

# India's Demonetization "Shock Therapy": State Sponsored Financial Repression

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*If You Can't Dazzle Them With Brilliance, Baffle Them With Bull.*"- WC Fields

*You never want a serious crisis to go to waste. And what I mean by that is an opportunity to do things you think you could not do before.*

*-Rahm Emanuel, Former White House Chief of Staff in the Obama administration.*

Naomi Klein in her bestselling book 'The Shock Doctrine: The Rise of Disaster Capitalism' wryly observed "Extreme violence has a way of preventing us from seeing the interests it serves." Perhaps the small coterie of advisors close to Prime Minister Modi, driven by the ideology of disaster capitalism, took Klein's observation seriously.

On November 8 the shock to the financial system was administered by Mr. Modi by demonetising 500 and 1000 rupee notes. India is an overwhelmingly paper currency country: some 90% of the transactions are done with cash. India's cash-to-GDP ratio is 12% More than half of Indians still don't have a bank account and some 300 million have no government identification. The two scrapped denominations - 500 and 1,000 rupees - account for more than 86% of the value of cash in circulation.

By this diktat the government effectively neutralized around 86 percent of the currency in India. The staggering implication for the informal sector in the Indian economy which employs close to 94% of the labour force was disastrous. The daily wage earners, farmers, small traders and small businessmen were left helpless clutching the dud 500 and 1000 rupee notes in their hands. Even the economist Lawrence Summers, author of the of the infamous World Bank Memo was driven to write... "Most free societies would rather let several criminals go free than convict an innocent man. In the same way, for the government to expropriate from even a few innocent victims who, for one reason or another, do not manage to convert their money is highly problematic....". 1

The RBI had its own Marie Antoinette moment a few days later in a press release of November 12, 2016. It said "public are encouraged to switch over to alternative modes of payment, such as pre-paid cards, RuPay/Credit/Debit cards, mobile banking, internet banking. All those for whom banking accounts under Jan Dhan Yojana are opened and cards are issued are urged to put them to use. Such usage will alleviate the pressure on the physical currency and also enhance the experience of living in the digital world." Economist Jayati Ghosh was aghast and wrote .. "Statements like this make one wonder whether the RBI is living only in the digital world. Surely the worthies in that institution have some idea of the conditions under which banking and money exchange occur for most Indians? 2 For some families for whom getting a square meal was a luxury the mocking advice of the Modi

government was if you don't have food eat plastic cards.

ATM machines became cashless and long queues formed outside banks to exchange the old notes for new ones. From this inane compliance ritual of standing in endless queues outside banks, heart wrenching stories emerged. A number of senior citizens died of exhaustion. Children and the elderly who were sick died as they were refused admission to hospitals as they could not pay with old notes. Farmers could not buy seeds for the sowing season as they did not have the new currency to pay for it. For the first time in post independent India the financial system went into a lockdown mode.

The collective punishment on India's poor and the informal sector where millions eke out a miserable livelihood was severe as close to 50 percent of them do not have bank accounts and formal identification papers to open bank accounts. However this draconian measure was justified by the NDA government of Modi as a patriotic duty to eradicate the twin evils of black money and counterfeit currency used by terrorists.

True to form the mainstream TV channels- with the exception of NDTV (Hindi) News- which largely serve as PR agencies of corporate houses spewed patriotic drivel about pain, sacrifice and stoicism as national virtues. Tall and ludicrous claims were made by the BJP ministers that terrorism was dealt a death blow by the surgical strike of knocking out 86% of the Indian currency. Critics of demonetisation were shouted down as unpatriotic with the passionate fervor of McCarthyism. Donning the mantle of a messianic prophet PM Modi exhorted the poorest of the poor to move towards a cashless society.

Cutting beneath the masochistic hysteria of pain and national sacrifice whipped up by the propaganda machine of corporate media and the Modi government, one discerns fundamental flaws in the argument that demonetization eradicates black money and counterfeit currency. It is as absurd as arguing that to prevent bank robberies one has to completely shut down the banks.

Firstly, all black money is not held as hoarded cash. At best it constitutes 6% of the black money. Bulk of it is spirited away in Tax free havens like Switzerland and Panama from there it is invested through mail box corporations in equity, real estate and bullion all over the world. It is a matter of utmost irony that a number of the celebrities who endorsed the demonetization scheme figure in the list of names of people who used the illegal offshore accounts in places like Panama.

