

Demonitisation

Steel'O Architectural Hardware

A Big step to stop Black money

On November 8, government announced the decision to discontinue the legal tender status of Rs 500 and Rs 1000 notes. The original objectives were stated as: eliminating fake currency; inflicting losses on those with black money; and disrupting terror and criminal activities. Later, new objectives were tacked on: enabling growth in bank credit, turning India into a cashless economy. A [cost benefit analysis](#) suggests that the benefits were relatively small when compared with the costs.

While there is much talk about the GDP impact of this decision, a unique feature of this episode is that there may considerable other costs that fall disproportionately upon the poor. The rich have access to electronic payments, employees who will stand in queues to obtain cash, and savings that are used to cope with a decline in income. The poor lack all these. If a poor person suffers an income shock, or is not able to get medical treatment, the consequences are enormous for the individual, but the GDP impact may be negligible. In terms of welfare implications, these costs matter a lot more than the impact on GDP.

The benefits are primarily in the form of losses inflicted upon those with black money, while costs are imposed on legitimate economic and social activities. Ordinary people, going about their lives, have suddenly been asked to bear a burden associated with the project of imposing costs upon people who have unaccounted wealth. Some of the costs are incurred by poor people, whose welfare loss might be much more for a given level of Rupee cost incurred. Given this difference in the nature and incidence of benefits and costs, before comparing costs and benefits, each rupee of cost should be given a much higher weight than each rupee of benefit. It seems that the economic costs of this decision are likely to outweigh its economic benefits. Some have compared this decision with a surgical strike, but it is more like a nuclear strike. The nuclear option has been exercised before exhausting other options. Although measures to help people disclose their undisclosed incomes have concluded, the efforts to directly or indirectly [curb illegality have barely begun](#). This raises concerns about the wisdom of using this lever of de-monetisation.