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INDIA TAKES A BIG STEP BACK FROM CASH

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India recently announced a bold, and potentially perilous, plan to withdraw eighty-six per cent of its paper currency from circulation. PHOTOGRAPH BY DHIRAJ SINGH / BLOOMBERG VIA GETTY

In the magazine's Money Issue last month, I wrote about a strange new economic notion: a number of economists, led by Kenneth S. Rogoff, at Harvard, are advocating phasing out big bills in the U.S. and letting the remaining cash fall toward disuse. Their goal is partly to smother an increasingly vast underground economy. (About eighty per cent of the U.S. currency is in hundred-dollar bills, but the whereabouts of much of that cash is unknown.) But, as I noted in the piece, the American economists are not alone in their cashless tendencies, and in recent weeks their club increased by hundreds of millions of people. Earlier this month, the Indian Prime Minister, Narendra Modi, announced that, in an effort to account for his nation's "black money," the two largest Indian bills, the five-hundred-rupee and thousand-rupee notes—which together make up eighty-six per cent of outstanding cash—would immediately be retired as legal tender. Rarely has an appealing hypothetical encountered so extreme a real-world test case, and so soon.

The decree is striking especially because Indian life is cash-intensive (even massive transactions, such as real-estate purchases, are routinely conducted in paper currency) and because the banned bills are in widespread daily use. A thousand rupees is about fifteen U.S. dollars; holders of the discontinued bills, Modi decreed, must trade in their obsolete notes within fifty days, after which time they will be worthless. In his recent book, "The Curse of Cash," Rogoff laid out a plan by which the U.S. could phase out its (commercially rare) large bills over nearly a decade. The discontinued rupee bills, by contrast, will be worthless by the New Year.

The move is the equivalent of an ocean liner turning with the radius of a Porsche. Although India undertook similar demonetization projects in 1946 and 1978, Modi's program is recently unmatched in scale and speed. It fits, however, with one of his big endeavors as Prime Minister. As I mentioned in my magazine piece, Modi has been on an intensifying crusade against banknotes, in an effort to stem widespread tax evasion and corruption. (India loses more than three hundred billion dollars in tax evasion every year.) Even by that standard, though, his new, fast-acting plan is radical. I phoned Rogoff to see what he made of India's new big-bill ban.

"It's a big show of force," he told me. Strictly speaking, the Indian demonetization is less about phasing out cash than it is about accounting for underground money. (With big bills about to be worthless, citizens will have to produce their secret stashes for exchange; those showing up with unaccounted-for millions are apt to raise red flags.) Instead of driving the cash economy into small bills, as Rogoff advises, Modi has introduced a *bigger* bill, a new two-thousand-rupee note, which Indians can get when they bring in their discontinued bills. In Rogoff's view, though, Modi's actions will have the long-term effect of reining in the cash economy by making Indians wary of paper money. "When you take bills out of circulation at short notice, that's going to cut cash demand in the future," Rogoff told me. "He's aiming, really, at the psychology."

On his blog this month, Rogoff wrote about the crucial differences between India's move and his U.S.-tailored plan (loosely modelled on the years-long exchange program that transitioned Europe to the euro). "One idea . . . is to allow people to exchange their expiring large bills relatively conveniently for the first few years (still subject to standard anti-money-laundering reporting requirements), then over time make it more inconvenient by accepting the big notes at ever fewer locations and with ever stronger reporting requirements," he wrote. Rogoff told me that he is unsure whether Modi's swift, jarring action will prove to be a boon or a misstep.

"If you want to know why India has not grown as much as China, as bad as the corruption is in China, it's *worse* in India," he said; targeting huge sums of black money all at once, as Modi has done, will have Jenga-like destabilizing effects on aspects of the Indian economy. The real-estate business, which regularly underreports transaction figures, is buoyed by dark money, and, following Modi's announcement, that market took a dive. Gold prices fell, too, as Indians rushed to convert their wealth.

Whether Modi's short-term demonetization succeeds will depend in large part on the initiative's long-term plan. Early signs don't all encourage confidence. Exchanging devalued bills for sound ones has been messy even for those trying to convert aboveboard money. Imagine dutifully gathering your five-hundred-rupee and thousand-rupee notes, receiving new two-thousand-rupee notes in exchange, and going to buy a loaf of bread. What do you get as change for your new money? Not, you'd hope, more of the hot-potato notes that you just purged. But, in practice, Rogoff said, the banned notes are likely to keep circulating in daily transactions, with mounting agitation, until they lose their exchange value, on December 30th.

Rogoff told me that he thinks it will be "a few years" before economists can cast an informed verdict on Modi's plan. "Over the long run, there will be a lot of studies: Is it a success? Is it something people are going to remember? Does it inspire other laws and other changes that energize people against corruption?" he said. The results will show how viable such rapid, radical action is for other countries, such as the U.S. At one point, Rogoff told me, he mulled the possibility of a bill-replacement program, like Modi's, but he came away with the conviction that it would never fly. "I kind of felt, given the way it is in the United States, the plan I was proposing was the simplest and the least inconvenient," he said. Modi, in his uncertain new effort, has sought something else.

Nathan Heller began contributing to The New Yorker in 2011, and joined the magazine as a staff writer in 2013.