



## Marketing Monetary Policy – India’s Demonetization of 2016

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### ABSTRACT

*On Wednesday, November 8, 2016, 20:00 hrs., the Government of India announced the demonetization of all ₹500 and ₹1000 banknotes of the Mahatma Gandhi Series with the objectives to curtail the shadow economy and crack down on the use of illicit and counterfeit cash to fund illegal activity and terrorism. In spite of the sound principles behind the policy and its objectives, and its actual effectiveness at the national level, its negative impact on the daily lives of small businesses and ordinary citizens turned it into a great controversy at home and overseas. This paper will first analyze the circumstances under which the policy was conceived and its implementation and evaluate its effectiveness at macro level for the country as a whole, and at micro level for small businesses, and individual citizens.*

### INTRODUCTION

On Wednesday, November 8, 2016, 20:00 hrs., the Government of India announced the demonetization of all ₹500 and ₹1000 banknotes of the Mahatma Gandhi Series. India’s Prime Minister Narendra Modi announced the demonetization in an unscheduled live national televised address at 20:15 IST. The ₹500 and ₹1,000 banknotes of the Mahatma Gandhi Series would be invalid effective the midnight of the same day.

EXHIBITS 1 & 2 show the demonetized notes. New ₹500 and ₹2,000 banknotes of the Mahatma Gandhi New Series would be issued in their place. (RBI 2016)

### EXHIBITS 1 & 2 DEMONETIZED BANK NOTES OF THE MAHATMA GANDHI SERIES



EXHIBIT 1: Demonetized ₹500



EXHIBIT 2: Demonetized ₹1,000

Source: RBI 2016



Indians living in India would have until 30th December 2016 to deposit their old, now demonetized, currency notes in the banks in order to receive credit. Nonresident Indians (NRIs) would have until March 30, 2017, to deposit their money.

The government claimed that the action would curtail the shadow economy and crack down on the use of illicit and counterfeit cash to fund illegal activity and terrorism. The announcement stated that as of midnight that day, the two demonetized currencies would become unusable in the market. (RBI 2016)

### INDIA'S HISTORY OF DEMONETIZATION (Nag 2016)

The following lists the previous 3 demonetizations in India.

- 1946: ₹1,000, ₹5,000 and ₹10,000 banknotes were demonetized
- 1954: The banknotes were reintroduced
- 1978: Same notes were demonetized again
- 2016: ₹500 and ₹1,000 banknotes were demonetized

Either the main or one of the main objectives in each case was to curb the menace of “black money” held by evading taxes.

### OBJECTIVES OF 2016 DEMONETIZATION (Ministry of Finance 2016, Nag 2016)

The stated objective of this 2016 demonetization of high value notes of denominations ₹500 and ₹1,000 as per the Gazette notification were:

- To wipe out unaccounted and tax evaded money stored in such high value notes
- To curb the menace of fake currencies
- To prevent use of high denomination notes for terror financing

People had two avenues to withdraw in cash, the money so deposited in the banks: either from the banks by giving a personal check, or through the Automated Teller Machines (ATMs). It was announced that each person with a separate bank account could withdraw up to ₹15,000 every week from the banks by giving a check. In addition, each person could get ₹2,000 each week from the ATMs.



The sound principles behind the policy and its objectives had raised expectations about the impact of the demonetization to unreasonable levels. However, unclear and far less visible effectiveness of the policy at the national level, in contrast to its very visible negative impact on the daily lives of small businesses and ordinary citizens resulted in turning the demonetization into a great national and international controversy.

This paper will analyze the circumstances under which the policy was conceived and evaluate its implementation and effectiveness at national, small business, and individual citizen levels.

### CHALLENGES OF 2016 DEMONETIZATION AT THE NATIONAL LEVEL

Challenges of the 2016 demonetization at the macro level become apparent when one compares how much of the total currency in circulation was accounted for by the demonetized currency in 2016 as compared to that in 2001. Exhibit 3 presents the information of such comparison.

As can be seen, of the total currency notes in circulation, the demonetized notes would have accounted for 26.0% by value and 3.1% by volume respectively in 2001; whereas, they accounted for 85.2% value and 24.4% by volume respectively in 2016.

