

RBI's Report on Demonetisation

What is the issue?

\n\n

\n

- RBI has said in its annual report that over 99% of the demonetised currency in November 2016 was returned back.

\n

- The new report has highlighted the futility of the whole demonetisation drive.

\n

\n\n

What are the highlights?

\n\n

\n

- 99.3% of the Rs 500 and Rs 1000 notes that were withdrawn from circulation were returned back.

\n

- Post demonetisation, the RBI spent nearly Rs 8,000 cr in 2016-17 on printing new notes.

\n

- This is notably more than double the amount spent in the previous year.

\n

- The value of banknotes in circulation increased by 37.7% over the year from demonetisation.

\n

- Also, compared to previous year, there is substantial increase in counterfeit notes of almost all denominations.

\n

\n\n

Why is demonetisation unjustifiable?

\n\n

\n

- **Objective** - Demonetisation targeted those who had hoarded ill-gotten

wealth in cash.

\n

- If these had been returned at a higher tax rate, the government would receive the taxes.

\n

- If not, it was expected that 15-20% of the cash in use as 'black' money would not return.

\n

- This amount was estimated to be in the tune of Rs 4-5 lakh crore.

\n

- So if not returned, it would count as a windfall gain on the RBI's balance sheet.

\n

- Because, unreturned money would mean a reduction in the RBI's liabilities by that amount.

\n

- So the plan was to transfer this resultant surplus from the RBI to the Centre.

\n

\n\n

\n

- This was, in fact, the principal reason for the whole demonetisation exercise.

\n

- Now that over 99% has returned to the system, the basic objective has not materialised.

\n

\n\n

\n

- **Black money** - Many converted the unaccounted money into legal tender.

\n

- Unintendedly, the demonetisation drive itself became a tool for making white the black.

\n

- Also, given the logistical difficulties in penalising all of them, the whole purpose gets defeated.

\n

- **Corruption** - It was claimed that the drive would root out and bring to light the corrupt rich.

\n

- This was, in fact, the reason why there was less public agitations, despite the difficulties.

\n

- But having not fulfilled this promise, demonetisation has had no political benefits as well.

\n

- **Savings** - Demonetisation seems to have had a problematic effect on household savings pattern.

\n

- Household savings includes the savings of small unregistered enterprises as well.

\n

- These units were some of the hard hit by demonetisation.

\n

- But the household savings figure is at a multi-year high of over 11% of gross national disposable income.

\n

- In fact, households are holding far more of their savings in cash than in the year prior to demonetisation.

\n

- So the attempt to financialise savings has, in fact, been set back.

\n

- **Cash** - The cash to GDP ratio has reached levels comparable to the period before demonetisation.

\n

- So the behavioural changes demonetisation brought in terms of holding cash were not as the government expected.

\n

- **Impact** - Clearly, the aims of demonetisation do not seem to have been met.

\n

- On the other hand, it has had many negative impacts, leading to

\n

\n\n

\n

- i. slowdown in growth

\n

- ii. damage to informal sector supply chains

\n

- iii. job losses in sectors such as construction (unskilled labour)

\n

\n\n

Had there been any benefits?

\n\n

\n

- The benefits, if any, would be the increase in the number of income tax returns filed.

\n

- Demonetisation has also led to formalisation of economy and more tax collections.
\n
- But these could have been achieved by other policy measures too and not necessarily by demonetisation.
\n
- Besides, cashless modes of payment have become more common.
\n
- But financial savings in the form of currency have also risen, suggesting that people still value cash.
\n

\n\n

What is the way forward?

\n\n

- \n
- The government must not disown its biggest reform attempt.
\n
- It should neither try to sidestep parliamentary scrutiny of the outcomes of demonetisation.
\n
- Instead, it could focus on fixing the problems that people still face.
\n
- Transactions with Rs 2,000 notes in the absence of Rs 1,000 notes are difficult.
\n
- This is indeed a departure from the currency denomination principle.
\n
- As per this, every note should be twice or two and a half times its preceding denomination.
\n
- Besides this, the larger lesson that sudden shocks to the economy are less likely to yield intended policy objectives should be learnt.
\n

\n\n

\n\n

Source: The Hindu, Business Standard, Economic Tim

\n



SHANKAR
IAS PARLIAMENT
Information is Empowering