Money and the Social Contract in India*

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The social contract between a state and its citizens is a complex thing. Philosophers of the European "Enlightenment" saw it as the basis on which society is organised so as to ensure the mutual protection and welfare of its members. It is therefore the implicit social arrangement whereby citizens give up some of their rights and freedoms to the state or a similar authority, in return for some degree of order and stability that would effectively ensure the protection of their remaining rights and freedoms. In very unequal societies, the voluntary nature of such a social contract is not particularly evident. Indeed, many would be hard put to find much evidence of its existence in the first place, even in ostensibly democratic political contexts where periodic elections provide at least the veneer of accountability.

But however strong or weak the social contract may be, the system of money – the currency of a country, especially in the form of its bank notes – is one of the most direct and obvious ways in which most people experience it.

Money has always been inherently of and between human minds. The commodity base of money, in the form of precious metals like gold and silver, allowed some mediation of this, but even that was typically extended by other forms of liquidity like merchants' promissory notes and bankers' bills. But ever since the disappearance of gold-backed money, worldwide fiat money is entirely built on trust. And that trust is ultimately trust in the issuing authority, that it will maintain and continue to recognise the value of what is described as "legal tender".

The flimsy pieces of paper that constitute "money" are inherently of little or no value in themselves, other than the promise made on them, typically by the representative of the central bank, which in turn is explicitly or implicitly backed by the authority of the state. Of course, that promise itself is rather circular: what does it mean, after all, to say on a hundred rupee note "I promise to pay the bearer the sum of one hundred rupees"? Yet that somewhat bizarre promise actually works, in terms of making that note an effective medium of exchange, simply because everyone believes in it and is willing to exchange it for goods and services of equivalent value.

So the currency in circulation is not just the most obvious material form, but in some ways the purest expression, of the social contract that binds a society together and keeps it functioning. It is obvious therefore that messing around with it can cause problems not only in material and economic management but also in the social fabric. Periods of history in different societies when trust in the currency has collapsed (say in hyper-inflationary situations) tend to be social and politically volatile as well, generating all sorts of different and warring tendencies.

That is among the reasons why the Indian government's demonetisation move is so startling and even incredible. It is without doubt the most extreme experiment of its kind ever. Such a large-scale demonetisation of major currency notes (around 86 per cent of the value of the currency in circulation) has occurred in the past only in extreme hyper-inflationary situations (as in several countries in Latin America in the "lost decade" of the 1980s) or in periods of war and civil conflict in which the currency was already debased (as in China just after the Revolution). For it to occur in

peacetime, in a period of moderate to low inflation and generally rapid growth of economic activity, is both unprecedented and remarkable.

There have been many adverse consequences of this decision, widely seen even if not as widely reported by the increasingly subservient mainstream media. But a deeper and more long-term concern has been less talked about: the breakdown of trust in money, especially in the form of currency, that could affect transactions in the economy in the foreseeable future.

On 8 November, the Government of India effectively de-recognised its own legal tender in the form of the existing notes of Rs 500 and Rs 1000 value. That would have been one thing if other notes were immediately available to be exchanged for these, but that was not the case – nor, it turns out, was it even intended to be the case. Instead, notes could be placed into bank accounts. Withdrawals from these accounts have been massively constrained by the absence of new notes. But that was hardly the only problem, as the move completely disregarded the problems faced by more than one-third of the population without bank accounts. The small amount of notes that could be exchanged directly was progressively reduced from Rs 4500 to Rs 2000 and then nothing at all.

The subsequent series of more than 170 different (and changing) notifications that have determined and affected implementation of this demonetisation have further deprived those without access to formal banking of the right to hold their wealth in this form, and indeed have effectively expropriated them. The presumption is that all those with such notes who are unwilling or unable to put them into bank accounts with PAN cards etc., are criminals, holding black money.

The possibility of relatively poor people painstakingly saving up their own cash hoards over years is simply not considered. Indeed, so strong is the opposite perception that the government has assumed that any large deposits into Jan Dhan Yojana no-frills bank accounts are necessarily benami inflows from rich people seeking to hide their own wealth. So deposits into Jan Dhan accounts above Rs 50,000 are no longer possible without linked PAN cards – a tall order for vast numbers of poor people who have had no encouragement or assistance to get into this system.

In effect, one part of the social contract had already broken down: the state no longer trusts its own citizens. Or rather, it trusts only those who make cheque payments or can engage in online transactions, not those who operate on the basis of its own legal currency. All others, no matter how poor or disadvantaged, are guilty unless proven otherwise, and must pay the price by losing their monetary wealth.

How long, then, before the reverse part of the social contract also breaks down? Before people start doubting the validity of the currency issued by the central bank and backed by the Indian state? Already, the embarrassing flaws in the new currency notes (including irregular sizes, copy-editing errors and even now printing mistakes that make them look different) are rendering them less usable and ironically easier to counterfeit. But these may be even less damaging than the inevitable rumours about these notes also being withdrawn suddenly and without notice at some later date.

Some analysts living in their own digital dreamland might actually welcome such a move, thinking that this would hasten the move to a cashless society, and that cashlessness is akin to godfulness. This is obviously foolish, given the state of development of both physical and digital infrastructure in India and the extent of education of the people in general. It also completely ignores the possibilities of fraud, identity theft and massive loot possible in online transactions through cyber-crime, something that the most advanced countries in the world are still struggling to contain.

Loss of faith in a currency through history has generally involved a shift into other assets, which increasingly become stores of value – and these could be anything from gold (always the favoured choice of the country that Keynes once described as "the sink of precious metals") to dollars to bitcoin. Debasement and creating aversion to its own currency is therefore something rarely done by any state out of choice, rather than in response to the most extreme of exigencies.

We are now in relatively uncharted economic territory in India. But this also means that we may be entering an entirely new phase of our social contract as well.

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