

THE CASE OF DEMONETISATION IN INDIA

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

Popular narratives play a much bigger role in economic policymaking than economists and policymakers acknowledge. If, indeed, these narratives are grounded more in myth than reality, the impact of such policy can be devastating. The [demonetisation of high-value currency in India in 2016](#) is a classic case of policy based on faulty narratives. Paradoxically, the [failure of the policy](#) does not appear to dent the narrative and, consequently, there is very little price to pay for its failure.

Narratives are often intertwined in the cultural belief systems of the society. Thus, the Great Depression of the 1930s came to be associated with the excesses of the “roaring twenties”, though many economic factors were responsible. The Weimar hyperinflation of 1921-24 is so deeply embedded in the German consciousness, that even now, nearly 100 years after the event, German society treasures financial stability and distrusts public debt. Fiscal conservatism remains the dominant narrative and has inhibited the post-2008 recovery in Europe. Though the recent novel coronavirus pandemic crisis has led to Keynesian remedies on steroids in many countries, there is already a murmuring of fiscal imprudence fuelling inflation.

Making of a mammoth tragedy

Indeed, narratives in economics, as in other social sciences, create myths which endure despite rational appeal to facts. The demonetisation story in India is also based on popular myth, the folklore of black money and its association with physical cash. The idea of demonetising large denomination currency as a tool to flush out undeclared hoards of cash was not new. It was done on two previous occasions, in 1946 and 1978, with poor results. But, unlike the limited impact of the previous events, the demonetisation in 2016 caused widespread disruption in the economy, whose costs are still to be properly reckoned.

Five years later, most observers have concluded that this policy was a failure. Very little of its declared objectives — of eliminating black money, corruption, moving towards a “less cash and more digital economy”, or increased tax compliance — were achieved. Expectations of windfall gains of some 2 trillion-3 trillion failed to materialise as more than 99.3% of the cancelled notes returned to the banks. If black money had existed as stockpiles of illegal cash, clearly all of it was very efficiently laundered. If the objective was to register a permanent upward shift in the tax base, it failed miserably. Perhaps the most telling evidence of the failure is that the cash-in-circulation has now exceeded pre-demonetisation levels.

And, post-COVID-19, reliance on cash is much higher, and with more higher denomination notes in circulation. By every measure, demonetisation as economic policy was a gross failure. But, as a narrative, it was presented and received in an altogether different light. Despite its manifest failure, the power of the narrative was such that it succeeded in creating a favourable or positive view of the policy.

When a reader of The Hindu came to the rescue of a destitute man, who lost his savings to demonetisation

The folklore of black money and the vivid imagery that accompanies it is easily recognised and understood by the common people, who witness corruption in daily life and see it play out in the cinema, newspaper stories or in daily conversation over the years. The very term, black money, is a loaded phrase, where the specie itself acquires a symbolic and a substantive form. The

wealth, representing ill-gotten gains, is perceived to be accumulated invariably in stacks of currency notes and gold, hoarded in safes, boxes, or ingeniously concealed cupboards.

The idea of dramatic action and the striking of a powerful blow against this wealth is deeply satisfying psychologically. It is the stuff of epics. The spectre of black money has been invoked frequently in Indian politics, sometimes truthfully and more often cynically. The narrative of black money is almost always couched in deeply moral terms.

It does not matter, as repeatedly emphasised in several economic studies, there is nothing to distinguish black or white money, except in the way it comes into being. Although income from corruption or criminal activities is by definition black money, most black money is earned through perfectly legal activities though not declared to the tax authorities. More importantly, black money is not really kept in cash except in small quantities but mostly accumulated through real estate and other assets. However, the way the narrative was framed made it hard for critics to explain their opposition. To denounce it outright would suggest that they have a vested interest in defending black money and corruption.

When it became clear that the cancelled currency was being returned to the banks in larger numbers than expected, the narrative changed focus from black money and fake currency to digital/cashless payments, the latter being elevated to some higher purpose than what it actually is, a mere technological change.

A key point in selling the story was to introduce complementary sub-themes to reinforce the main narrative and, at times, to obscure the facts on the ground. Virtue signalling was key: appeals to nationalism and patriotism are always handy, while modernity and change are implied as means to progress towards some form of technological utopia.

The call to sacrifice has deep resonance in India, as elsewhere. The act (of demonetisation) was an act of collective sacrifice. The people in long queues were reminded of the sacrifices of the soldiers guarding the nation's borders and not to think of their own suffering. Indeed, there was satisfaction in being told that the rich had it worse. In reality, the sacrifice called for was somewhat skewed in its impact, and the suffering of the poor was disproportionately greater.

An extract from 'Demonetisation and Black Money'

The real irony lies in the fact that the moral high ground claimed by the demonetisation narrative worked better than contesting narratives of observed reality. It worked because it understood the nature of the moral economy of the poor. For the poor, long used to being at the receiving end of the state and its representatives, the impact of demonetisation would be one more blow in a series of blows with which they had to perforce deal. At least in this instance, there would seem to be a measure of justice if the rich really did suffer more.

Despite the overwhelming evidence to the contrary, five years after the event, the Government does not acknowledge any failure, or have even a smidgeon of doubt. Noticeably, however, there have been no tall claims of success either.

Most of the studies, opinion polls, media reports and anecdotal evidence showed an overwhelming support for the policy. Despite personal hardship, long queues, and the loss of income and savings, there was a degree of ambiguity in criticising the decision. Most tended to distinguish the intention from the reality. That the policy was good but perhaps not implemented well seemed to be the main theme. This effectively insulated the original sin — that the very design of the policy ensured its outcome.

Demonetisation had no effect on Indian economy: Nirmala Sitharaman

The case of demonetisation demonstrates that popular narratives can trump economic facts.

It is clear that where narratives succeed there is very little political cost. A failed policy that carries no cost is likely to generate more such policies. Unlike most economic shocks, which could be traced to endogenous or exogenous causes, demonetisation was an entirely self-inflicted shock, which was very likely carried out as much in a sincere belief in the narrative as in cynical political calculation.

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