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# The cycles of demonetisation: A look back at two similar experiments in 1946 and 1978

By [Vikram Doctor](#), ET Bureau | Nov 12, 2016, 07:22 AM IST[Post a Comment](#)

In West Bengal, a pundit had to postpone the marriage of his daughter. The Rs 1,000 notes he had scraped together for the marriage were no longer legal tender.

In Nainital a big businessman fell over and died from heart failure when he went to hand in his Rs 1,000 notes. And in Calcutta, an enterprising gentleman who handed in notes to the value of Rs 6.03 lakh, the largest amount deposited that day, claimed he had got them for "an official secret which could not be disclosed to the public."

These are not scenes from the current round of demonetisation, though similar ones might well happen (it would be interesting to see if the official secrets argument works). Nor are they from 1978, which is the [demonetisation](#) round that an older generation still remembers, when the newly installed Janata government decreed it as proof of the commitment to cleaning up the system.



For a while after 1946, black money ceased to be a major issue. The demonetisations that took place were technical, dealing with the currencies of the native states.

These stories are from 70 years back, when on January 12, 1946, the pre-Independence government of India passed the High Denomination Bank Notes (Demonetisation) Ordinance. The background was World War II, which had just got over, but during which businessmen in India were supposed to have made huge fortunes supplying the Allied war effort and were concealing their profits from the tax department.

Letter writers to the Times of India (ToI) exulted at this first formal demonetisation in India. "The money that is concentrated in the hands of these people is not simply wealth. It is the life blood of thousands of Indians who starved and died during the last five years while black marketeers went on piling up money in their safes," fumed SR Rangnekar from Bombay (now Mumbai). He advised the government to follow this up by cracking down on their stocks of gold "if they exceed 100 tolas."

G Pingle from Kalyan noted snidely that many black marketing businessmen "tried to play the role of true nationalists. It passes my comprehension why so-called nationalists did not make any attempt to improve the condition of their war-weary fellow men." Eric Miranda from Bandra suggested that people handing in high-value notes "might even be allowed to smoke a cigarette made out of one of these notes, as some are now doing, as some consolation."



A writer using the name [Non-Idealist](#) suggested, more practically, that the government not waste time moralising about the black market, but just focus on getting the money. Noting that a large amount of notes might just never get handed in because they could not be accounted for, and hence go to waste (or be used to make cigarettes), the writer suggested the Reserve Bank of India (RBI) simply offer 30-40% of the value of the notes, with no questions asked.

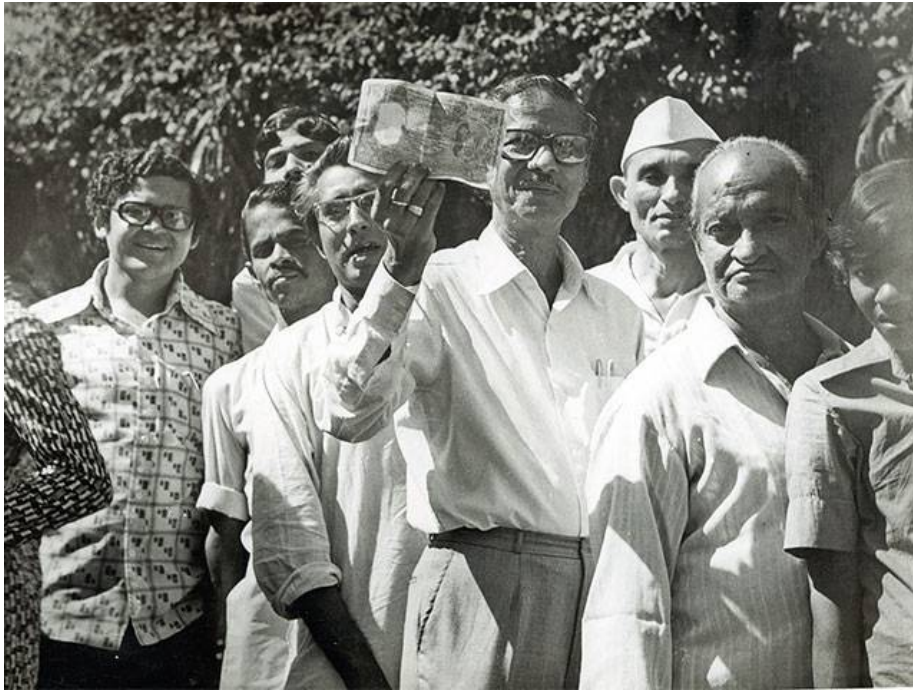
The Indian nationalist leaders, who hadn't been party to the decision, sounded dubious about its effects. [Rajendra Prasad](#), who would become the first president of India, declared that "while we, [Congressmen](#), have no sympathy with profiteers and dealers in the black market, it is not right to penalise honest people who in good faith have their savings in notes of demonetised value... A large number of people belonging to the middle and lower middle classes will be hit hard."

