production etc. Bringing systematic regulations that make it easy for the participants in the value chain to accept electronic payments will curb black money.

Black economy depends on black money financiers. These are money lenders earning like 2% per month on their investments for financing the activities in black money friendly sectors. Film financing, construction financing, financing retailers, dance bars, alcohol, etc. These financiers also need enforcement mechanism to ensure their money is safe. Naturally they ally with criminal elements. Al Capone, the famous Chicago mobster, was previously an enforcer but later a financier. Black money faces the same invest or consume choice as legitimate money. On the investment side, it seeks sectors that are friendly for black money. So those people who buy many apartments from developers and developer later sells these for profit, are contributing to investment side when their agreements are not registered and do not pay stamp duty. Jewellers and traders of precious stones also contribute helpfully in this area.

On the consumption side, black money seeks to buy three things legitimate goods that can be consumed openly (i.e. normal things in abnormal amounts—say many shoes, many suits etc.), illegitimate goods that can be consumed secretly (banned or imported exclusive foods—caviar or expensive wines, expensive furnishings, home decorations etc.) or stored secretly (high-end safes, etc.). Within these sectors there exist trails that lead to the people hoarding the money.

Black money is also used in legitimate investments. Foreign channels play critical role. Quite substantial investments in P-Notes are actually round-tripped black money. The key aspect of these instruments is creating anonymity by being away from arms of the laws of the country from where income can be fed into the legitimate hands. In such cases, the source of income is illegal. Thus, many businesses in tax-havens such as Mauritius, Cayman Islands etc. exist to convert illegal money into legal money. Many of these investments come under the purview of money laundering. Incentives for electronic transactions help prevent use of cash. Income tax deductions on credit cards or e-payments up to a certain limit can incentivise electronic transfers. South Korea used credit card income deduction experiment has been haled as a success by OECD.

4. Strategies for Tackling Black Money

The distillation of various approaches can be summarized as under:
1) Establish identity of persons (through PAN Card, Aadhar Card etc.) operating in the country—citizens and foreigners.
2) Enable low the cost direct bank transfers (Implementation of NEFT/IMPS/RTGS and other formats) including direct transfers of subsidies to the beneficiaries under the Aadhaar scheme.
3) Enable electronic register of assets (Underway through electronic land records, digitization of revenue records)
4) Reform tax system so that cost of compliance is lower than cost of tax evasion. (through initiatives such as Saral forms, e-filing, self-declaration etc.)
5) Widen the net for disclosure by filing Income Tax return. (auto-processing returns for tax refunds)
6) Regulations that increase costs for black money creating activities. (Prevention of Corruption Act etc.)
7) Create attribution chain for funds entering and exiting the country (such as through P-Notes, FDI, Prevention of Money Laundering Act etc.)
8) Create e-trails of both incomes and expenditure
9) Control on holding of cash and physical money including Indian and foreign money. (FEMA, recent demonetisation)

It is clear that black money clean up is underway on many fronts. Many of the pieces of puzzle have been put in place.
announcements. So in effect the only places where they will be accepted will be banks. Second, even the banks have been given time until when they can accept the notes – 30th December. Third, the cash swap carries restriction. Thus, in effect the announcement forces these notes into the banks deposits within a short period of time. As per RBI estimates [https://www.rbi.org.in/scripts/AnnualReportPublications.aspx?id=1181], 15 billion notes of 500 denomination (approx. Rs. 7853.75 billion) and 6 billion notes of 1000 denominations (approx. Rs. 6325.68 billion) exist. In addition, RBI estimates that fake 0.2 million notes of Rs. 500 and 0.15 million notes of Rs. 1000 were discovered. The actual number of fake notes in circulation will be higher. These will be worthless from 09 November 2016 but you can get the credit for the money held as these notes in the form of bank deposit. Naturally, those who can disclose deposits equal to the amount they hold in cash will have no problem.

Hasn’t It Been Done Before?

