

The Utter Failure of Demonetization: The RBI says so even as it says not

Surajit Mazumdar

Since the statement by the Deputy Governor on 13 December 2016 which gave a figure of Rupees 12.44 lakh crores of the old 500 and 1000 rupee notes (Specified Bank Notes or SBNs) received by the RBI or in currency chests, the RBI has put out no figures on the deposits of SBNs the public has made with banks or the value of such notes returned to the RBI. The exact amount of fresh valid or non-SBN banknotes (new 500 and 2000 rupee notes and notes of smaller denominations) the RBI has put into circulation after 8 November has also not been provided for a long time (and the one statement of 7 December that did was subsequently withdrawn from the RBI website). Only a rough idea of this can be got from the data on valid banknotes issued to the public by banks since 10 November since. The last figure of this put out by the RBI was Rupees 5.93 lakh crores and was the amount issued up to 19 November 2016.

It is, however, possible to get around the RBI's miserly attitude towards releasing the data in its possession to get at a reasonably accurate picture of what has happened – and the picture itself provides a possible explanation for the RBI's otherwise inexplicable increasing secretiveness. Let's see how.

Figures for the Currency in Circulation (CIC), which is the sum of Currency with the Public and Cash with Banks, are given out weekly by the RBI through its routine releases of Reserve Money data. The last date before the demonetization announcement for which this data was released was 4 November 2016, at which time the CIC was Rupees 17.97 lakh crores. Even on 11 November, after two days of the working of the banking system post the demonetization announcement, the CIC was Rupees 17.88 lakh crores. According to the latest figures issued by the RBI on 28 December 2016, the CIC stood at Rupees 9.42 lakh crores on 23 December, Rupees 8.55 lakh crores (17.97-9.42) less than the level on 4 November. Indeed, the CIC has come down every week after the demonetization announcement, which means that the net infusion of fresh currency by the RBI in each of these weeks has been less than the value of the old 500 and 1000 rupee notes or SBNs being returned to it over the same period.

Now, we know that the CIC on any date must be the sum of the values of the SBN and non-SBN banknotes held by the public and banks. In other words, it would exclude the SBNs that had been already returned to the RBI by that date but would include SBNs deposited by the public with banks that were still in the hands of banks and had not yet been transferred to the RBI. We also know that the value of SBNs in the CIC on 8 November was Rupees 15.44 lakh crores. Let us now consider 21 alternative hypothetical scenarios of combinations of the two types of currency, SBN and non-SBN, that are all consistent with their sum being Rupees 9.42 lakh crores, the CIC on 23 December. Columns A and B in the table show these 21 combinations numbered from 1 to 21 in which the value of SBNs ranges in increasing order between zero and Rupees 2 lakh crores. Subtracting the SBNs value in each scenario from 15.44 lakh crores then give us the corresponding hypothetical value of SBNs returned to the RBI (Column C).

Table: Alternative Hypothetical Combinations of SBN and non SBN currency in the CIC on 23 December 2016 and Corresponding Magnitudes of other Variables (Values of Currency in Rupees lakh crores)

Scenario No.	Combination of SBN and non SBN currency in CIC on 23 Dec 2016		SBNs Received by RBI	Fresh Currency issued by RBI (Net)	Fresh Currency Issued as Percentage of SBNs received by RBI
	SBN	Non SBN	= (15.44 - A)	= (B - 2.53)	= (D/C) X 100
	A	B	C	D	E
1	0	9.42	15.44	6.89	44.62
2	0.1	9.32	15.34	6.79	44.26
3	0.2	9.22	15.24	6.69	43.90
4	0.3	9.12	15.14	6.59	43.53
5	0.4	9.02	15.04	6.49	43.15
6	0.5	8.92	14.94	6.39	42.77
7	0.6	8.82	14.84	6.29	42.39
8	0.7	8.72	14.74	6.19	41.99
9	0.8	8.62	14.64	6.09	41.60
10	0.9	8.52	14.54	5.99	41.20
11	1	8.42	14.44	5.89	40.79
12	1.1	8.32	14.34	5.79	40.38
13	1.2	8.22	14.24	5.69	39.96
14	1.3	8.12	14.14	5.59	39.53
15	1.4	8.02	14.04	5.49	39.10
16	1.5	7.92	13.94	5.39	38.67
17	1.6	7.82	13.84	5.29	38.22
18	1.7	7.72	13.74	5.19	37.77
19	1.8	7.62	13.64	5.09	37.32
20	1.9	7.52	13.54	4.99	36.85
21	2	7.42	13.44	4.89	36.38

