The lowdown on one year of note ban

November 8 will mark one year of Prime Minister Narendra Modi’s radical plan to demonetise 86% of the currency in circulation in a bid to fight black money, counterfeiting and terrorism. In a late-evening address to the nation last year, Mr. Modi announced that from November 9 all Rs. 500 and Rs. 1,000 notes would cease to be legal tender. A window of time was provided till December 30 to allow those holding such notes to deposit them in their bank accounts.

The thinking behind the move was that a chunk of the Rs. 15.44 lakh crore of the two high-value bank notes would not be tendered back to the banking system by holders fearing punitive action. It was estimated that the windfall gains made from the scrapped notes that could not be deposited in banks would be anything between Rs. 3 lakh crore and Rs. 5 lakh crore, which would be used for social welfare and other projects.

The RBI issued new Rs. 500 and Rs. 2,000 notes. Demonetisation, however, did not simply include just the currency exercise. After the announcement, lakhs of people had to line up at bank branches and ATMs to exchange old notes for new, losing work hours, and thus productivity. They also struggled with almost daily changes in rules as the government tried to improve the process. Demonetisation impacted the informal and unorganised sectors that depended on cash, but the extent of the damage has not yet been fully mapped.

The reason for demonetisation has been a matter of great debate. In his speech, Mr. Modi cited corruption, black money, fake notes and terrorism as the main reasons. The idea was that unaccounted wealth would come out with the mandatory depositing of the withdrawn notes. Terrorists’ funding would dry up as cash left the system, and new notes would also stymie counterfeiters. Some economists and political commentators critiqued it, saying demonetisation boosted digital transactions for the benefit of e-wallet and credit card companies and destabilised the funding of rival political parties in the run-up to key Assembly elections — in Uttar Pradesh, for example.

In its biannual economic update in October, the World Bank said disruptions by demonetisation and the Goods and Services Tax (GST) had affected India's growth momentum. While the World Bank said growth was expected to slow to 7% in 2017 from 8.6% in 2015, the International Monetary Fund projected the GDP growth at 6.7% in 2017, slower than China’s 6.8%. “While the macro-economic impact of demonetisation has been relatively limited, the distribution of costs is uneven as the informal economy is likely to have been hit especially hard,” the World Bank said in a report in May. The liquidity crisis that followed demonetisation impacted the investment climate. By June, the economy’s four growth engines, including exports and private investment, slowed down.

According to the RBI’s annual report released on August 31, 98.96% of the withdrawn notes had been returned by June-end. While defending demonetisation, the government and its then Attorney-General Mukul Rohatgi had said Rs. 3 trillion would not return to the banks as they were in the form of black money and were unaccounted for. With the return of nearly 100% of the demonetised notes, that argument does not hold.

Electronic transactions, too, have not taken off as expected, slowing down the move to a cashless economy. RBI data show cash transactions are nearly at their pre-demonetisation levels, though new methods of payments such as UPI have seen a sharp increase in usage. However, one upside is that demonetisation forced companies to document transactions. When the Centre initiated action against 2 lakh shell companies as part of Operation Clean Money, their bank accounts came under scrutiny. According to the government, it has identified 18 lakh bank accounts in which the amounts deposited during demonetisation did not match the income profiles of the account holders.

The banks are also starting to compile and release data on the deposits and accounts. The government earlier this month said 13 banks had provided data on 5,800 of the companies that had been blacklisted. The data showed that many of these companies had multiple bank accounts where suspicious currency movements occurred in the days after demonetisation.

TCA Sharad Raghavan

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