

India's Currency Reform 2016

A Brief Analysis of Objectives and Outcomes

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If the objective was to:
Combat counterfeit currency

What should have been done

Remove old notes from circulation gradually.

*Replace with higher security notes.
Promote cashless transaction.*

Promote the use of banking system.

What was done

Old notes were withdrawn abruptly.

New notes do not have additional security features.

What we should expect

One-time removal of stock of counterfeit currency.

Potential recurrence of counterfeit currency in the near term.

More counterfeit money can be smuggled in due to higher denomination notes.

If the objective was to:
Counter funding of terrorism & insurgency

What should have been done

Remove old notes from circulation, gradually or immediately.

Promote cashless transactions.

Promote the use of banking system.

What was done

Old notes were withdrawn abruptly.

What we should expect

One-time removal of cash stocks.

Terrorists & insurgents will face a temporary cash crunch impacting activities that depend on it.

The speed of their recovery will be similar to that of the rest of the economy.

If the objective was to: Punish holders of unaccounted money

What should have been done

Remove old notes from circulation immediately.

Not introduce higher denomination notes.

Limits and identification while exchanging old notes.

Targeted punitive action against those who didn't use the tax amnesty necessary for credibility and fairness.

What was done

Old notes were withdrawn abruptly.

New higher denomination notes were issued.

Limits and identification during exchange were imposed.

Punitive action was imposed but inconvenienced everyone.

Exemptions were given to farmers, wholesale traders, weddings, petrol bunks, hospitals etc.

What we should expect

Most holders of unaccounted money in cash incurred losses to various extents.

Many holders of unaccounted money could convert into other assets or new currency notes at various levels of transaction costs.

Some holders of unaccounted money are likely to face legal consequences.

No effect on holders of unaccounted money in other assets like gold, real estate, art, luxury goods etc.

Holders of legitimate cash unduly penalised if they are unable to exchange for various genuine reasons.

Mass inconvenience of cash exchange to individuals and small businesses.

Negative impact on the overall economy due to cash supply shock and shortage.

If the objective was to: Eliminate generation of unaccounted money

What needed to be done

Implement structural reforms that lower licensing requirements, inspections, onerous compliance requirements and regulatory overhead.

Eliminate government interventions in prices of goods and services, including price ceilings, price floors, tariffs, quotas etc.

Simplify and lower tax structures.

Implement laws that govern political parties, including on political contributions, lifting of limits on campaign expenditure etc.

Simplify procedures and reduce stamp duty for real-estate transactions.

Review the definition of agricultural land with a view to reduce its utility as a generator of unaccounted money.

What was done

255 million Jan Dhan accounts have been created.

UPI has been introduced in mid-2016.

Favourable regulatory climate for FinTech innovation is in place.

Ecosystem is in place for urban and semi-urban areas.

What we should expect

Many people will use cashless mechanisms to tide over the cash shortage.

Uncertain as to whether fully cash-dependent persons will switch to cashless payments in a substantial way.

Reintroduction of new notes will reduce incentives for pure cashless transactions.

Many bank accounts could be used for laundering unaccounted money.

If the objective was to:
**Promote cashless economy &
banking culture**

What needed to be done

Created incentives and mechanisms for financial inclusion.

Reduce costs of cashless transactions.

Ensure that there is an ecosystem of payment banks, telecom connectivity, wallet providers and IT infrastructure, security and privacy to enable mass cashless transactions.

What was done

255 million Jan Dhan accounts have been created.

UPI has been introduced in mid-2016.

Favourable regulatory climate for FinTech innovation is in place.

Ecosystem is in place in urban and semi-urban areas.

What we should expect

Many people will use cashless mechanisms to tide over the cash shortage.

Uncertain as to whether fully cash-dependent persons will switch to cashless payments in a substantial way.

Reintroduction of new notes will reduce incentives for pure cashless transactions.

Many bank accounts could be used for laundering unaccounted money.

If the objective was to:
Replace old currency notes

What needed to be done

Remove old notes from circulation very gradually to avoid economic disruption.

What was done

Old notes were withdrawn abruptly.

Exchange hampered by shortage of supply of new notes.

What we should expect

Large scale public inconvenience and economic disruption.

Likelihood of exchange of counterfeit notes for new legal tender.

Likelihood of introduction of poor quality new notes due to time constraints.

If the objective was to:
Recapitalise the banking system

What needed to be done

Use bank restructuring and debt management bureau to improve bank balance sheets.

Finance part of the bank recapitalisation through transparent budgetary provisions.

What was done

Individuals and businesses were required to deposit their old currency with banks within a short span of time.

What we should expect

Banks are flush with cash, with a low cost of capital.

Government treasury does not bear the fiscal burden of bank recapitalisation.

Because recapitalisation is an unintended consequence of another policy, banks do not have incentives to change their lending patterns.