Taking the 4 November figure for the CIC to be also the figure on 8 November, we can determine that the value of notes of denominations less than 500 in the CIC on 8 November was Rupees 2.53 lakh crores (17.97 – 15.44). Deducting this amount from the value of non SBN currency in each scenario would then give us the corresponding magnitudes of the hypothetical net infusion of fresh currency by the RBI between 10 November and 23 December (Column D). Comparing the figures in Column D with the corresponding ones in Column C then gives us for each hypothetical scenario the corresponding proportion of fresh infusion of currency by the RBI to the value of SBNs returned to it (Column E). It may be noted also that the difference between the magnitudes in Columns C and D in each scenario is Rupees 8.55 lakh crores, which as mentioned earlier is the figure for the post-demonetization reduction in the CIC.

From the Table, the following definitive or incontrovertible conclusions can be arrived at:

1. The infusion of fresh currency by the RBI up to 23 December could not have exceeded 45 per cent of the value of the SBNs in circulation on 8 November – this is clear from looking at Scenario Number 1.
2. The *higher* was the figure of SBNs still with the public or with bank sat the end of 23 December, *the lower* had to be the degree of replacement of the part received by the RBI with fresh currency. This can be seen by going down the rows in the Table and comparing the movements of the figures in Columns A and E. In other words, there had to be an *inverse* relationship between two yardsticks for measuring the success and efficiency of the demonetization exercise.

Given the figure of the value of fresh banknotes issued by banks to the public by 19 December as per the RBI's press release (5.93 lakh crores), it would seem reasonable to also conclude that the actual position on 23 December would be closest to any one of the hypothetical scenarios with number 10 or less. This in turn would mean the following two things one week before the 30 December deadline:

- a) That the amount of the old 500 and 1000 rupee notes not returned to the RBI by 23 December was almost insignificant. At less than Rupees 1 lakh crores, the value of such currency would be below 6.5 per cent of the value of these notes in circulation on 8 November. The value of such notes with the public would be even less as some part would be held by banks. Any extinguishing of the RBI's liability after 31 March 2017 resulting from the Ordinance enacted on 28 December 2016 would therefore be of an inconsequential magnitude.
- b) We are still very far away from the full replacement of the cash withdrawn from circulation, with such replacement falling well short of the halfway mark by 23 December. The severe cash shortage whose effect has been magnified by the fact that too large a proportion of it is in 2000 rupee notes is therefore going to continue well beyond 30 December.

From the Government's point of view, the hard reality thus seems to be that while the initial contention that a large amount of black money will not come back has fallen flat on its face, the promise that the cash shortage will ease by 30 December will remain unfulfilled by a wide margin. Is the reason for the RBI's reluctance to put out the specific data because that these would reveal this reality in black and white? Is the RBI waiting for the Government to first work out what spin it wants to give to this otherwise deeply embarrassing picture, particularly given the severe pain that demonetization has inflicted on the people? It's hard to think of any other plausible explanation for the RBI's reticence because one thing that is certain is that it's not possible that the RBI does not have the data or hasn't been able to put it together. It's silence on the figures, however, only serves to confirm what its own data indirectly reveals. This silence, which must be broken at some time, can therefore achieve very little other than damaging further the credibility of India's central bank.