In simple words, the 2016 demonetization was far more serious as it would affect most of money supply in the economy. (Nag 2016)

#### EXHIBIT 3 CHALLENGES OF 2016 DEMONETIZATION Comparing 2001 vs. 2016 Share of Demonetized Currency in the Economy

High value notes of ₹500 and ₹1,000 as % of total currency in circulation

	2001	2016	2016
Share of high value notes of ₹500 and ₹1,000			
By Value (₹)	26%	85.2%	14.18 T₹ of 16.42 T₹
By Volume (#)	3.1%	24.4%	22.03 B# of 90.26 B#
Share of high value notes in M1	14.8%	54.5%	T = Trillion, B = Billion
M1 = demand deposits + currency + other deposits			

### CHALLENGES OF 2016 DEMONETIZATION AT THE INDIVIDUAL LEVEL



In every respect, the 2016 demonetization was far more challenging for the country as well as for individuals compared to any demonetization done in the past.

Exhibit 4 below shows the comparison between the 2016 demonetization and the previous 1978 demonetization. The lowest denomination note demonetized in 1978 was ₹1000, equivalent to ₹14,000 in 2016. The 1978 demonetized note of ₹1000 was relatively so large that just 1.49 such notes would amount to the prevalent per capita net national income (NNI). In contrast, the 2016 demonetized note of ₹500 was much smaller, and it would take 187 such notes to account for the prevalent NNI.

In simple terms, the 1978 demonetized note was so large that an average person would almost never use it in real life. Consequently, most people were unaware of and unaffected by the 1978 demonetization.

In contrast, the 2016 demonetized note was much smaller and would be used by an average person on a daily basis for living expenses. Looking at it in another way, unlike in the past, in 2016, the demonetized high value notes were supporting more of the transaction demand for money, rather than the “store of value” demand. Therefore, the 2016 demonetization of such a medium of exchange was far more serious as it would affect virtually every person in the country. (Nag 2016)

EXHIBIT 4  
CHALLENGES OF 2016 DEMONETIZATION:  
Comparing 1978 and 2016 Demonetizations

	1978	2016
Notes Demonetized	1,000, 5,000, 10,000	500, 1000
Value Equivalent Notes	1000 of 1978	14,000 of 2016
Net Per Capita National Income	1,491.70	93,293
Per Cap Nat Inc/Lowest Denomination Demonetized	1.49	186.59
Av No. of Lowest Denomination Demonetized	1.49 per Year	1 per 2 days
Notes Spent	Very Rare	Regular, Daily
Usage by average Person		
Lowest Denomination Demonetized	Not normally used by most people	Almost always used by most people

If the previous demonetizations were described as precision radio surgery, the 2016 demonetization was like a chemo therapy that would affect the whole body of the nation.



**EXHIBIT 5**  
**DETAILS OF THE INDIAN GOVERNMENT'S DEMONETIZATION PLAN**  
(RBI 2016, Ministry of Finance 2016, Economic Times 2016)

Exhibit 5A presents Demonetization Plan 1 - Depositing or Exchanging the Demonetized Currency

**EXHIBIT 5A**  
**DEMONETIZATION PLAN - DEPOSITING AND EXCHANGE OF DEMONETIZED CURRENCY**

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Demonetized notes could be:

- deposited in banks over next 50 days Nov 09 – Dec 30
  - Exchanged at bank counters. Limits per person as below:
    - ₹4,000 = Nov 8-13
    - ₹4,500 = Nov 24-17
    - ₹2000 = Nov 18 on
  - Exchanged at airports for International travelers ₹5000
  - Exchange stopped completely after Nov 25
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Exhibit 5B presents Demonetization Plan - Cash Withdrawals for Living Expenses

**EXHIBIT 5B**  
**DEMONETIZATION PLAN - CASH WITHDRAWALS FOR LIVING EXPENSES**

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From Current and Cash Credit Bank Accounts

₹10,000/day and ₹20,000/week = Nov 10-13

₹24,000/week = Nov 14 on

From ATMs

₹2,000/day = till Nov 14

₹2,500/day = till Dec 31

₹4,500/day = from Jan 01

₹10,000/day = from Jan 16

From Savings Accounts

₹24,000/day = till Feb 20

₹50,000/day = till Mar 13

No limits after Mar 13

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Exhibit 5C presents Demonetization Plan - Cash Withdrawals for Weddings and Farmers