Moreover, elaborate tax frauds are committed by corporate giants in squeaky clean cashless financial environment. As I explained in my article [Inside the Spiders Web: Tax havens and Dirty Money](#) 3

“In an elaborate charade called transfer pricing, corporations with their army of accountants and lawyers create a maze of shell companies (i.e. companies which have no real business activity) in Tax Havens which have secrecy laws concealing the ownership and the source of the funds. The tax strategy is fairly simple: book the profits in shell companies located in tax havens having low or nil rates of tax and show reduced or better still zero earnings in countries which have higher rates of tax.”

Then there is another game called capital round tripping played by big corporate businesses which bring back their black money through bogus companies which have no real business.

These funds are invested in the economy as Foreign Direct Investment. There have been no efforts by the Government to clamp down on these activities. At the Mahesh Buch Memorial Lecture at Bhopal on October 5, 2016 former Reserve Bank of India governor Y.V. Reddy said “there is a subsisting interest in influential policy circles to keep a window for round tripping open..” 4

The Indian stock market is also rigged through the route called the Participatory note where the black money from Indian origin is parked in Mauritius in a shell company from which there is flow back of black money as investment in the stock market causing inflated share prices. It is no secret that demonetization is a wrong policy instrument to handle such sophisticated chicaneries. It is like slicing a loaf of bread with a hammer.

Secondly, the engines of black money are left intact especially election campaign contributions are often accepted in cash and unaccounted for. The BJP which is now on a moral crusade of eradicating black money has been guilty of accepting large sums of unaccounted money as campaign contributions. Moreover, bribes of government officials and the political class would continue unabated even after demonetization. There are already reports that government officials are taking bribes in freshly printed notes! It was reported in the state of Gujarat where Mr Modi hails from government officials demanded bribes in freshly printed 2000 rupee notes.

And lastly, counterfeit notes circulating in the economy is estimated to be in the region of 400 crores out of a total of sixteen lakh crores. In percentage terms it amounts a mere 0.03% of the entire currency. A sensible policy practiced by most governments is to gradually phase out certain notes with certain serial numbers to lessen the dangers of counterfeiting instead of firebombing the currency.

There is no gainsaying that by rendering 86% of the currency as paper trash and carpet bombing the informal sector dependant on cash, the demonetizing of currency can best be described as a quixotic venture. Or is it a dress rehearsal for something more ominous in the form of draconian capital controls preventing physical withdrawal of cash from banks? Is the lack of availability of currency on account of “poor planning” or a manufactured crisis for the Government to push its agenda for a war on cash?

Before we discuss this issue we have to take a snapshot of the Indian economy. Beneath the rosy headlines of robust GDP growth rates the fact remains that the growth is fueled by expansion of credit and not incomes from steady job growth which in a state of decline. The top corporate elites have borrowed heavily from public sector banks without any hope of paying off the debt. The public sector banks are groaning under the weight of corporate loans which may never be paid. The real estate sector of the economy is primed up with bank loans and credit expansion. The stimulus to the economy is through easy access to credit for consumer spending. Thus an illusion of prosperity is maintained on a mountain of credit.

The crisis point in the Indian economy has reached as credit induced asset bubbles are in imminent danger of imploding unless there is fresh induction of credit into the system. The Indian economy is in a danger of deflationary spiral and the credit ponzi scheme has to be maintained through the expansion of demand of new credit money. But limit to credit expansion is hitting the proverbial road block as there are few lenders and few takers of credit as business confidence is low and the much lauded animal spirits is in short supply. As

Nicole Foss observes

“Natural limits for both borrowing and lending threaten the capacity to prolong the credit boom any further, meaning that even if central authorities are prepared to pay almost any price to do so, it ceases to be possible to kick the can further down the road. Negative interest rates and the war on cash are symptoms of such a limit being reached. As confidence evaporates, so does liquidity. This is where we find ourselves at the moment — on the cusp of phase two of the credit crunch, sliding into the same unavoidable constellation of conditions we saw in 2008, but on a much larger scale.”<sup>5</sup>

Given the scenario of deflationary spiral and a lull in the credit off take, the access to interest free money (bank deposits with zero rate of interest) and worse with negative rates of interest (where the bank deducts a fee or bank charges from the deposits made with the bank) become imperative policy push for the coterie of financial elites and their political friends in the government.

But the constraint to monetary expansion is the engendered tribe of savers and the hoards of cash lying dormant in lockers or under the proverbial mattresses. On them the war on cash must be declared to achieve the big push for credit expansion. There must be a moral crusade against physical cash which is hoarded and not available for the orgy of borrowing and spending. To prise open the cash hoard there must be the shock of demonetization and laws against physical withdrawal of cash which ensures that the physical cash is corralled and sequestered in the banks for further credit expansion. The mirage of prosperity is maintained by kicking the can down the road.

