

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 6 | Issue 1

2023

© 2023 *International Journal of Law Management & Humanities*

Follow this and additional works at: <https://www.ijlmh.com/>

Under the aegis of VidhiAagaz – Inking Your Brain (<https://www.vidhiaagaz.com/>)

This article is brought to you for “free” and “open access” by the International Journal of Law Management & Humanities at VidhiAagaz. It has been accepted for inclusion in the International Journal of Law Management & Humanities after due review.

In case of **any suggestions or complaints**, kindly contact Gyan@vidhiaagaz.com.

To submit your Manuscript for Publication in the **International Journal of Law Management & Humanities**, kindly email your Manuscript to submission@ijlmh.com.

Indian Demonetisation of 2016: It's Comparison with 1978 and 1946 Demonetisations

SANDEEP KHAKASE¹ AND DR. DEEPAK HAWALDAR²

ABSTRACT

The Supreme Court judgement date Jan 02, 2023, about "the Demonetisation of 2016", announced by honourable Prime Minister Narendra Modi, has reopened the discussion related to the big bang event of 2016. In 2016, the 'Demonetisation' term was new to the vocabulary of many, but it was not unknown to India. India saw similar events of demonetisation in 1946 and 1978.

This paper attempts to understand the Indian demonetisation of 2016 and compare it with the previous two demonetisations of 1946 and 1978.

This literature review-based study is aimed to study the demonetisations of 1946, 1978 and 2016; and compare them. This comparison may help policymakers of various countries and scholars understand these economic events and help them decide on a future demonetisation prudently after analysing the effect of a few economic indicators of these demonetisations.

Keywords: *India, Demonetisation, Demonetization, Comparative, Analysis, deciding factors, economic factors, 2016, 1978, 1946, GDP.*

I. INTRODUCTION

On Jan 02, 2023, after six years of the 2016 demonetisation, the Constitution Bench upheld the demonetisation decision with a 4:1 majority. The split of the judges' opinions also muddled the big bang reform of 2016, 'Demonetisation', a step taken by honourable Prime Minister Narendra Modi, which was appreciated, supported and praised by almost all classes and masses then.

The term demonetisation was unheard of for years but not new to the Indian economy. First, demonetisation occurred in 1946 in British India, when 6.3% of high-value currency notes were not being exchanged (Rastogi, 2018). The Second demonetisation was taken place in 1978 when Mr Morarji Desai was Prime Minister; even then, 11.02% (Lahiri, 2016) demonetised currency was not exchanged. In 2016 demonetisation, the figure came down to 0.7% (RBI, 2018).

Honourable Prime Minister Narendra Modi announced demonetisation on Nov 8, 2016; Dr.

¹ Author is a PhD Scholar & Visiting Faculty at Amity University Mumbai, India.

² Author is a Head of Institute at Amity Institute of Liberal Arts, Amity University Mumbai, India.

Urjit Patel, then RBI³ Governor and the PM, both stated several objectives in their early appearances after the demonetisation announcement like an attack on black money, corruption, terrorism, counterfeit currency and making low cash economy. Similar objectives were stated in the earlier two demonetisations.

This study is based on the available literature with the objective of a comparative study of these Indian demonetisations of 1946, 1978 and 2016. A few economic indicators which are closely related to demonetisation and monetary policy are compared. Indeed, this study is expected to help researchers and policymakers understand various variables of Indian demonetisation. It may also assist other countries in deciding on demonetisation of their currencies and also guide them on the factors which can influence demonetisation in their country.

II. DEMONETISATION

Sandeip Khakase in his book ‘Demonetisation: Monumental Blunder or Master Stroke’ (Khakase, 2017) has stated “Demonetisation means a specific currency unit ceased its status as legal tender”. The author further stated that the ‘Demonetisation’ is the act of stripping/ removing/ recalling/ cancelling a legal tender status of one or more or all currency units or denominations prevailing in the territory.

Demonetisation is essential when there is a need to change a national currency or its one or more units. A new currency or currency unit will replace the outgoing currency or currency unit (Raju, 2016).

(A) DEMONESTATION OF 1946

The idea of 1946 demonetisation in British India seems to have come from its then ruler Britain that has demonetised 10 Pound and higher denomination notes after the Second World War. After the war, the British Government was finding to ways to averting the expected economic downturn. The British Government devised plan to check black market operations and tax evasion which was expected to be prevailed at reasonably then. The British Government, following other countries like France and Belgium, demonetised its currency of £ 10 and higher denominations in 1945. British India followed the same in January 1946. The (British) Indian Government aimed to fight against black market money and tax evasions (RBI, 1970).

