

RBI's Report on Demonetisation

What is the issue?

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- RBI has said in its annual report that over 99% of the demonetised currency in November 2016 was returned back.
- The new report has highlighted the futility of the whole demonetisation drive.

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What are the highlights?

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- 99.3% of the Rs 500 and Rs 1000 notes that were withdrawn from circulation were returned back.
- Post demonetisation, the RBI spent nearly Rs 8,000 cr in 2016-17 on printing new notes.
- This is notably more than double the amount spent in the previous year.
- The value of banknotes in circulation increased by 37.7% over the year from demonetisation.
- Also, compared to previous year, there is substantial increase in counterfeit notes of almost all denominations.

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Why is demonetisation unjustifiable?

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

wealth in cash.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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- i. slowdown in growth

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- ii. damage to informal sector supply chains

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

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Had there been any benefits?

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

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

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

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