However, to nail down the escape hatch for bank customers who may become uneasy with deposits not earning any interest or worse negative rate of interest and withdraw cash physically, it is necessary to put in place draconian capital controls which prevent withdrawals of cash and also prevent the messy spectacle of bank runs. Once locked in the bank account the depositors can get a surgical scalping to take care of the messy NPA's of banks caused by profligate lending to corporate elites. The entire class of savers such as senior citizens, deposit holders belonging to the lower middle class would be thrown under the bus.

The winners of the demonetization shock therapy would be the corporate elites who caused the debt crisis for the banks in the first place.<sup>6</sup> For them the loans would be written off at the cost of bank customers. Following the dictum that every disaster offers a windfall they would appear once again as saviours after getting the licenses for starting digital banks or wallets. Here the shell shocked ordinary people would invest their capital without returns whatsoever for the joy of walking cashless in the digital space. It is de rigueur that animal spirits should be rewarded handsomely in the business friendly environment of NDA government.

The demonetization of the currency has also a shock and awe element to it: the shock of losing real money and the awe of being herded in digital pen. Cash carries a bad odour. Are you using cash because you are engaged in drug trafficking or are you a terrorist wanting to buy arms and explosives? Should you be flagged for suspicious activities for questioning by the national security state?

Apart from the searing stigma that cash is associated with criminality, there is immense

pressure on the denizens of the informal sector to tread the virtuous path to digital- “you pay- we play” pens like Paytm. Also comfortingly called digital wallets they offer bleating sheep solace and comfort from the ordeal of cash transactions. Once secure in the pay pen the sheep can be burdened with transaction costs which swells the profits of the digital banks and also the ubiquitous service tax can be imposed by the government which swells the coffers of a state hostile to social spending. To sum up :

1. Every financial transaction can be taxed
2. Every financial transaction can be charged a fee
3. Bank runs are eliminated 7

In this digital pen we shall serve with docility and endure “the stifling hygiene of the digital panopticon being constructed to serve the needs of profit-maximising, cost-minimising, customer-monitoring, control-seeking, behaviour-predicting commercial bureaucrats” and tax officials.

Don Quijones at the website “Raging Bullshit” is more blunt when he says..

” The reality is a whole lot darker. The war on cash is being waged for the exclusive benefit of those who already wield an inordinate amount of power and control over the economy and the people that are struggling in it. And they want more. By slowly, quietly killing cash, they seek to seize the last remaining thing that offers people a small semblance of privacy, anonymity, and personal freedom in their increasingly controlled and surveyed lives. And the way things are going, they’ll get it...” 8

Imprisoned within the narrow confines of this digital panopticon from which there is no exit, we will lose our freedom over our money. We will no longer have the choice of withdrawing cash from banks plagued with bad debts or withdrawing from irrational credit orgies as the risk of losing our money is too high.

Facing the signs of no cash and no exit we shall be agitated at the first signs of Financial Meltdown but we shall be pacified by the handlers of the pen. We will be reminded of our patriotic duty to the state to pay taxes. Ultimately calm will return.

After all the handlers imbued with the wisdom of Jean Baptiste Colbert the French finance minister to King Louis XIV know, “The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing.”

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## Notes

1 Corruption Will Continue, Says Former US Treasury Secretary Larry Summers on Demonetisation <http://thewire.in/81659/larry-summers-on-demonetisation-india/>

2 The Political Economy of Demonetising High Value

Notes <http://www.thehindu.com/news/resources/the-political-economy-of-demonetising-high-value-notes/article9348002.ece>

3 C R Sridhar Inside the Spiders Web: Tax havens and Dirty

Money [http://www.opednews.com/articles/Inside-the-Spiders-Web-Ta-by-C-R-Sridhar-Corporations\\_Economy\\_Globalization\\_Money-Power-Psychopaths-141028-742.html](http://www.opednews.com/articles/Inside-the-Spiders-Web-Ta-by-C-R-Sridhar-Corporations_Economy_Globalization_Money-Power-Psychopaths-141028-742.html)

4 Former RBI Governor Y.V. Reddy on Black Money, Tax Evasion and Lawlessness in India

<http://thewire.in/82333/yv-reddy-speech-black-money/>

5 Negative Interest Rates and the War on Cash part 1- Nicole Foss- Automatic Earth

6 RBI grants "in-principle" approval to 11 Applicants for Payments

Banks [https://rbi.org.in/scripts/BS\\_PressReleaseDisplay.aspx?prid=34754](https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=34754)

7 The War On Cash: Officially Sanctioned

Theft <https://www.peakprosperity.com/blog/93050/war-cash-officially-sanctioned-theft>

8 Who's Powering the War on

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