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## Demonetization - India's attack on terrorism

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Delivering on his election promise to effectively combat corruption, tax evasion, counterfeiting of currency notes and the concomitant rampant use of these fake notes in stoking terrorism, the Indian Prime Minister Narendra Modi announced on 8 November 2016 in a broadcast to the nation that the 500 (€7,00) and 1,000 currency notes would no longer be considered legal tender from midnight on. He announced that the 500 and 1,000 rupee notes would be replaced by new 500 and 2,000 rupee notes. Other currency denominations (banknotes of 5, 10, 20, 50 and 100 rupees) remained valid. No changes were made to any other form of tender such as cheques, debit cards, credit cards or online transfers. Indians who held cash in 500 and 1,000 rupee notes were given the opportunity to deposit such notes into their bank accounts or exchange them for new notes between 10 November and 30 December. A limit (₹ 24,000 per week) was imposed on how much could be exchanged or withdrawn from individual accounts.

Prime Minister Narendra Modi informed Indian residents that the demonetization move was part of the Indian Government's *'Clean India'* campaign.

In order to smooth the operation petrol- and gas stations, government hospitals, railway and airline booking counters and crematoriums were instructed to accept the old 500 and 1,000 banknotes until 24 November 2016. International airports were also instructed to facilitate an exchange of notes amounting to a total value of ₹5,000 for tourists and Indian flying abroad.

### India's economy

India's Gross Domestic Product (GDP) grew by 7.3% in the quarter ending September 2016, higher than the previous quarter and stronger than China's growth of 6.7%. These numbers translate into the fact that India is still the fastest growing major economy in the world.

Prime Minister Narendra Modi, leader of the Bharatiya Janata Party (BJP), took office in 2014, and is widely credited with reviving the economy and rejuvenating India's foreign policy. Despite internal and external challenges acting as barriers in the overall economic environment, aided inter alia by lower global oil prices the Indian economy has been sustaining a growth rate of about 7%, with huge investments from overseas. United States' (US) investments in India alone increased by 500% over the past two years to reach a staggering \$4.2 billion.

Standard & Poor's (S&P) expects that the demonetization will mainly affect private consumption demand in an economy like India's, which is mainly cash-dependent. Private consumption demands account for 55% of the nation's GDP. According to the ratings agency the drop in consumption will moderate economic growth in the second half of the current fiscal year ending in March 2017. S&P lowered its growth forecast to 6.9% for the full fiscal year, from an earlier estimate of 7.9%. It expects

prices to fall in the short-term and private sector investments to be shelved initially. It also expects lower private consumption in fiscal 2017, but forecasts that demand will revive in fiscal year 2018, which will revert the Indian economy back to an 8% annual growth trajectory.

The ratings agency does not expect any significant, near-term impact on the credit profiles of India. Despite the short-term disadvantages, in the long run, S&P believes, *"these reforms should significantly improve India's business climate, and the country could regain its status as the world's fastest-growing major economy within a year"*.

### Aims & objectives of the move

Besides fighting corruption and tax-evasion, among the primary reasons for adopting such a drastic measure has been the overwhelming amount of counterfeit Indian banknotes circulating in the market. These counterfeit bills have been used to fund drug trafficking, smuggling, and most alarmingly for India, terrorism.

A report of 2013 of The Financial Action Task Force (FATF) stated that the Indian rupee was the ninth most counterfeited currency in terms of its value and third in terms of the number of counterfeit currency notes detected around the world. The demonetized 500 and 1,000 banknotes were the most widely counterfeited among all Indian banknotes.

The demonetization also aims to restrain the shadow economy in India, the major driver of inflation that deprives the government of its tax revenue. In addition, the move will reduce cash circulation in the country. According to estimates, 92% of transactions in India are made using cash.

### Counterfeit notes and terrorism financing

Money laundering, counterfeiting of currency and terrorism financing can have potentially devastating economic and social consequences, in addition to posing a serious threat to national security. While these menaces can occur in any country, they have particularly significant economic and social consequences for developing countries, emerging markets and countries with fragile financial systems. The negative impacts tend to be magnified in these markets because they tend to have less stable financial systems, a lack of banking regulations and effective law enforcement, and, therefore, are more susceptible to disruption from criminal or terrorism influences.

The counterfeiting of currency is a rampant phenomenon. The seizure of high quality counterfeit currency notes in multiple jurisdictions throughout the world appears to indicate the involvement of criminal groups operating internationally, and, worryingly, at times even nation states.

India, Kyrgyzstan, Nepal, Russia, Tajikistan and the US have reported the linkage of counterfeit currency with organized crime and terrorist financing. These countries also refer to links between organized criminal groups, terrorism and its financing. Studies reveal that in addition to financing of terrorism, the use of counterfeit money serves as a means of economic warfare. Apart from financing their operations with the use of counterfeit currency, research has also suggested that terrorist organizations active in Europe, Asia, and Latin America, rely on otherwise 'common' criminal activities,

such as extortion, kidnapping, narcotics trafficking, money laundering, and fraud. Such overlapping activities have been the reason behind their close collaboration with organized criminal groups.

