

***Shobhana's edit*****... only if govt policies, like on tax, totally reengineered**

In an economy as dependent on cash as India, demonetising Rs 500/1,000 currency notes was always going to disrupt both households and businesses, choking both demand and supply in the near term. While the inconvenience to individuals and businesspeople has been more severe than anticipated, the government has done well to come up with some damage-control measures. On Monday, it raised the cash-handling limit for banking correspondents to Rs 50,000 while, at the same time, enhancing the supply of cash to 1.3 lakh post office branches, primarily in rural areas. The government is also making sure consumers in urban India are able to access more money whether via ATMs, including micro ones, or bank branches. Most importantly, businesses can withdraw as much as Rs 50,000 a week from current accounts provided these are at least three months old – this has been done in response to complaints that workers are not getting paid their daily wages. It is critical the government ensures there is enough cash to go around since there is a very real possibility of businesses slowing down or even grinding to a halt, bringing the economy to its knees – and if the situation persists till the 50 days the prime minister has talked of, the damage can be quite severe.

While the pain is evident, getting the gains will require more than just the demonetization, courageous as that was. There is considerable uncertainty as to how, if at all, the gains will flow to the government. If Rs 2-3 lakh crore of Rs 500/1,000 notes are not deposited with banks, this will be a blow to those with black money but it is not clear if this can be transferred to the government by RBI – former Governor C Rangarajan has said he doesn't think it can be transferred, and if it cannot, the government cannot spend more to compensate for the reduction in consumption by those with black money. More important, cash holdings cannot be

more than 5-10% of all black holdings, so, to make the most of the demonetization, the government must stop future generation of black money. This requires big tax reforms and comprehensive work on ease-of-doing-business parameters. To begin with, tax rates for individuals need to be lowered to improve compliance – the 30% tax rate kicks in way too early at the Rs 10 lakh income slab. Given the government just collected Rs 7,000 crore in long-term capital gains taxes in FY14, removing capital gains taxes is another overdue step and will ensure less black money in real estate transactions. More critically, the business of government has to be re-engineered to prevent harassment and discretion. If the taxman can arbitrarily arrest a senior official of a MakeMyTrip for alleged sales tax violation, and without even a show cause notice, that's a system tailor-made for corruption. If building permits take forever, that is an invitation to corruption; a mind-boggling 50 permits are required to set up a retail outlet, liberalized FDI rules in a host of areas from aviation to single-brand retail leave almost all discretion with government ... If this does not change, businessmen will simply go back to the old ways of bribing their way out of trouble, defeating the entire purpose of the clean-up. Equally, if political parties do not have to disclose the source of the bulk of their funds – and there is no meaningful control on election expenses, including expulsion of MPs/MLAs if these are exceeded – it is difficult to see how black money can be eradicated.