Then the British India government announced on January 11, 1946 that Rs. 500, Rs. 1000 and Rs. 10,000 currency notes will ceased to be legal tender from the next day that is January 12, 1946. The daily newspaper Indian Express of demonetisation day, January 12, 1946, stated that

³ RBI is an abbreviation for Reserve bank of India, the Central bank of India.

the demonetisation was exercise with an objective of curbing black marketing. The people were stunned with the announcement; exceptionally long queues were seen at banks for exchanging currencies.

There were several litigations related to deposit of demonetised currencies during 1946 Demonetisation. In *Mehta Parikh & Co vs. CIT*⁴, the Supreme Court decided in the favour of the assessee (Petitioner) and held that income of the assessee from undisclosed sources was based purely on surmises and the matter had to be quashed in absence of any evidences. In another matter, *Gur Prasad Hari Das vs. CIT*, the Allahabad High Court held that the prima facie value of high denomination currency notes held by the assessee, must presumed to be part of his cash balance. If the income tax department wanted to treat or consider such value as his concealed income or income from undisclosed sources, department has to establish it on basis of material facts in their possession.

(B) DEMONESTATION OF 1978

The next demonetisation took place under the Janata Party government in 1978. This demonetisation has a back story: In the early 1970s, a committee was established to augment revenues of the state named Direct Taxation Enquiry Committee, also known as the Wanchoo committee on Black Money as Mr. K.N. Wachoo has chaired it. This committee has made several recommendations inter alia withdrawing certain banknotes, although it could not be acted upon as the publicity of the committee recommendation made black money operators in getting rid of high-value currency notes (Gopakumar & Nair, 2016).

At 9 am on January 16, 1978, All India Radio had broadcasted the ordinance declaring demonetisation. Through the Radio, all banks and government treasuries announced to be closed on the immediate next day that is January 17, 1978 for transaction of all business activities except the preparation and presentation or the receipt of returns in which are required in relation to the announced demonetisation. The public were given the time of 3 days⁵ for exchanging Rs. 1,000, Rs. 5,000 and Rs. 10,000 notes.

Higher denominations of Rs. 1000, Rs. 5000 and Rs. 10,000 notes amounting Rs 145.42 Crore were ceased to be legal tender whereas only Rs 16 Cr were not presented for exchange (Lahiri, 2016). Compared to this, Rs 1,067 crores were added in Rs 100 denomination alone and the rest of the smaller denominations made up another Rs 650 crores. So, it did not reduce any cash

⁴ Messrs Mehta Parikh & Co vs The Commissioner Of Income Tax 1956 AIR 554 : 1956 SCR 626

⁵ By providing the satisfactory reasons for his failure to exchange within the said time limit of 3 days, people were permitted to exchange within 7 days.

liquidity, at least some reduction was observed in 1946 demonetisation.

Alike earlier demonetisation, there were several disputes related to demonetisation of 1978. In *Naresh Kumar Tulshan vs. Fifth Income- Tax Officer*⁶, the High Court held that the assessee (and his firm) himself had failed to explain the source of Rs. 6 lac worth high denomination notes and the assessee had asked for a settlement. Observing all the evidence produced by the assessee, the High Court concluded that the notes had never been a part of the assessee's firm's cash and the lower authorities were directed to act accordingly.

(C) DEMONESTATION OF 2016

On November 8, 2016, Indian Prime Minister, Mr. Narendra Modi, followed by Reserve Bank of India (RBI) Governor, Dr. Urjit Patel, announced that 'the 500 rupee and 1,000 rupee currency notes presently in use will no longer be legal tender from the midnight that is after 12 am of November 9, 2016. In the same TV appearance of Mr. Narendra Modi, the Government claimed that it was fully prepared for the action and situation would be sorted out within few days (IANS, 2016). Within few hours, the higher denomination notes of Rs.500 and Rs.1000 constitute 86.9%⁷ (Bhupal Singh, August 11, 2017) of the total currency in circulation in the economy, by value, have ceased to be legal tender. People at large, have appreciated and welcome this move throughout the country, in first few days, few weeks and then observed mix responses.