Indeed, it has. The first demonetization took place in 1946 and Rs 1000 and Rs 10,000 notes were demonetized. Later in 1978, Rs. 1000, Rs. 5000 and Rs. 10,000 were demonetized. This is the third time demonetization has taken place. The critical difference is in the quantum however. The first and second demonetizations effected really high value notes which formed a small part of notes in circulation. We can arrive at the estimates by comparing the denomination of the note with the annual per capital GDP. In 1960, India’s per-capita GDP was Rs. 400 (then currency), in 1978 per capita GDP was Rs. 1722/- whereas today it is Rs. 103,000/- (today’s currency). [World Bank data in currency of respective year. Earliest data available is 1960 so we have used 1960 data. Devaluation was in 1946 which was way before this year]. Thus in 1960, a 1000 Rupee note was 2.5X and in 1978 it was 0.5X per capita GDP, considerably easy to withdraw. The second aspect is that today the 500/- and 1000/- currency notes represents ~85% of physical money in circulation. At that time, it was considerable less [The numbers based on estimates by various agencies]

Proposed by various people such as Arthakranti and also by Peter Sands in essay titled Making It Harder for the Bad Guys: The Case for Eliminating High Denomination Notes, M-RCBG Associate Working Paper Series | No. 52 in February 2016 and later discussed by Lawrence Summers and others.

RBI earlier removed pre-2005 notes of all denominations from circulation as they have fewer security features compared with subsequent notes. The process of removing the older notes from circulation continued for nearly one year. The deadline was extended till December 2015 and those notes continued to remain legal tender till November 8. This was not exactly demonetization but removing from circulation and has now subsumed into the present demonetization.

5. Why Attack The Cash?

First, who holds black money in cash? Mostly corrupt people. Their pay-offs are in suitcases and hoarded in their houses. These are balances held till they find their target investments. A lot of black money itself is mainly held in gold and land.

As explained earlier, cash, i.e. black money is the currency of black economy. The government cannot do much about black money that remain stagnant if it remains a legal tender. But remove the legality of it and the government is able to alter the cost-benefits equation of corruption. Demonetization attacks the currency supply of the black economy. But removing the cash available to buy these gold and you affect the supply chains in black economy. When the flow gets interrupted the cost of corruption increases and payoff reduces dramatically. Such action attacks the chain that processes black money.

It is possible that as a result land prices and gold prices will fall. If land prices fall, middle class will be able to purchase land. If gold purchases are reduced, the forex pressure on INR will ease a bit. Thus, legitimate money which was being priced out of the economy gets an opportunity. Further, it prevents the black money processing chains from forcing white money into black.

Objectives

1) To predict the source of funding during elections.
2) To study the role of election commission to reduce the corruption in election.
3) To know the demonetization effect on the election of UP and Punjab.
4) To find out media accountability in demonetization process.

Research Methodology

The methodology used is Case Study Method, where in-depth investigation of election polls of Punjab and UP 2017 is studied. Typically, data are gathered from a variety of sources and by using several different methods like observation and interviews. The ratio for data collection is 25% as primary data and rest 75% is secondary data.

Interpretation

The government of India has demonetized Rs 500 and Rs 1000 notes to get back the black money. The impact of demonetization can be clearly visible on the elections of the two states i.e Uttar Pradesh and Punjab. As per the election commission, parties those who have organized the money will not be facing any problem but parties who have not organized it may find them in trouble in gaining attention of the people through political campaigns. It is difficult to analyze the election report, as it is a game of twist and turns. Money plays a great role in Punjab elections, the flow of money, depicts the impact of demonetization on the people. In Punjab Election 2017, People are in favor of the demonetization as it would control the flow of money, election committee makes sure that the flow of cash would be under control and the black money won’t flow easily.

Impact of Demonetization not only be seen on the voter’s mindset but could be sense in the matters of Political parties. As all the money collected by Political parties become...
useless with further collection of money from businessmen will be difficult because they will not have black money to give. Workers for electioneering will be difficult to mobilize without funds. Candidates will not be able to spend money on elections because of their inability to generate funds. Huge election rallies will be a thing of the past. Since the parties or candidates cannot mobilize people for rallies, attendance in election rallies will be thin. It will be even difficult for the parties to even purchase votes.