EXHIBIT 5C  
DEMONETIZATION PLAN - CASH WITHDRAWALS FOR WEDDINGS AND FARMERS

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For Wedding Expenses

Families could draw from one account ₹250,000

Farmers could draw from their accounts against crop loans ₹25,000 per week

Gas Pumps, Govt. Hospitals, Railways, Airlines, Crematoriums, and State recognized Dairies and Ration Stores

- Could accept the banned notes till Dec 2

Nonresident Indians could exchange banned notes after Dec 30

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### EVALUATION OF THE DEMONETIZATION AT THE MACRO LEVEL

Exhibit 6 presents the quantitative outcomes of the demonetization at the national level. In 2016, total currency in circulation in India was valued at 17.65 T₹. The demonetized currency notes were valued at 15.00 T₹. It was estimated that only about 12 T₹ (80%) worth of that currency would be returned to the banks and about 3.0 T₹ (20%) of the demonetized currency would not be returned and would therefore go out of circulation permanently as it represented illegitimate wealth acquired from unreported earnings.

Unfortunately for the predictions, but fortunately for the country, 14.55 T₹ (97%) worth of demonetized banknotes were returned to the banks by Dec 2016. Further, by August of 2017, 14.85 T₹ (99%) of the demonetized banknotes were returned to the banking system. It is not easy to say that the higher than expected return rate of the demonetized banknotes indicates that the earlier estimates of 20% of the total currency being used to store illegitimate income were wrong, far too excessive, and pessimistic, and no more than 0.15 T₹ (1%) of the demonetized notes were holding such unreported income. Was it a good news that the amount of black money in the economy was far less than estimated? For the economy, it certainly was a good news, but for the demonetization, it was not a good news since it suggested that the demonetization was not really needed for the country. It was similar to a person undergoing chemotherapy and then finding out that he or she did not really have cancer. How would he/she take that: as a good news, or a bad one?



Further, it was not at all easy to assess as to how much illicit currency was in circulation before the demonetization that had now become useless and had gone out of circulation. In other words, it was not easy to assess the extent to which the demonetization was able to achieve the second objective of curbing the menace of fake currencies as there was no easy way to measure the prevalence of such currencies before and after demonetization.

EXHIBIT 6  
QUANTITATIVE OUTCOMES OF THE 2016 DEMONETIZATION AT THE NATIONAL LEVEL

Value of Total Currency in Circulation in 2016	17.65 T₹	100%
Value of Demonetized Banknotes in 2016	15.00 T₹	85.2%
% Value of Demonetized Currency Expected Not to be Returned (and be removed/ go out of Circulation) as originating from illegitimate sources	3.0 T₹	20% of Demonetized notes
% Value of Demonetized Currency Expected to be Returned as originating from legitimate sources	12.00 T₹	80% of Demonetized notes
Actual % Value of Demonetized Banknotes Returned - by 30-Dec-2016	14.55 T₹	97%
Actual % Value of Demonetized Banknotes Returned - by Aug-2017	14.85 T₹	99%

(RBI 2016, Financial Express 2017, India Today 2016; Hindustan Times 2016)

### UNINTENDED CONSEQUENCES OF DEMONETIZATION AT THE MICRO LEVEL

Separate from what happened at the macro level, there were several unintended consequences of the demonetization that affected the operations of many financial institutions and through them, the daily lives of small businesses and ordinary citizens. The following paragraphs list the unintended consequences of demonetization grouped based on where they occurred: banks, ATMs, and retail trade.

### UNINTENDED CONSEQUENCES OF DEMONETIZATION AFFECTING BANK OPERATIONS

Listed below are the unintended consequences of demonetization that affected bank operations to varying extent across the country.