The US Government has on many occasions reported that individual terrorists use counterfeit currency and distribute it through terrorist networks. The revenues are invested to strengthen terrorist support infrastructures and to finance individual attacks. Based on these findings, the eurozone has decided that it will be eliminating the largest euro note (€500) and the US has been for long trying to reduce the number of 100 dollar bills in circulation.

Forensic examination of counterfeit currencies seized by law enforcing agencies worldwide suggests that in some cases counterfeit currency is produced in liaison with sovereign states. There are specific instances in India, which show the close nexus between terrorist financing and the use of hawala for routing the funds to terrorists. These hawala networks are controlled by organized criminal groups. In recent times, India has also reported large scale use of counterfeit currency by state actors to fund terrorist acts. Case studies by FATF in this regard expose the scale and intensity of the problem. In particular, there is evidence of multiple bases being used to flood India with counterfeit notes, and the use of such fake notes to fund specific terrorist acts. The attempt is to attack the '*economic security*' of the country. The involvement of some state actors in counterfeiting of currency is also prevalent in other parts of the world. North Korea has been proven to be involved in the production and smuggling of counterfeit US currency.

### Terrorism financing in India

According to the Reserve Bank of India's (RBI) annual report of 2014-2015, almost 600,000 counterfeit notes were detected in 2015 by Indian authorities. Analysts assess that this is a third of all the counterfeit Indian notes in circulation at any given time. RBI data also suggested that the most counterfeited Indian notes were the 500 and the 1,000 rupee notes.

India asserts that counterfeit currency notes are being printed by state actors in Pakistan in printing presses in Punjab, Balochistan and along the Line of Control (LoC). According to investigating agencies in India, Pakistan uses complex networks of couriers, infrastructure of international organized criminal organizations and the various hawala networks in South Asia to fund terror operations in Jammu & Kashmir, Maharashtra, Gujarat, Karnataka, Kerala, Andhra Pradesh, Bengal and Bihar.

In addition to India's neighbouring countries like Nepal and Bangladesh that are extensively used to inject counterfeit notes into India, countries like the United Arab Emirates, Thailand, Malaysia, Sri Lanka and China have also been identified as important transit routes.

Traditionally, Nepal has been extensively used by traffickers because of the open border it shares with India. The largest number of counterfeit Indian currency notes is seized from Nepal. Bangladesh is the second most favourite transit route for counterfeit Indian currency notes being smuggled from Pakistan.

There are numerous instances in which law enforcement agencies in Bangladesh have seized counterfeit Indian currency notes from traffickers who had either direct or indirect links with Pakistan.

Some research put the number of Pakistani nationals involved in counterfeit Indian currency notes cases throughout South and Southeast Asia, to an astonishing 50%.

David Headley (convicted for his role in the 26/11 Mumbai attacks), declared to law enforcement agencies that officers of the Inter-Service Intelligence (ISI), Pakistan's premier intelligence agency, provided him with counterfeit Indian currency for circulation and use in India. According to law enforcement agencies, another terrorist, Syed Abdul Karim Tunda (bomb expert of the Lashkar-e-Taiba, accused of masterminding more than 40 bombings in India), who was arrested in 2013 close to the Nepal border, had received several consignments of counterfeit Indian currency notes directly through an ISI officer of the rank of a Brigadier.

The traditional method of counterfeiting is the use of offset production. The use of an offset press requires specific know-how and such machines are very difficult to find on the market. The high quality of counterfeit Indian currency notes suggests of professional counterfeiters with expert knowledge in printing, security features and who also have possession of professional printing equipment and the know-how to use this equipment. Such equipment and the specific knowledge are believed to be only available to state agencies.

Above mentioned reports from law enforcement agencies, confessions of convicted terrorists and examination by FATF implicate state actors in Pakistan beyond reasonable doubt as being involved in the practice of producing counterfeit Indian currency notes to fund terrorist acts and wage economic warfare against the Indian State.

### Effects on Terrorism Financing due to Demonetization

During his address announcing the demonetization of the 500 and 1,000 rupee notes, Prime Minister Modi spelt out that one of the reasons behind the move was related to the above mentioned large-scale terrorism financing by saying that *"enemies across the border have been responsible for the circulation of counterfeit Indian currency notes"*.

The demonetization is a brilliant move to counter this activity. In the span of a single night, all counterfeit currency notes and even genuine currency notes used by terrorist infrastructures became defunct. It is not hard to imagine that an industry that runs on cash transactions (whether in counterfeit or genuine currency notes) will find it impossible to operate if cash loses its value overnight and is not accepted anymore.

