



## The demonetisation case

 [sanskritiias.com/current-affairs/the-demonetisation-case](https://www.youtube.com/watch?v=sanskritiias.com/current-affairs/the-demonetisation-case)



**(Mains GS 3 : Indian Economy and issues relating to planning, mobilization, of resources, growth, development and employment.)**

### Context:

The demonetisation of high-value currency in India in 2016 is a classic case of policy based on popular narratives in economic policymaking than economists and policymakers acknowledge.

### Faulty narrative:

- 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.

### Based on myth:

- 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.

### **Objectives not achieved:**

- Most of the declared objectives of demonetisation like eliminating black money, corruption, moving towards a “less cash and more digital economy”, or increased tax compliance remained unachieved.
- 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.
- Infact the cash-in-circulation has now exceeded pre-demonetisation levels AND post-COVID-19, reliance on cash becomes much higher.

### **The black money:**

- The government expected demonetisation to extinguish at least Rs 3-4 lakh crore of black money.
- However, RBI data show that 99% of the money that was invalidated came into the banking system.
- In several economic studies it is repeatedly emphasised that 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.

### **A self-inflicted shock**

- The case of demonetisation demonstrates that popular narratives can trump economic facts.
- The personal hardship, long queues, and the loss of income and savings, are criticism of the decision.
- Unlike most economic shocks, which could be traced to endogenous or exogenous causes, demonetisation was an entirely self-inflicted shock.

