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# India's cash bonfire is too much, too soon

The demonetisation programme has been poorly designed and executed

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[New rupee notes worth \\$13m seized in India black money raids](#)

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by: Kenneth Rogoff

What lessons can be learned from India's disastrous and still continuing demonetisation? Just over a month ago, on the same day as the US presidential election, the country's prime minister, Narendra Modi, announced perhaps the most radical macroeconomic experiment the developing world has seen in decades. He told the country's 1.3bn population

that, from midnight, the two largest bills, the Rs500 and Rs1,000 (roughly \$7.50 and \$15), would no longer be legal tender and that they would have 50 days to convert their old notes into new ones.

At a stroke, Mr Modi decommissioned 86 per cent of India's currency supply in an economy where 90 per cent of transactions are in cash. The rationale, the Indian people were told, was to fight rampant corruption, tax evasion and crime, as well as to deal with a surge in counterfeit notes being used to finance terrorist activities.

These are laudable goals, but, as events have unfolded, it is now clear that the design and execution of the Indian exchange has been deeply flawed. Most fundamentally, the Reserve Bank of India simply had not printed nearly enough new notes to replace the old ones. It will take months to fill in the gap. In the meantime, commerce is crippled in huge swaths of the economy where wages and suppliers are typically paid in cash, and where the vast majority of people do not have access to electronic payments.

While there may still be significant long-term benefits to Mr Modi's radical policy, the short-term results have been catastrophic, probably knocking 1-2 per cent off growth in gross domestic product, with those on lower and middle incomes and the poor bearing a particularly heavy burden.

For advanced economies, the idea of recalibrating the use of cash is an entirely reasonable one. While paper currency has many virtues that will continue into the distant future (including privacy as well as robustness to electrical outages), the vast bulk is held in large denomination notes such as the US \$100 and the [€500](#) that have little significance in most retail transactions. A broad array of evidence suggests that high-denomination notes (there are 34 \$100 bills for every man, woman and child in the US) mainly serve to facilitate [tax evasion](#) and crime.

Although cash remains very important for small transactions, it is becoming increasingly vestigial for larger legal tax-compliant payments, and on track to play an increasingly marginal role over the next decade. Yet demand for most advanced-country currencies continues to grow, in no small part fuelled by the underground economy.

I believe we should move to a "less cash" society, not a cashless one. There are many approaches to recalibrating the use of cash, including limiting the size of cash transactions (as many European countries have done), wiring cash registers to transmit data (as Sweden has done), and for central banks to institute small charges for redeeming cash. The most light-touch approach is

to phase out the large bills that are particularly useful for porting, concealing, hiding and hoarding cash, say getting rid of all bills \$50 and above. This idea was first advocated for the US by McKinsey chief economist James Henry in the mid-1970s, and by me since the late 1990s, and recently (and eloquently) by former US Treasury secretary [Lawrence Summers](#) and former chief executive of Standard Chartered [Peter Sands](#).

Developing economies probably should not think about phasing out cash until they have sufficient electronic payments infrastructure. Mr Modi's India has taken substantial steps to this end, including by cataloguing biometric data for almost a billion people, after which they are entitled to heavily subsidised basic accounts. But well over half have not yet set up accounts (even if they are now rushing to do so) and 300m people have yet to be catalogued.

I have proposed phasing out large bills slowly, over 5-7 years rather than overnight. India's approach more closely parallels Mr Henry's pioneering plan, in which he hoped that by leaving only a short timeframe for conversion, the US Internal Revenue Service and the justice department would be able to nail people who acquired their stashes of dollars illegally.

The problem, as the Indian example illustrates, is that there is just too much collateral damage. The Rs500 note, especially, is widely used by ordinary Indians. Moreover, India did not have a large note to start with, and it is in fact replacing the Rs1,000 note with a Rs2,000 note. In addition, as already mentioned, India did not have nearly sufficient stock of new currency on hand to replace the old, throwing the cash economy into seizure.

In an economy profoundly crippled by tax evasion and corruption, India's radical demonetisation may yet have positive long-run effects. In a sense, Mr Modi's broader goal is to change the mindset of India.

If followed up with a broad range of actions to fight corruption and to enhance financial inclusion, his monetary revolution may yet succeed. But for now, most Indians can only hope the government will soon have printed enough currency for the country to return to some sense of normality.

*The writer is author of 'The Curse of Cash'*