Honourable Prime Minister Narendra Modi and Governor of RBI, Dr. Urjit Patel, both have mentioned several objectives in their early appearances after demonetisation announcement. These objectives were:

1. Removing Black Money from the Economy
2. Restricting Corruption
3. Removal Of Counterfeit Notes
4. Restricting Terrorism by hitting its funding sources

After couple of weeks, the government also asserted few more objectives like promoting cashless economy and making transparent business environment. It was also aimed to increase

⁶ *Naresh Kumar Tulshan vs Fifth Income-Tax Officer* 1985 11 ITD 537 Mum

⁷ As per RBI Report of March 2017 (RBI, March 10, 2017), Rs 500 and Rs 1000 currency was of Rs 15.4 Lac Crores constituting 86.9% of total currency in circulation; whereas this report didn't mention denomination-wise currency in circulation as on that date. Considering this, total currency in circulation as on November 8, 2016 is computed to Rs 17.7 lac Crore. Also, Weekly Statistical Supplement (issued by RBI) dated November 18, 2016 mentioned that the total currency of Rs 17.74 Lac Crores and Rs 17.64 Lac Crores was in circulation on November 4, 2016 and November 11, 2016. (RBI, Nov 2016)

tax revenues and deposits in the banking system.

III. DISCUSSION & ANALYSIS

(A) Demonetisation of 2016

The 2016 demonetisation has several similarities and peculiarities with historic 1946 and 1978 demonetisations. Government and RBI have stated demonetisation as an act of attack on black money, corruption, counterfeit currency and terrorism. Unfortunately, demonetisation proved to be tangential to these objectively, barely touched it.

In 2016, there was a mixed response in regards to demonetisation as a tool against black money and fake currency racket and terrorism. Although, the criticism was predominantly revolved around the manner in which the entire exercise had been executed. The demonetisation has dried 86.9% of cash, whereas 11.65% and 1.74% in 1946 and 1978 demonetisation. This has, literally halted the cash economy; such situation is difficult to handle, specifically in cash driven country.

Secondly, it was argued that India did not have banking infrastructure to serve its 129 Cr people; distribution of new currency again will be a challenge. Also, people, facing difficulty in meeting their daily needs may protest.

More importantly, 2016 period when India should concentrate on economic growth, the demonetisation had decelerated the growth trajectory and destabilised it. Destabilisation may or may not bear fruits but economic deceleration definitely pokes.

(B) Objectives of the 2016 Demonetisation: Black Money, Counterfeit Currency, terrorism and Cashless

World Bank estimated the size of the black economy in India was of 23.3% and 21.4% in 1999 and 2006 respectively of GDP; the average ratio of shadow economy to GDP was computed to 22.4% for period of 8 years from 1999 to 2006 (Scheider, Buehn, & Montenegro, 2010).⁸ Further in 2013, McKinsey & Company has estimated Indian Shadow economy of 26% to GDP (Denecker, Istace, & Niederkorn, March 2013) for the year 2011. IMF estimated Indian shadow economy of 17.89% in 2015 (Medina & Schneider, 2018).

According to income tax probes in 2015-16, black money holders keep only 6% (Suresh, 2017) and (Mahmood, 2017) or less of their ill-gotten wealth as cash, hence targeting this cash may

⁸ (Department of Economic Affairs, 2016). In this Press Release of Department of Economic Affairs, the shadow economy, referring to the World Bank Report, wrongly mentioned to “20.7% of the GDP in 1999 and rising to 23.2% in 2007”. The world bank Report (Scheider, Buehn, & Montenegro, July 2010) mentioned as “20.7% of the GDP in 2007 whereas 23.2% in 1999”.

not be a successful strategy. It simply mean demonetisation would distress only 6% of black money which was kept in cash, rest black money would be unaffected by demonetisation.

In India, as mentioned in the Annual report of RBI for FY 2015-16, 7.01 pieces of counterfeit notes per million of NIC (Notes in circulation) were floating, on an average. Counterfeiting in lower denomination notes (less than 100 rupee) has been negligible, were of Rs 0.32 mn in total; whereas highest FICN⁹ notes were in Rs 500 currency, followed by Rs 100 and Rs 1000. FICN currency in terms of value, Rs 500 and Rs 1000 note contribute to 92.42% of total FICN whereas Rs 100 shares 7.47% of FICN currency. The value of these fake notes in 2015-16 was Rs 29.64 crore, which was 0.0018 per cent of the Rs 16.41 lakh crore currencies in circulation.

