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November 22, 2016 1:00 pm JST

## Chaitanya Kalbag -- India struggles to find its feet after demonetization



An Indian shows new 2000 rupee notes he received after exchanging discontinued currency notes in Jammu, India. © AP

Every Indian banknote carries two reassuring messages: "Guaranteed by the central government," and above the signature of the governor of the Reserve Bank of India, the words: "I promise to pay the bearer the sum of ... rupees."

At midnight on Nov. 8, Indian Prime Minister Narendra Modi used an executive fiat to extinguish both those promises, rendering around 16.5 billion bills of 500 Indian rupee-notes and 6.5 billion bills of 1,000 rupee denominations worthless at one stroke.

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Two weeks into his wrenching demonetization of high-value bills, analysts believe Modi has taken the biggest gamble of his career, combining political audacity with economic brinkmanship.

The decision has triggered nationwide chaos. Much of India's cash-based economy has ground to a near standstill. Stock markets are at six-month lows. Millions of people have spent days waiting in line at overburdened banks to exchange useless old currency or deposit it in bank accounts. Nearly every day, the government has announced new steps to manage the crisis, first increasing the limit of money that could be exchanged, then slashing it; one day granting a higher withdrawal limit to farmers who desperately need to buy seeds as the winter sowing season starts, and on the next, allowing more money to hapless families as the country's wedding season kicks off.

The pain has been made worse because India, despite its size, is very underbanked. The World Bank says that as of 2014 India had 13 bank branches per 100,000 population, compared to 32.4 in the U.S. and 33.9 in Japan. The country has only about 200,000 automated teller machines, many of which still need to be recalibrated for newly-printed banknotes of different sizes.

### Political gamble

After a four-day silence on the issue, Modi has used unusual situations to talk about his crusade against black money. On Nov. 12 during his recent visit to Japan, he told a crowd of about 500 Indians at the port city of Kobe that he thanked the millions of his countrymen who had coped with the inconvenience. "Many people [with black money] who had parked their aged parents in old people's homes suddenly decided to deposit up to 250,000 rupees (\$3,675) in their accounts," he said mockingly, referring to the limit of old notes an individual was allowed to deposit in an account. A week later he spoke by video link, just before a Coldplay concert at a youth festival in Mumbai, telling the crowd: "To make public policy cool is no mean task!," and vowing to clean up India before quoting Bob Dylan's lyrics from "The Times They Are A Changin'."

A senior official involved in policymaking said that while Modi had emphasized the secrecy of his demonetization plan ahead of the announcement, it had been in the works for months. He said the central bank's former Gov. Raghuram Rajan had been opposed to demonetization, while his successor Urjit Patel, who took office on Sept. 4, had immediately signed off on the printing of a new 2,000 rupee banknote, along with new designs of existing denominations. Although two government printing presses had been working overtime to print the new notes, supplies have been slow to reach the big cities and the vast Indian hinterland.

Modi said demonetization was aimed at India's huge black economy -- some sources estimate it comprises around half of the nation's \$2 trillion gross

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domestic product. But the official said the demonetization would hit transactions in the works; about three quarters of the cancelled currency was in play in current transactions.

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