DEMONETISATION- A HISTORICAL PERSPECTIVE

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Abstract

Demonetisation has become a much discussed and debated term post 8th November 2016. Prime Minister Narendra Modi took to national television on 20:00 hours IST, in an unscheduled address to the nation to announce the demonetization of the Rupees 500 and Rupees 1000 currency notes of the Mahatma Gandhi series with almost immediate effect. The ban on the two currencies which together accounted for almost 15.44 lakh crore or 86% of the total currency in circulation in India was to be enforced from midnight onwards i.e. roughly 4 hours from the time of announcement leaving almost no time to the citizens to respond. More than a year after the event and almost 99% of demonetized currency legally converted opinions continue to remain divided and as extreme as on day one. But the concept of demonetisation seemed to have gained traction globally as three countries namely Australia, Pakistan and Venezuela have announced plans for demonetisation of their currency post November 2016 albeit in varying degrees. The current paper is an attempt to study the concept of demonetisation and investigate the history of demonetisation with its resultant impact on the economy with special reference to India. The study is based entirely on secondary data obtained from website publications and reports of reputed institutions.

Key Words: Currency, Demonetisation, History, Impact

Introduction

8th of November, 2016 resembled any other day in November in India till Prime Minister Narendra Modi took to national television on 20:00 hours IST, in an unscheduled address to the nation to announce the demonetisation of the Rupees 500 and Rupees 1000 currency notes of the Mahatma Gandhi series with almost immediate effect. The ban on the two currencies which together accounted for almost 15.44 lakh crore or 86% of the total currency in circulation in India was to be enforced from midnight onwards i.e. roughly 4 hours from the time of announcement leaving almost no time to the citizens to respond. The banned currencies were to be replaced by issuance of Rupees 2000 and Rupees 500 currency notes of the Mahatma Gandhi New Series. The next day, the 9th November, 2016 was declared a Bank holiday to allow the banks to prepare for the sudden changes. The Prime Minister described his drastic action as a planned and concerted action ‘a triple strike’ against black money, counterfeit currencies and terrorism. What followed ranged from disbelief, chaos to general appreciation for leader who had come to occupy the most powerful chair in the land on the promise of weeding out the almost endemic corruption, and black money in the country. There was widespread disruption in the economy. The two major stock market benchmark namely BSE Sensex crashed nearly 1,689 points or 6.12% while Nifty fell by over 541 points or 6.33%. Huge lines were seen across the country at select Public sector Banks for exchange of old currencies with the new ones. The
economy appeared to have come to a standstill in the week leading to the announcement. The cash reliant unorganized, rural, small and micro enterprises sector was the hardest hit. Over 150 people lost their lives in demonetisation related incidents across the country.

Opinions were as expected was divided with the government and the party in power the BJP going to town as a purported surgical strike on terrorism, black money and counterfeit currency and the opposition deriding the move as hasty and stubborn. Even experts swore by the move. For instance, in a jointly authored article written for Mint newspaper on 27 December, 2016 renowned economist and Columbia university professor Jagdish Bhagwati, resident senior fellow at the IDFC Institute Vivek Dehejia and Chung Ju Yung distinguished professor of international economics at Johns Hopkins University and deputy director of the Raj Center on Indian Economic Policies at Columbia University Pravin Krishna defended the Modi government’s demonetisation move in the following words “Clearly, at least from the perspective of its effectiveness in dealing with the black money issue, success has to be measured by the sum of tax revenue generated and black money destroyed. Suppose we accept the estimate that one-third of the approximately Rs 15 trillion in demonetised notes is black money,”

Whereas noted Indian economist and Nobel Laureate Dr. Prof Amartya Sen criticized the act in the following words “It is a gigantic mistake, both in terms of its objective of dealing with corruption as well as the objective of one rapid jump of getting into a cashless economy,”

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A Brief History of Currency in India

History of currency in India makes for a fascinating reading. It traces its roots to almost 6 BC (as old as recorded human history). The Indians due to their orientation and skills in metallurgy were one of the earliest civilizations to adopt coinage along with the Chinese, Egyptians and the Lydians (Indo-European clan settled in the middle east) The first Indian minted coins were essentially of Silver and were punch of different shapes and figures including that of humped bull, swastika and other symbols were called Puranas, Karshapanas or Pana. They were believed to be minted in the 6th century BC by the Mahajanapadasie republic kingdoms of ancient India. The Mauryan Emperor Chandragupta is credited to been the first royal to have a royal standard inscribed to the his currency which came in different standards namely Gold, Silver, Copper and Lead (Arthashastra). The Indo-Greek Kushan kings introduced the Greek custom of engraving portrait heads on coins. The Kushan empire and its system of intricately designed coinage also influenced a large number of local tribes, dynasties, and kingdoms, which began issuing their own coins. The practice continued well in to the advent of Turkish and Mughal Sultanates in India. The Mughals in particular attempted to bring a unified and consolidated monetary system for the entire kingdom. However, it is Sher Shah Suri who undisputedly credited with the introduction of the term ‘rupiya’ to the silver coin weighing 178 grams divided into 40 copper pieces termed ‘paisa’. The popularity of the coinage system
introduced by Suri was such that the British utterly failed in their quest to convert the coinage system from ‘rupiya’ to ‘pounds’.⁶

The 18th Century saw the introduction of the paper currency notes in India by the British Raj with the Bengal Bank, Bank of Hindostan and the General Bank of Bengal – the first banks in India to issue paper currency. The Mutiny of 1857 saw the British establishing its complete fiefdom over the whole of India and with it the ‘rupee’ became the official colonial currency with the head of the King of England replacing the native designs and symbols. The Reserve Bank of India (a privately held company set up in 1935) was empowered as the first Central Bank of India and empowered to issue government of India currency notes. Post Independence, Reserve Bank of India was nationalized w.e.f 1st January, 1949.