India had reasonably low counterfeit currency as compared to USA, UK and Europe that is 7 FICN notes per million whereas Euro, Pound and Dollar are having 50, 72 and 100 FICN currencies respectively.

This simply means that combating counterfeit currency could not justify a reason for such a big decision of demonetisation when economic losses were certain.

Unavailability of cash currency will restrict the terrorism for some time; once cash is available it will regain momentum.

India has been largely a cash economy due to dependence on agriculture, and existence of non-formal sector and insufficient banking infrastructure. In one sense, demonetisation looks sensible to make India cashless; but India needed banking infrastructure to make the cashless economy.

(C) Comparison of the Indian demonetisations

There are similarities as well differences among these three demonetisation events. Importantly, all these were aimed at curbing black money (and to generate extra income to the government as in 1946). In the earlier demonetisations of 1946 and 1978, RBI was mostly against the exercise and that was proven right after the event. In 2016, it seemed RBI had welcomed the idea of demonetisation. Decision of demonetisation was upheld valid by the Supreme Court while deciding the *Vivek Narayan Sharma v. Union of India*¹⁰ with majority 4:1.

The big difference, obviously, was the size recalled currency in circulation that was over 86.9% of currency in circulation in 2016 whereas there were 11.65% and 1.74% in 1946 and 1978 respectively.

⁹ FICN is an abbreviation for Fake Indian Currency Notes.

¹⁰ *Vivek Narayan Sharma v. Union of India Writ Petition (C) 906/2016*, decided on 02-12-2022.

Again, a critical difference of 2016 demonetisation with the earlier was the quantum of economic effect. The first and second demonetisations affected really high value currency denominations which formed a smaller part of currency in circulation (CIC).

Comparison of the denominations of the demonetised currencies with the annual per capita GDP of that time is mentioned in the table below. In 1946, India's per-capita GDP (nominal) was Rs. 278 (Saini, 1969)¹¹, in 1978 per capita GDP (nominal) was Rs. 1,267 (Government of Kerala, 1981) whereas in 2016 it was Rs. 1,17, 427 (nominal at current prices (2011-12 series) (Government of India, May 31, 2018). Thus in 1946, a 1000 Rupee note was 3.59 times and in 1978 it was 0.78 times of per capita GDP, considerably easy to withdraw than 2016 situation when the ratio was below 1%.

Demonetisation	1946	1978	2016
Prime Minister	British India	Mr. Morarji Desai	Mr. Narendra Modi
Governor	Sir Chintaman Deshmukh	Mr. I.G.Patel	Dr. Urjit Patel
RBI's Stand on the Demonetisation	Against	Against	Pro
Date of Announcement	January 12, 1946	January 16, 1978	November 8, 2016
Currency denomination demonetised	500, 1,000 & 10,000	1,000, 5,000 & 10,000	500 & 1,000
Time Given for exchange	10 Days	3 Days	51 Days*
Time Given for exchange with explanation	26 Days	8 Days	For NRI residents abroad
Demonetised Currency in circulation	143.97	145.42	15.41 tn (RBI, 2018)
Total Currency in Circulation	1235.93	8354	17.74 tn (RBI, Nov

¹¹ The estimation made by second method of Arora and Iyengar, is used; the first method estimate comes to Rs 283. In this period, the rise in the business activity index is so large that, in spite of adjustments, its use may lead to a considerable overestimation of national income. (Saini, 1969)

			2016)
Demonetised Currency (% to Total Currency in circulation)	11.65%	1.74%	86.9%
Currency Exchanged	134.9	129.4	15.31 tn (RBI, 2018)
Currency not presented for Exchange (Rs Cr)	9.07	16.02	0.10 tn
Currency not presented (% to total demonetised currency)	6.30%	11.02%	0.7%
Per Capita Income (in Rs at current price)	278 (Saini, 1969 Series 15)	1267 (Government of Kerala, 1981)	1,17,427 (Government of India, May 31, 2018)
Ratio of 1,000* to per Capita Income (in %)	359.71%	78.93%	0.85%
Ratio of Per Capita GDP to Rs 1000 note	0.278%	1.27%	117.43%

Note: *Abruptly stopped exchange on 45th day that is on December 25, 2016 whereas deposits were permitted as per the schedule.