The demonetization policy left many terrorist groups unable to operate. The effects on Pakistan and Pakistan Administered Kashmir-based religious extremist groups, India's left-wing extremist groups and insurgent outfits active in North-East India has been the largest. Due to the finances held by terrorist organizations largely being in demonetized notes, recruiting, buying weapons, sustaining logistical support, remunerating over-ground workers, and even paying bribes have become almost impossible.

As many as ten states in India are affected by *Left Wing Extremism*. Maoist groups have some territorial control in tribal and forest areas that they call '*liberated zones*' in which an illegal system of

taxation is imposed on the population. The attempts of placement, integration and even collection of this 'tax' has been halted immediately due to the demonetization move. Several leaders and members of the People's War Group (PWG) have surrendered in the face of demonetization as their funds have dried up.

The porous borders between India and Bangladesh and between India and Myanmar have contributed to the influx of counterfeit Indian currency notes used by terrorist groups in North-East India. Reports indicate that North-East Indian insurgent groups such as the United Liberation Front of Assam (ULFA), National Democratic Front of Bodoland (NDFB), National Socialist Council of Nagaland (NSCN) and others, whose leadership is sheltering in Myanmar but whose funds are extorted in Assam and other North-Eastern states, are also struggling to operate. The cash withdrawal limit from banks imposed by the Indian Government post-demonetization has also contributed to drying up of fresh funds for these outfits on account of disruption in collection of illegal 'taxes', extortion amounts, etc. Extortion, dividends from real estate, drug trafficking and use of counterfeit currency have been the primary sources of funding of these groups. Inability of those being extorted to pay up due to demonetization squeeze has had a major impact on the revenue of these groups, which are experiencing huge difficulties in running their offices and field units due to the demonetization.

The state of Jammu & Kashmir has been witnessing a period of unrest for the last four-five months after the killing of the chief-commander of the Pakistan-based terrorist organization, Hizbul-Mujahideen (HM), which is proscribed by the United Nations. Despite curfews being imposed, concerted attacks by violent protestors, mainly youth from less affluent families, on public property, civilians and security forces were the order of the day. The All Party Hurriyat Conference (a conglomerate of small political and religious parties seeking Jammu & Kashmir's accession to Pakistan) has been spearheading the unrest.

According to officials of the Jammu & Kashmir police, the funding for militancy and the separatist movement in Jammu & Kashmir originates, and is sustained from, Pakistan. Hawala channels in Pakistan, Bangladesh, Nepal and Dubai have been providing a steady flow of funds into Jammu & Kashmir to sustain the separatist movement there. Post-demonetization, these hawala channels are faced with the need to recuperate their stacked funds in Indian currency, which could take months if not years.

Stone-pelting incidents and other violent attacks by protestors had shown a decline of 15-20% every subsequent month after the killing of the HM commander on 8 July. The majority of the population had voiced discontent because of the continuous shutdowns, loss of tourist revenue and the blockade of educational establishments by the separatists. After the demonetization, pelting incidents and violent attacks by protestors declined steadily, and have almost stopped completely now.

## Conclusions and suggestions

The demonetization move in India is a courageous and bold step of Prime Minister Narendra Modi to counter various challenges that the nation had been facing. While analysts differ on the degree of impact demonetization has had on some of the stated aims such as curtailing black money, tax-evasion and corruption, it is evident that its strategic merit has been enormous. Industries of counterfeit currency, organized crime and in particular terrorist financing have been dealt a heavy blow. Accumulated funds, counterfeit currency, and hawala stocks in these complex infrastructures, which take huge investments to build and sustain, have overnight become redundant because of this one courageous and visionary move.

Although the financial highways of terrorist and separatists groups have been choked and it will take these industries years to regroup and rebuild their networks, it is of utmost importance that India takes swift efforts for the inclusion of all its citizens in its aim to move to a cashless economy.

Due to poverty, traditional values, cultural customs and illiteracy, 35% of Indians do not have a bank account. The digitalization of every part of the Indian economy requires careful planning and accurate implementation. Demonetization is one of the many steps required in the process of '*financial inclusion*' of all Indians. The rural areas in India and its informal economy, which are almost entirely dependent on cash transactions for day to day business, will require special attention and education in order for the mindset to change and to accept a cashless economy.

A major vulnerability of digitalization and a more cashless economy, which the eurozone has experienced the hard way, is cyber-security. Governments all over the world and especially in India's vicinity, like Iran, Pakistan, China and Russia, have become increasingly active in using '*digital war*' in lieu of conventional warfare.

There is an urgent need to secure digital systems, educate and train millions of technology users and invest heavily in defence strategies against digital threats. A cash-based economy has its challenges and disadvantages. The same can be said of a cashless economy. The revenue - penalties and tax collections - generated because of the demonetization move should enable the Modi government to facilitate these steps.