And in a display of scepticism about government regulations that, sadly, would not carry over to the later Indian government, Prasad wondered how the problem had been created in the first place: "Many of the wartime ordinances succeeded in complicating the problems which they were intended to solve and in creating opportunities for corruption. The new ordinances are not going to fare any better."

The similarity of all these reactions, from the fulminations of letter writers (Net commentators today), to the need for a mysterious, corrupt group to blame, to concerns for the impact on regular people, all suggest that there is something cyclical about demonetisation. Even the secrecy with which the current government pulled it off has parallels in 1946. "Never was a secret so well kept in [Delhi](#)," wrote Tol on January 26. Even government officials were left with high-value notes to hand in.

Tol wrote that only eight officials knew about the plan, including the RBI governor and the finance member of the Viceroy's Council (the equivalent of today's finance minister). "In order to be issued on Saturday, January 12, the ordinance had to be flown in a special plane to Poona for the Viceroy's signature. It was then flown back."

During the discussions with governor [Chintaman Deshmukh](#) (later to be Nehru's finance minister), the officers took notes and typed drafts themselves, without the help of secretaries. "Handwritten notes exchanged between these officials were carefully burnt. No carbon copy of the documents was made or kept." Even extra staff wasn't allocated to the RBI's currency department just in case that raised suspicions.



The collections made justified the precautions. Tol reported that currency notes to the value of Rs 47 crore had been deposited across India, with Bombay in the lead with Rs 27 crore, followed by Calcutta (now Kolkata) with Rs 7 crore, Karachi with Rs 3 crore, Lahore with Rs 2.5 crore and Madras (now Chennai) with Rs 60 lakhs. New Delhi, as a newly constructed government town, didn't seem to count at all. The Indian princes weren't exempt, but were allowed to use a special form approved by the crown representative in their state.

For a while after 1946, black money ceased to be a major issue. The demonetisations that took place were technical, dealing with the currencies of the native states. In 1949, for example, Kutch's koris were converted; they were pure silver and were causing problems in the bullion market. After the takeover of Hyderabad, the Osmania sicca, a 148-year-old currency, was converted to Indian rupees in 1957, with a grace period of two years for the change. In 1963-64 the old annas and pice coins were converted to paise, also a technical demonetisation.

But around that time, the rumours about black money started rising again. In 1965, finance minister TT Krishnamachari had to face questioning from increasingly assertive opposition members about the quantum of black money, and using demonetisation to stop it (high-value notes came back in 1954).

On April 20, 1965, Krishnamachari replied in Parliament that "demonetisation was neither feasible nor would produce results." He felt that estimates of black money were hugely over inflated and what did exist had been converted to "bonds, property and shares," all beyond the reach of demonetisation.

Yet the demand never went away. In 1970, it got a boost of sorts when neighbouring Ceylon (now Sri Lanka) conducted a truly radical demonetisation that extended to Rs 100 and Rs 50 notes. A commission on direct taxation was set up under Justice Kailas Nath Wanchoo that looked at the issue and, perhaps inspired by Ceylon, it suggested even demonetising down to Rs 10 notes!

This seems to have been more on the lines of what will happen with our current Rs 500s, where the denomination still exists, but the physical notes will change. As Prem Shankar Jha noted in a column in Tol on August 28, 1972, this in itself would have required a major feat: "The government will have to print no less than 3,500 million currency notes – at least ten times as many as in a normal year – and transport them to every treasury office, bank and post office in the country." It would, he pointed out, be impossible to do this secretly.

