

Nation Rejoices Over Demonetization of Rs. 500 and Rs. 1000 Notes

Vast masses across the country, living on their honestly earned incomes without any illicit wealth, have been rejoicing over the historic move of the Narendra Modi government to do away with Rs. 500 and Rs. 1000 currency notes, with effect from midnight November 8, 2016. It aims to curb counterfeit currency, and black money earned without paying taxes and also the money possessed by terrorists and unscrupulous elements. People, having fairly earned cash, in such higher denomination notes can fearlessly deposit them in banks. This deposit of idle cash will increase bank deposits, making more money available to banks to lend for economic activities. Elimination of black money from circulation may lead to deflation, curb inflation and increase the value of money, as the supply of currency would go down in relation to the commodities and other things that are available in the market. The most noteworthy and unbelievable response to this step which has been seen is that most of the people had such a high praise for this decision that, in spite of the collective call of 13 political parties for a bandh, people did not respond at all.

Though the decision was altogether sudden and unexpected, and it has caused some spontaneous discomfort too, yet, there has been no public anger or outcry against it. It may cause slow-down for a while in certain sectors, thriving on black money, like real estate, construction, film industry, tourism etc. in the short run. Even people employed in such sectors like masons, plumbers, electricians and so on may feel the brunt of the slowdown for a short while into these sectors. In the short run, the Indian stock markets too have fallen a bit more than other emerging markets in Asia.

But, on the contrary, it would have several positive impacts over the economy:

(i) Overall GDP may increase as the cash being deposited would be supported by back dated sales, may be only on papers to vouch for the cash in hand. (ii) The sale of gold and diamond jewelry would drastically decline and help curb outgoing of foreign currency and ensure a better balance of payment situation. (iii) Corruption would be reduced drastically. (iv) Credit/debit cards and other legal transactions would go up. (v) Taxes (Income Tax, Excise, Service tax and Sales Tax) would go up substantially since more transactions would be in white and improve our tax-GDP ratio. (vi) Criminal activities would greatly reduce. (vii) More funds would come into circulation. (viii) Use of illegal money in elections would be reduced drastically. (ix) Inflation would be curbed and overheated property rates would reduce drastically thus enabling common masses to get a house at more affordable prices.

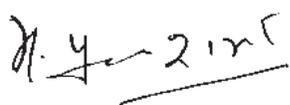
The subsequent economic boom in the economy would be much more widespread and perpetual to last long for the benefits of all sections of the society. The money being used in hoarding and black marketing would be wiped out and idle capital lying at home would come over the surface to add growth, generate jobs, raise incomes for masses and revenue for the exchequer to be spent on welfare, infrastructure, defense and so on. Introduction of GST would soon bring further unprecedented turnaround in the government revenues and growth in the economy. As an economy we should aim at going to a less-cash system. Cash facilitates crime, because it can be anonymous and big bills are easy to carry. The new Rs. 2,000 bills have been designed with enhanced security features, so this is not just new money replacing old money in the system, but more secure currency. India has one of the highest levels of currency in circulation at over 12% of gross domestic product and of this cash, 87% is in the form of Rs. 500 and Rs. 1,000 notes. Most of such cash supports underground black economy. For decades, economists such as Ken Rogoff and Richard Thaler have been arguing for a less-cash economy because it is safer and fairer.

It is the third attempt to wipe off black money and corruption in India by selective demonetization of higher denomination notes. First time in 1946 Rs. 1000, Rs. 5,000 and Rs. 10,000 notes were taken out of circulation in January, a year and a half before the country won Independence. All three notes were reintroduced in 1954. In the early'70s, the Wanchoo committee, a direct tax inquiry committee set up by the government also suggested demonetization as a measure to unearth and counter the spread of black money. But, the then Prime Minister Indira Gandhi could not dare to do so. Then, in 1978, the Janta Party government of Morarji Desai chose to crack down on counterfeits and black money by passing the High Denomination Bank Notes(Demonetisation) Act, on Jan. 16,1978 and removed the Rs. 1,000, Rs. 5000 and Rs. 10,000 notes.

On 28 October 2016, the total currency in circulation in India was Rs. 17.77 lakh crore. In terms of value, total bank notes in circulation valued to Rs. 16.42 lakh crore of which nearly 86% i.e. Rs.14.18 lakh crore was 500 and 1000 rupee notes. In terms of volume, 24% i.e. 2,203 crore of the total 9,026.6 crore banknotes were in circulation. Moreover the supply of notes of all denomination has increased by 40% between 2011 and 2016. The 500 and 1000 rupee notes increased by 76% and 109% respectively in this period owing to counterfeit money. This was used to fund terrorist activities against India.

The timing of this announcement is most appropriate, when with the massive rollout of the Pradhan Mantri Jan-Dhan Yojana (PMJDY) in India, citizens' access to bank accounts is almost complete. Thus, even the low-income households, who were earlier unbanked can now deposit their demonetised notes in their bank accounts. The government had also brought in the twin income disclosure schemes, where people were given an opportunity to declare black money. However, in spite of India being a USD 2.3 trillion economy, in the twin income disclosure schemes of 2015 and 2016, less than Rs. 4147 crores and Rs. 65250 crores were declared. While in Indonesia, which is only a USD 900 billion economy, USD 379 billion (equal to Rs. 25, 40, 00 crores) were declared as black money. This vast sum of undeclared black money would now get eliminated.

In the long run, this is a significant step to boost the government's financial inclusion drive, pushing more households towards efficient banking and payment infrastructure. In the immediate run as well, we are likely to witness larger bank deposits, price corrections and better tax collection possibilities in the economy.



(Prof. Bhagwati Prakash Sharma)