History of Demonetisation

As stated earlier, Indians like many other flourishing civilizations across the globe were quiet used to use of multiple currencies at a given point of time. Withdrawal of currencies by victorious rulers or successors seemed to be the order of the day. Nonetheless, in the age of coins, the concept of demonetisation would have failed to capture the imagination of historians and experts alike was the fact that the coins in themselves were precious metals and carried certain intrinsic value. This aspect helped the people to tide over the rumblings caused by repeated demonetisation almost automatically. However, history does record certain fascinating tales. In the 14th century medieval India, Muhammad Bin Tughlaq of the Tughlaq dynasty attempted the best recorded case of demonetisation in coinage era. To tide over the shortage of gold and silver metal coins, he introduced a token currency system wherein brass and copper coins (tankas) could be exchanged for gold and silver coins in pre determined ratio. To make the minting easier, the royal seal was replaced by simple inscription. This exercise led a flood of counterfeit currencies as people could easily replicate the make of the original coins. Traders refused to deal with the new currency resulting complete chaos and paralysis of trade activities. With token coins becoming practically valueless leading to hyperinflation, the King was forced to withdraw the circulation of the token copper and brass coins.⁵

The Demonetisation of 1946

The pre-independence government of India banned the much in circulation Rupees 1000 high denomination notes on 12th January, 1946. The rationale behind the exercise was unearth black money on account of tax evasion by businesses which had made a killing by supplying materials to the allied forces in the just concluded second world war. Nonetheless, the then governor of RBI Sir Chintaman Deshmukh went on record to observe his apprehensions on the sad exercise. The then Indian National Congress Party adopted a cautious approached welcoming the move aimed at weeding out black money but at the same time expressing its concern on the difficulties caused to the honest by the ban. Nonetheless, an estimated value of 47 crores were collected from all over India.⁷ Though there were incidents of distress, exercise did not inconvenience the majority as it involved only a miniscule percentage of money in circulation.

The Demonetisation of 1978

One of the major actions of the erstwhile Janta Party government under the Prime Ministership of Morarjee Desai was the demonetisation of Rupees 1,000, Rupees 5,000 and Rupees 10,000
currency notes on 16th January, 1978. Unlike 2016, the public were allowed three days to exchange. In historical perspective, the 1978 demonetisation was said to have been inspired by the successful Sri Lankan (Ceylon) experience of 1970. While the then Finance Minister H.M. Patel and his government declared the exercise a success, the erstwhile RBI governor IG Patel went on record to express his displeasure over the said exercise. On a whole, the entire exercise was termed as a success more for its political agenda rather than its monetary one. As in case of 1946, as the denominations were of higher values, the banned currency notes did not form a significant proportion of the money in circulation. Noteworthily, the present ruling party BJP in its erstwhile avatar the Jan Sangh was a part of the Janata Party government and had vociferously pitched for the entire exercise of demonetisation.

The United States Demonetisation of 1873 (Coinage)

The 1873 Coinage Act, called for demonetisation of the silver coins to a gold standard. The move was not welcomed and the result was a contraction in money supply that led to a half a decade of depression that could be controlled only by remonetisation of the silver standard in 1878.

The Sri Lankan (Ceylon) Demonetisation of 1970

One of the few popular and successful demonetisation drives saw the government of Ceylon declare the 50 and 100 rupee notes illegal tender. The then Finance Minister of Sri Lanka N.M. Perera spelt out the objectives of the demonetisation drive as ‘bringing of the large amount of currency into the banking sector’. The move is believed to have created the base for the strong Sri Lankan banking sector of the 1970’s. There was no chaos. The common Sri Lankan responded positively and it is said to have contributed to the return of the party in power in the next general elections.

The Ghanaian Demonetisation of 1982

The Rawlings government facing a host of political and economic issues, decided to demonetise its 50 cedi currency notes in 1982. Through this measure it sought to put a plug on tax evasion, corruption and improve liquidity position of the already fragile economy. The move was a colossal failure. The ordinary Ghanaian lost faith in the country’s banking system and migrated his savings and investment in physical assets and foreign currency holdings increasing spread of black money and inflation in Ghana.

The Nigerian Demonetisation of 1984

The then military dictator of Nigeria, President Muhammadu Buhari, in the middle of an anti-corruption campaign, completely withdrew the old currencies within a limited time frame and replaced it with a coloured one. The goal to put an inflated and debt ridden economy back on track derailed badly causing severe strain on the already fragile economy.

The Soviet Union Demonetisation

The last Secretary General of the USSR Mikhail Garbochev under his economic and political reform programme named ‘Perestroika’ and ‘Glasnot’ went for withdrawal of large rubble bills.
from circulation in late 1980’s. The move backfired and resulted in mass protest and the ultimate demise of the once mighty USSR.

**The Zimbabwean Demonetisation of 2015**

One of the successful stories of demonetisation, saw the government demonetise the Zimbabwean dollar as a way to combat the country’s hyperinflation that was recorded at 231,000,000%. The 3-month process involved expunging the Zimbabwean dollar from the country’s financial system and solidifying the US dollar, Botswana pula, and South African rand as the country’s legal tender in a bid to stabilize the economy.

**Conclusion**

Historical evidences prove that demonetisation as an instrument of monetary disruption has vast potential of making an impact. Whether the impact would be favourable or unfavourable is matter of investigation for experts and policy makers. Nonetheless, given its capacity to cause turmoil in the lives of the ordinary people and the economy at large, it would be advisable to carry out a detailed analysis of its after effects well in advance. Demonetisation as a mere political tool has the capacity bring enormous strain on the economy and is best ill advised.

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