

Demonetisation: A resounding success

India was transfixed and transformed a year ago on 8 November, when Prime Minister Narendra Modi, in his resolute war against corruption and black money, demonetized Rs500 and Rs1,000 currency notes. The political verdict came swiftly with stunning wins for the Bharatiya Janata Party (BJP) in Uttar Pradesh and Uttarakhand, and rapid government formation in Manipur and Goa. The prime minister's popularity reached new heights and his approval ratings soared to levels rarely seen in democracies. The people of India recognized that a surgical strike was required to curtail illicit activities and blessed demonetisation. Thus, in political terms, demonetisation has already proven to be a resounding success.

On the other hand, in economic terms, a heated debate is under way whether demonetisation has been a success or not. Several reputed economists have pronounced their judgements on demonetisation.

For instance, Dr Raghuram Rajan has mentioned that he believed that while there might be long-term benefits, the short-term economic costs of demonetisation would outweigh them and that there were alternatives available to achieve the main goals. He has chosen not to elaborate what he thought the long-term benefits might be nor has he quantified the short-term costs.

Dr Manmohan Singh has estimated the cost of demonetisation to be 2% of gross domestic product. These quick assessments appear specious. Zhou Enlai, when asked in 1972 about what he thought the impact of the French Revolution of 1789 was, is said to have commented that it was too early to tell. When revolutionary changes take place, it takes years, decades, or even centuries before the impact of such transformations can be studied and commented upon.

Note that we lack scientific data and thorough analytical studies on the economic impact of demonetisation. For any massively complex system, judging the impact of a large disruption requires careful understanding of influence channels, distilling its impact on multifarious variables and finally, measuring its bearing, if any, on a variety of outputs. An economy as varied as India's is highly complex with multiple inputs, not-completely-understood dynamics, many agents and actors with different motivations, and finally, outputs which are not measurable with accuracy or certainty. It will take many years to filter out the economic impact attributable to demonetisation and, indeed, this bold move and its implications will, quite probably, be the subject of hundreds of dissertations. Consequently, any snap judgements will be coloured largely by ideology and opinion.

Some data is beginning to emerge on how the economic trajectory actually played out as opposed to estimates of how the various models predicted that they would play out.

Since demonetisation, the government has embarked on another ambitious bipartisan reform of consolidating various levies and taxes in different states into one comprehensive goods and services tax (GST): such a large reform intervention also creates its own changes in the economy.

To appreciate the changes that demonetisation brought about, we need to carefully choose and measure the relevant short-term high-frequency indicators and a few emerging long-term indicators which point to the direction that the economy has since taken.

High-frequency and quantitative indicators like (1) cash-to-GDP ratio, (2) volume of digital payments, (3) number of new registered taxpayers, and (4) estimate of "unaccounted for" money and the number of tax notices sent indicate that demonetisation has generated material changes. The cash-to-GDP ratio is now down to 9.7%, from 11.3% pre-8 November last year. This cash is

now in the banking system which has helped swell the current accounts and savings accounts balances of banks: this will allow them to lend and invest more, and at lower rates. Digital payments, at Rs50,000 crore in the month of October 2017, are up 41% year-on-year. The finance minister has stated that 9.1 million taxpayers have been added to the tax net as a result of actions taken by the income tax department during fiscal year 2017. Further, the ministry of finance has indicated that between Rs3 trillion and Rs4.2 trillion is “unexplained” during the cash deposit rush post-demonetisation and hence has sent out 1.8 million notices to assesses: apart from the one-time benefit to revenue of such “declarations”, these moves could bring significant stock and flow of incomes into the tax net. This data shows that demonetisation has had a positive impact on the formalization of the economy, improving the tax base and hastening the use of digital payments. Consequently, it is quite plausible to argue that these effects, which will clearly have an ongoing GDP impact, could easily swamp the impact of a one-time 2% decline in GDP.

Apart from these purely economic factors, there is another more profound behavioural change that has been accomplished. A new normal has been established—Indians are paying their taxes and moving towards a less-cash society. There is a pronounced trend towards tax compliance driven by the belief that the system is working to reward honest taxpayers even as it makes life difficult for those who have been used to evading or underpaying taxes. GST and the implementation of the benami transactions Act make it even more difficult for anyone in the economic chain to opt out of the taxation system.

Massive reforms like demonetisation cannot be measured solely by using economic parameters but need to take into account the structural shift that such reforms induce in society. Societal and long-term economic changes are difficult to measure and require more reasoned, detailed, and patient analyses: this should increase our resolve to do deeper research rather than jumping to hasty, ill-informed conclusions. demonetisation has provided Indian citizens a unique opportunity to re-imagine not only their currency, but also their own social mores, honesty, compliance with law, and their willingness to change and adapt to a more transparent and New India. We should celebrate this New India.

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