

# Demonetisation is for the long run

It is only rule-based capitalism combined with clean government that can transform India



DHIRAJ NAYYAR

The critics of demonetisation are absolutely right about the adverse short-term impact of the policy. It has caused major inconvenience to a vast majority, particularly to those who have the least financial resources. Of course, it will shave off some amount of GDP growth for anywhere between a quarter and three quarters because of the economic disruption it has caused in different sectors of the economy. According to some, including the venerable Dr. Manmohan Singh, this alone is sufficient to damn demonetisation. After all, the short run is all that matters because in the long run, as Keynes famously said, we are all dead.

While that proposition may be true for individuals, it certainly isn't true for nations. India has a long-term future even if you and I don't. Also, there is a medium term, longer than an electoral cycle or two (certainly longer than a quarter or two) but shorter than a generation (say, 30 years). The real impact of demonetisation must be weighed in the medium/long term.

## Stamping out cronyism

India's economic progress is at an inflexion point. Twenty five years of liberalisation have yielded far superior outcomes for almost every Indian than four and a half decades of socialism did. But the gradual opening of markets with continued, substantial government control over the economy also unleashed a virulent strain of crony (and indeed phoney) capitalism at about the same time that India grew at its fastest between 2003 and 2012. Rules and fairness were simply cast aside. The policy paralysis in United Progressive Alliance 2 and the spectacular downfall of a government that had won an unprecedented second consecutive full term in office (a first post-1991) was a backlash against cronyism and loot.

It is to Prime Minister Narendra Modi's credit that he was able to separate the virtues of capitalism from the pitfalls of crony capitalism in his campaign for India's highest office. Thus the rhetoric of minimum government (pro-market) went hand in hand with the rhetoric against black money and illicit wealth accumulation (anti-crony). But the sustainability of pro-market policies is only feasible if there is a firm stamping out of



**REBUILDING FAITH:** "Demonetisation is an important step in dislocating those who don't play by the rules of the game." A cafe in Hyderabad which introduced a swiping machine after the demonetisation announcement. PHOTO: K.V.S. GIRI

cronyism. Otherwise, it is easy for public perception to view any pro-market policy as pro-business and pro-crony. Eventually, if that perception makes strong roots, India's relative economic success over the last quarter century could be quickly eroded by a populist backlash.

It is, therefore, important to put demonetisation in the context of this political economy. The reason that opinion polls and anecdotal evidence continue to suggest the popularity of the move despite the obvious hardships is because it is perceived as a decisive act against the crooked — those who made their money unscrupulously and then chose to hide it — not the rich who earned legitimately and paid their taxes.

## Technology-enabled transparency

This is no throwback to Indira Gandhi-style socialist populism. For a start, it is not confiscatory — your money remains yours provided you are willing to disclose it. More importantly, Mr. Modi remains committed to markets and entrepreneurship of the rules-based variety. That commitment is evident in other policy measures being implemented. The removal of discretion in the auctioning of all natural resources has already happened. There is a move to technology-enabled transparency elsewhere in government. Unsurprisingly, there has been no corruption scandal

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even as the government completes half its tenure. There is a new emphasis on the "personal" sector (moving away from a singular obsession with public sector or private sector jobs to productive self-employment), through schemes like Start up India and Stand-up India and through a commitment to get the government out of the business of doing business.

But the success of all of that depends on rooting out the hold of crony capitalists in the system. Demonetisation is an important step in dislocating those who don't play by the rules of the game.

It is often asked why politicians have failed to make a case for the free market in India. At least part of the answer lies in the widespread cronyism which gives the free market a bad name. If any politician is ever to make that case — and for now Mr. Modi seems the likeliest to do so — he or she has to eliminate crony capitalism.

A system will be viewed as fair if no individual or business is able to manipulate the rules of the game whether in terms of gaining favours from the gov-

ernment or by evading taxes. Free markets and capitalism will get mass public support if everyone is on a level playing field and when the rich/well off pay their taxes which can then be used to invest in those left behind so that they too have an opportunity to rise.

It is only a rule-based capitalism — sans cronies and phonies — combined with a clean government that can transform India. It is said that the quality of India's democracy is what give it an edge over authoritarian China. That will hold true if democracy delivers a rules-based capitalism and efficient government. It is a tortuous path but few nations in history have got there easily.

That is why a long-term view is important. It is easy to be cynical and say that demonetisation will not alter the behaviour of the crooked. It may not change everyone but it will nudge a certain number in the right direction — to pay taxes, to transact without cash. More importantly, demonetisation will rebuild the faith of a disenchanted people in staying invested in a system that is rotten but that can still become fairer for all. The crooks don't have the keys to power and influence in perpetuity. That's an important message as India aspires to a prosperity for all.

Dhiraj Nayyar is officer on special duty and head, Economics, Finance and Commerce at NITI Aayog. Views are personal and do not reflect the views of NITI Aayog.