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- 99.3% of the Rs 500 and Rs 1000 notes that were withdrawn from circulation were returned back.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