

# Modi's Demonetisation Two Years On: Economic Necessity or Political Ploy?



Two years ago today, India's prime minister Narendra Modi, took the radical step to take all 500- and 1,000-rupee notes out of circulation in a bid to tackle 'black money' in the Indian economy. Twenty-four months on, **Bhaskar Pant** asks if that decision was motivated by politics rather than economics.



Indian Rupee Note | Credit: [PixaBay](#)

We are two years on, but the fallout from Narendra Modi's announcement that his government would be pursuing a policy of Demonetisation feels like yesterday: the [decline in wages](#), [the queues](#) outside banks, [the hit to farmers and the agricultural industry](#), the spike in [job losses](#) for those working in unorganised retail, the [1.5 million jobs lost](#) and the [150 million people](#) left without pay for weeks across India.

The currency notes that were demonetised on November 8, 2016, have finally been counted and accounted for by the Reserve Bank of India (RBI), according to its [annual report](#) for the year 2017-18. The report states that currency notes amounting to Rupees 15.31 lakh crores have returned to the banking system. These numbers represent around 99.3 per cent of the total currency notes that were in circulation when Narendra Modi announced the demonetisation of 500- and 1,000- rupee notes. At the time of the decision, the total value of these high-value currency notes in circulation was Rupees 15.45 lakh crores.

This policy was taken with the motive that a substantial amount of the demonetised currency would not come back into the banking system. This would in effect show that some part of the 'black money' in the India economy, which was not accounted for, would be eliminated from the system. However, as the RBI report showed almost all of the demonetised currency has come back into the system, raising the question of whether there was any economic rationale at all behind such a disruptive monetary decision.

## Demonetisation and Black Money

Demonetisation, as a measure to restrain black money, has been in existence for a long time in the world of economic policy. There is not much evidence however on the relationship between demonetisation and the subsequent reduction in black money. Many leading economists including [Arun Kumar](#), [C. Rammanohar Reddy](#) and [Raghuram Rajan](#) have observed this trend and the previous attempts at demonetisation undertaken in other countries, such as [North Korea](#), [Myanmar](#) and [Nigeria](#) revealed that after the initial period of demonetisation, the previous situation tends to repeat itself.

In India, demonetisation caused a commotion at a time when there was macroeconomic stability in the country. It was imposed on the people of India during normal economic and political conditions. There was no immediate economic necessity for demonetising 86 per cent of legal currency in the country. The government did not rely on the usual practices of providing more scientific data to garner enough support from the public to achieve a predefined policy goal of implementing a policy like demonetisation. The RBI was kept in the shadows, which in turn has undermined its position as the country's foremost monetary institution.

## The Politics of Demonetisation

Demonetisation essentially was a tool to manipulate public opinion by the government. The political actors '[deliberately portray problems](#)' in a calculated manner in order to gain support for their viewpoint. [Yaron Ezrahi](#) has explained this by looking at 'political deliberations', which are not limited to the substance of policies that are selected by the government. There is a clear political objective when decisions are made about how to identify problems in certain social conditions. The identification of policy problems, similar to the policies designed to deal with them, are essentially guided by political objectives. The selection of policy problems and the way they are defined is a way to win support from the electorate, distract attention from other existing problems, and express electoral commitments that were made.

There was a strong political motivation behind demonetisation and it was not driven by good economics. Narendra Modi [had promised](#) to return black money from foreign tax havens as an election promise in 2014 and redistribute it amongst the poor. However, despite taking a series of measures being less fruitful than expected, the prime minister wanted to portray demonetisation as a demonstration of his commitment against corruption and black money.

Demonetisation also comes across as more of a political ploy to undermine opposition funding and, in turn, benefit the ruling party in elections. The decision taken by the government indeed has political underpinnings: the policy is a continuation from the past experiences of demonetisation in India. Both the 1946 and 1978 Demonetisation exercises were highly political in nature and were not driven by any economic inevitability.

The framing of demonetisation highlighted a strong relationship between cash and black money, which was not supported by any economic evidence. The RBI report is the final nail in the coffin. The government though is still adamant and claims that Demonetisation has achieved its objectives of [reducing black money, fake currency, terrorist financing and promoting digital transactions](#).

Perhaps the biggest consequence of demonetisation is that a dangerous precedent in a democracy like India of unilateral decision-making in monetary affairs has been set. A consequence, we will only be able to see the effects of in the long-term.

*This article gives the views of the author, and not the position of the South Asia @ LSE blog, nor of the London School of Economics. Please read our [comments policy](#) before posting.*



**Bhaskar Pant** is a Public Policy Consultant based in New Delhi, who works at the intersection of technology, policy and politics. He has held various roles across government, non-profit consulting, multilateral and political institutions. A Chevening Scholar, he holds an MSc in Public Policy and Administration from the London School of Economics and Political Science. He tweets [@bhaskar\\_pant1](#)