In a sign of the rising demand for action though, Jha concluded his piece by suggesting that, despite the logistical problems, it was needed as a scare: "The real value of demonetisation lies in its therapeutic effect on the economy. Large numbers of habitual tax evaders conceal their incomes only because years of laxity and permissiveness in the present tax laws have lulled them into a sense of security."



There is an echo here of our current Prime Minister's speech, urging India to accept the short-term pain for the long-term, cleansing effect. And it shouldn't be a surprise that later that same year the Jan Sangh, the precursor to the [Bharatiya Janata Party](#), adopted demonetisation in a resolution at a party conference in Jaipur. "The resolution said between high prices and high taxes the citizen was being 'crushed'," wrote Tol, and one can see an argument that the flow of black money was causing the first and was caused by the latter.

So when Janata came to power, with the Jan Sangh as part of the coalition, demonetisation was always likely to be on the agenda. Again, it was put into effect with speed and secrecy. According to the RBI's official history, on January 14, 1978, R Janakiraman, a senior RBI official was asked to go to Delhi on "some urgent work." Despite being told to go alone, he took an assistant and when they reached they were told they had 24 hours in which to draft a demonetisation ordinance.

They were forbidden from communicating with RBI headquarters in Bombay. They managed to get a copy of the 1946 ordinance and used it to draft a new one. On January 16 it was announced that Rs 1,000, Rs 5,000 and Rs 10,000 notes were being withdrawn from circulation. As with Modi's announcement on November 8, the next day was declared a public holiday to allow banks to prepare for the onslaught. The public was given just three days to exchange their notes.

Long queues formed in front of RBI and State Bank of India offices from very early in the morning. Additional counters were set up but, according to the RBI history, January 18 "started with utter confusion over the issue of declaration forms at the Reserve Bank headquarters at Bombay and working hours were stretched to 6.30 pm." Tempers rose and there was a particular outcry from foreign tourists who faced the prospect of running out of legal money far from home.

Despite the problems, finance minister HM Patel declared he was pleased. Tol quoted him saying, a bit cryptically, "You will see me smiling whatever the result." He deflected suggestions that it would harm trade and industry by saying the measure "would affect smugglers who were in any case on the fringes of trade and industry." Rather oddly, he played down the impact on black money since, for that, he said it would have been necessary to demonetise Rs 100 notes. This measure, he said, was just to reduce the money used in illegal transactions.

If the finance minister was vague, RBI governor IG Patel was not. In his memoirs, *Glimpses of Indian Economic Policy*, he made clear he went along with demonetisation reluctantly. He had pointed out to the finance minister that "such an exercise seldom produces striking results." People who have black money on a substantial scale rarely keep it in cash. "The idea that black money or wealth is held in the form of notes tucked away in suit cases or pillow cases is naïve." Patel pointed out that even those who are caught with black money can usually find agents who will convert the notes through a number of small transactions "for which explanations cannot be reasonably sought." Yet the government was insistent, and so "the gesture had to be made, and produced much work and little gain." Patel didn't mention it, but another former finance minister C Subramaniam suggested that, then as now, the real aim was political and aimed against other parties.

The same point was made by two economists--CN Vakil and PR Brahmananda. They pointed out that the measure might have had some merit if it had reduced money supply, perhaps by exchanging the notes for a little less. As it stood it was just "a publicity boost" to the government and they recalled how the 1946 demonetisation had just resulted in Rs 10 crore going out of the circulation and the recent Sri Lankan experiment had much the same impact: "One guess is that the present measure has primarily a political and not economic

objective. In such a case it becomes a business in and among politicians.”

The rapidity with which black money became an issue again in following decades suggests that the doubters had a point. Perhaps demonetisation is always more of a political gimmick. Perhaps, as Jha had suggested, it is a needed warning to discourage black marketers – though as the doubters might argue, the question remains if the really big players are affected, while regular people suffer the pain.

Perhaps it is cyclical, a tactic that every 30-40 years is tried out again. But perhaps this time will be different, because of the existence of the whole system of online, mobile and card-based banking that extends the formal banking sector far beyond what it was in 1946 and 1978. Perhaps there will never be a need again to demonetise the Rs 500, Rs 1,000 and Rs 2,000 notes that will soon be introduced. Or perhaps come 2046 or 2056, we will be back here, all over again.

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