Demonetization has impact on the mindset of the people. Many people have changed their percept on the particular party or you can say it has diverted the mind and gained utmost attention of the people. Not only that as per the Uttar Pradesh election 2017, things may change differently, as Akhilesh Yadav is not in favor of BJP for coming into the power in Uttar Pradesh, it depends on the majority of the people. The impact may effect on different constituency, such as in Punjab Assembly election in 2017, people are in favor of Narendra Modi, depending on the consequences one cannot depict the results as it may not be convincing.

Uttar Pradesh is such a state which suffers with bold problems that lacks in infrastructure, corruption and terrible law and order which need bold solutions. Prime Minister’s movement towards demonetization might attract people of UP towards BJP with a hope to resolve the bold issues. On the grounds of UP Elections, people are not criticizing demonetization neither they protested against demonetization. That clearly states that the people in UP are not against demonetization. Though the parties of UP both Mulayam Singh and Mayawati are claiming the inconvenience faced by poor.

SP is playing their trump card of neutral politics of development, not even talking of caste, political abuse, poor vs rich statement. But SP is fighting in between the party. If they didn't make peace in between themselves they will definitely loose UP with big margins because vote share will divide.BJP played trump card of demonetization, BSP still talking caste based votes, and Congress is still trying to connect with lost voters.

Most people believe that the prime minister’s intentions were right. He had taken the decision to demonetize the bigger currencies of Rs 500 and Rs 1,000 in national interest, even at the risk of sacrificing his party’s interests.

AAP in Punjab is working at ground root level and taking rural citizen in its fold. All other parties are working at majorly cities only and online. AAP actually stroked that area which was affected by demonetization. That can be sense in rural areas of Punjab which was even worse, with farmers finding it tough to buy fertilizers and pesticides. What adds poignancy to the farmers’ woes is the fact that many of them have had to sell their freshly harvested paddy at almost half the price. And there are few takers of the perishables such as fruits and vegetables in mandis.

With Demonetization effect, many political parties of Punjab visited the premises of many spiritual leaders to ask for the votes.

Demonetization might not even affect Punjab’s Election due to charges on SAD-BJP is known with Family acquitted in many corruption cases and issues of secret file on Punjab’s Drug Barons. Demonetization just consolidated the concept to vote against SAD as businessman and low income group is affected. Salaried and students are not affected at all, so that might play crucial role.

Urban people of both Punjab and UP will not affect election polls because urban class took demonetization as Anti-corruption drive but also a modernization drive with the cash less statements. Semi-urban people might affect elections due to switching cash alternatives whereas most affected area that will be Rural which can cause affect on elections towards BJP as they suffered more in terms of Farming.

Association of Democratic Reforms and UP Election Watch conducted a survey to study the impact of demonetization in the upcoming UP assembly polls. Here’s a look at the results. Total 9,000 persons covered (300 persons from 30 assembly seats in 10 districts, including Jhansi, Kanpur, Lucknow and Varanasi participated.

1) Impact of demonetization on horse trading of voters; results in 65% Horse trading would continue, 20% believes that it will not easy to buy voters and 15% admit that it is unable to decide the impact.

2) Impact in terms of number of payments post demonetization; stated 60% with no effects, 30% thought that there will be very little effect and 10% people can’t say.

3) Impact of Note ban will affect distribution of wine, jewellery and other goods; 65% stated that it will not affect whereas 26% believes that it will affect and rest 9% can’t say.

4) Changes in way of campaigning post-demonetization; 70% believes changes, 20% opposes and 10% have nothing to say.

5) Difficulty in polls during post-demonetization; 80% feel difficulty during post-demonetization rest 20% finds no difficulty.

6. Conclusion

The demonetization has huge impact on both voters as well as political parties. No matter people of Uttar Pradesh and Punjab suffered a lot due to demonetization but many people supported it also. The flow of cash reduces for the political parties, as earlier lot of money is to be spent on the campaigning but this time due demonetization effect, many parties didn’t able to spend lavishly. Some parties took the advantage of demonetization by speaking against the party whereas some just focused on portraying the real picture in front of the people. This 2017 election will be marked as the History to know who wins because both Voters and Political parties suffered due to demonetization.

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