- Inadequate of supply of, and resultant extreme shortage of New ₹500 notes in banks and ATMs
- Insistence of banks to give out only ₹2,000 notes for all withdrawals and their reluctance to give out smaller denomination notes for the fear of running out of supply
- Long lines to deposit and exchange banned banknotes at the banks
- Banks running out of cash and closing withdrawal counters early
- Customers waiting for hours in lines at banks to withdraw cash only to find out that the bank has run out of cash for the day
- Tight daily and weekly limits on withdrawals resulting in everyone to line up again and again, day after day, week after week
- Deaths of persons standing in cash lines were blamed on the demonetization



## UNINTENDED CONSEQUENCES OF DEMONETIZATION AFFECTING ATM OPERATIONS

Listed below are the unintended consequences of demonetization that affected ATM operations across the country.

- ATMs previously calibrated only for ₹100, ₹500, and ₹1000 notes
- With ₹500, and ₹1000 notes now demonetized, ATMs could give out only ₹100 notes
- As a result, ATMs soon ran out of cash
- Customers waiting for hours in lines at ATMs to withdraw cash only to find out that the machine has run out of cash for the day with the only option to line up at another ATM hoping to get some money

## UNINTENDED CONSEQUENCES OF DEMONETIZATION AFFECTING RETAIL TRADE

Listed below are the unintended consequences of demonetization that affected retail trade across the country.

- Indian citizens' and merchants' normal experience of shortages and hence the tendency to hold on to small notes and change
- Unwillingness of traders to accept new ₹2,000 notes for small purchases
- Inability to carry out cash transactions affected all cash-based businesses and activities: Contractors, daily wage earners, truckers, farmers, of contractors to pay daily wages and resultant disruption of work and loss of employment

Our initial plans were to investigate the proportion of small businesses and ordinary citizens negatively affected by the demonetization, the nature of their hardships, and determine whether the government could have avoided or at least minimized them through better planning and implementation.

It is important to note that in the past India had experienced chronic shortages of currency notes and coins from time to time. And as such, both small businesses and common citizens had experience of dealing with such shortages through many creative and defensive strategies. On this background, our exploratory work indicated that that a majority of both small businesses and ordinary citizens had not experienced intolerable hardships under demonetization. Further, the government had done a fine job of explaining the objectives of the demonetization. As a result, a vast majority of the people were willing to accept the good intentions behind the demonetization and bear the hardships in the interest of the country's good. This positive attitude had further diminished the felt-pain for people during these times.



## PUBLIC VIEW OF THE EFFECTIVENESS OF DEMONETIZATION

The following lists some of the commonly held public views of the total demonetization experience.

- Demonetization is an effective way to bring out all unreported money by forcing it through the banking system
- Demonetization will destroy the existing stash of counterfeit currency and make it difficult for hostile foreign powers to disrupt the economy and finance terrorism
- Demonetization can have very only a small impact on black money since most of such income is invested in real estate, precious metals, jewelry, art and such other assets unaffected by demonetization.
- No matter what you do to stamp out corruption, the corrupt politicians and the rich always find ways to escape detection. Only the poor, who neither have black money nor are the targets of demonetization, suffer
- Overall, the demonetization was good for the country.
- Overall, the demonetization was okay for me.

In view of these findings, we changed our original plans of conducting a large and representative sample study and decided to focus on the causes that resulted in extreme cases of hardships experienced by individuals and made the demonetization controversial through their wide publicity.

Our exploratory interviews and pilot surveys indicated that most such hardships were the result of unique circumstances of each individual case. For example, families having to pay large medical bills in cash for urgent and serious hospitalizations, financially stressful wedding plans in poor families, etc. While some hardships in these cases could have been avoided and/or softened through better planning, others would have to be dealt with through delegation of authority and flexibility at local levels.

## CONCLUSIONS

It is not easy to draw an overall clear-cut conclusion whether or not demonetization is a good solution to stamp out black money and fake currency from an economy. However, there are several specific lessons one can learn from India's experience of 2016 demonetization. These are listed below:

- Demonetization may be a good in principle to stamp out black money and counterfeit currency from the economy
- Most short-term effects of demonetization are negative for everyone: the nontargeted innocent as well as the targeted guilty
- Smaller the demonetized currency, larger the nontargeted population negatively affected
- To be effective, demonetization must come as a surprise to everyone: the targeted and the nontargeted populations



- To keep it a surprise minimum number of people must be involved in the decision and planning its implementation
- Thus, a perfectly painless demonetization may be inherently impossible.  
Either it can be well planned, well leaked and ineffective, or hurriedly planned, effective, but very painful

END



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