IV. CONCLUSION

“2016 Big Bang Reform” against black money, corruption, terrorism, counterfeit currency and cash economy by the way of demonetisation has mixed response. There were similarities as well differences among these three demonetisation events. Importantly, all these were aimed at curbing black money (and to generate extra income to the government as in 1946). In 2016, it seemed RBI has welcomed the idea (though there may be reservations which will appear only later) whereas RBI was mostly against the demonetisations of 1946 and 1978.

The major difference amongst these demonetisations, obviously, was the size recalled currency in circulation that was over 86.9% of currency in circulation in 2016 whereas there were 11.65% and 1.74% in 1946 and 1978 respectively. This large currency demonetisation in 2016, indeed, has to affect everyone of the nation.

Total demonetised currency (% to total currency in circulation) and ratio of demonetised currency denomination to per Capita Income (in %) are vital deciding factors, decision maker

must give attention these while considering demonetisation.

Similarly, demonetised currency to the per capita GDP is also influential factor. If demonetised currency is too high as compared to per capita GDP, as in the case of 1946 demonetisation, common public will hardly be affected as they can't afford have such a high denomination.

All these Indian demonetisations of 1946, 1978 and 2016 had a certain similarities but distinctive economic situation which reflected economic indicators differently. Summing up with the hope that the states may make more planned economic decisions in the future.

V. REFERENCES

- Bhupal Singh, I. R. (August 11, 2017). *Demonetisation and Bank Deposit Growth*. Mumbai: Reserve Bank of India.
- Denecker, O., Istace, F., & Niederkorn, M. (March 2013). *Forging a path to payments digitization*. McKinsey & Company.
- Department of Economic Affairs. (2016). *Press Release*. Ministry of Finance, Government of India.
- Gopakumar, G., & Nair, V. (2016, November 9). Rs 500, Rs 1000 notes may be back, if history is a guide. *mint (Livemint)* .
- Government of India. (May 31, 2018). *Highlights of Provisional Estimates (PE) of Gdp, 2017-18 and Estimates of GDP for the Fourth Quarter, January-March (Q4), 2017-18*. Press Information Bureau, Ministry of Statistics & Programme Implementation, Government of India.
- Government of Kerala. (1981). *Economic Review-1980*. Trivandrum: State Planning Board.
- IANS. (2016, November 15). Government was fully prepared for demonetisation: Jaitley. *Business Standard* .
- Khakase, S. (2017). *Demonetisation: Monumental Blunder or Master Stroke*. Mumbai: Peoples Literature Publication.
- Lahiri, A. K. (2016, December 17). Demonetisation and Cash Shortage. *Economical & Political Weekly* , 51 (51).
- Mahmood, Z. (2017). Politics sans economics: commentary on the political economy of demonetization in India. *Conjuntura Austral: Journal of the Global South* , 8 (41), 73.
- Medina, L., & Schneider, F. (2018, January). Shadow Economies Around the World: What Did We Learn Over the Last 20 Years? . *IMF Working Paper* , p. 72.
- Raju, P. K. (2016). Demonetization - Online Transactions. *International Journal of Academic Research* , 12(4), 1-4.
- Rastogi, S. (2018, March 22). Demonetization: From history to geography: History tells us whilst others used demonetization as a tool to give instant result, PM Modi used it after slew of initiatives. *DNA (Daily News Analysis)* .

- RBI. (2018). *Annual Report 2017-18*. Mumbai: Reserve Bank of India.
- RBI. (1970). *History of Resrve Bank of India (1935-51)*. (2. ed, Ed.) Mumbai: Reserve Bank of India (RBI).
- RBI. (March 10, 2017). *Macroeconomic Impact of DemonetisationA Preliminary Assessment*. Mumbai: Reserve bank of India.
- RBI. (Nov 2016). Weekly Statistical Supplement. *Reserve Bank of India Bulletin* , 31 (47).
- Saini, K. G. (1969, September). The Growth of Indian Economy: 1860-1960. *The Review of Income and Wealth* , 15 (3), pp. 247-263.
- Saini, K. G. (1969 Series 15). Trends In The Indian Economy: 1900-1960. *The Review of Income and Wealth* , 247.
- Scheider, F., Buehn, A., & Montenegro, C. E. (July 2010). *New Estimates for the Shadow Economies All Over the World : New Estimates for 162 Countries from 1999 to 2007*. The World Bank, Development Research Group, Poverty & Inequality Team.
- Suresh, A. E. (2017, February 16). Why govt's demonetisation move may fail to win the war against black money. *Hindustan Times* .
