

DEMONETISATION

Why Cry Over Spilt Milk? Remonetise the Old Rs 500 Note on January 1, 2017

BY SASHI SIVRAMKRISHNA ON 16/12/2016 • 3 COMMENTS

The first phase of Modi's demonetisation exercise, until December 30, 2016, could be viewed as a "sunk cost", after which the old notes be remonetised.



The old Rs 500 and Rs 1000 notes hung up as a memory in a dhaba in Bundelkhand.
Credit: Ajoy Ashirwad Mahaprashasta.

Three things are becoming increasingly clear as we move towards the deadline of December 30, 2016 for deposition of demonetised Rs 500 and Rs 1000 currency notes. First, most of the demonetised notes will find (<http://thewire.in/83821/may-not-demonetisation-end/>) their way back into banks by the deadline. Going by reports published on December 14 some Rs 12.44 lakh crore has already returned to the banking system out of the Rs 14.2 lakh crore that was in circulation as on March 31, 2016. Given that this amounts to some 87%, and with a fortnight remaining before the deposit window closes, it is likely that almost all the demonetised currency will return back to commercial banks and in turn to the Reserve Bank of India.

Second, there are serious bottlenecks in the printing of new notes, especially the much-desired Rs 500 notes. Several reports (<http://thewire.in/85597/re-monetisation-debacle-new-notes/>) have highlighted the constraints faced by the government including capacity of presses, capability of presses to print security features on new notes as well as procurement of paper and ink. All-in-all, it is estimated that an adequate number of Rs 500 notes will come into circulation only by

April 2017 while full restoration to original levels may take until July or August 2017.

Third, the disruption of economic activity and distress of people is growing at an exponential rate since the day demonetisation was announced. From vegetable and flower markets to the silk weaving and garment industry, from automobiles and construction to mobile phones and the FMCG sector, production in not just the informal sector but also the formal sector is getting adversely impacted with plummeting demand. The situation is worsened by the non-payment of wages and hardship of people having to stand in never-ending queues to withdraw cash. Moreover, given the ground realities in India it is unlikely that the government's drive for a cashless economy can alter the situation fundamentally in a matter of few months. If indeed the government was sure that India could become completely cashless, then why print so many new notes?

Going forward, the problem is essentially the lack of notes available with the Reserve Bank of India. With physical injections of cash expected to remain sluggish, economic distress is only likely to worsen in the coming months. While people have resorted to ad-hoc means and measures (extended credit and even barter) to tide over the cash crunch, these are not likely to endure over an extended period of time. Moreover, given the fact that new notes are scarce, particularly the Rs 500 note, there is problem of hoarding. This will mean that even as supply by the presses increase, the actual notes in circulation may not do so at the same rate. Consequently even more notes may have to be printed before we reach the same effective levels as prior to demonetisation. Keeping in mind this grim reality, what then is a possible "solution" to this crisis? Will the government only watch an economic disaster unfolding in real time as silent spectator? Although experts have provided many insights and analyses of the impacts of demonetisation, there are few suggestions on possible ways to reduce the imminent predicament.

Legitimise old notes

This may sound bizarre – though only as much as the idea of demonetisation itself – but why can't the government announce "remonetisation" of the old Rs 500 note on January 1, 2017? Assuming that almost all demonetised currency has been deposited in bank accounts by the end of 2016, the purpose of this exercise, or rather experiment, has been served and over with. People who have brought large amounts of cash into their bank accounts will have to prove their income source/s to the government and if not convincing, pay the stipulated penalties. *Looking ahead*, the problem that now exists is availability of new currency and, as mentioned above, delay in its supply is likely to drag the economy downhill. So why not just "remonetise" the old currency, particularly the Rs 500 notes, so that the immediate cash crunch is overcome? The economy can be put back on track without delay even as the old notes are withdrawn once and for all over the next year as new notes become available.

The first objection that will immediately be raised against such a proposal would be about those who may still be sitting with some old undeclared "black" notes. If the old Rs 500 notes were to become legitimate currency once again, it would provide an avenue for people to turn it into "white" money. This is true but the quantum will be extremely small going by the present trends in deposition of old notes; it may ultimately be just a few tens of thousands of crores. It does not seem worthwhile to inflict such widespread suffering and disruption in order to punish a few people who may still be hoarding old notes.

However, the most difficult objection to surmount will be to ignore the "sunk cost" of demonetisation while taking a rational decision on the optimal future course of action. As economists would know, it is difficult for economic agents to ignore sunk costs or to put it in more common parlance, when it comes to decision-making, the popular adage, "don't cry over spilt milk" is not easily put into practice. An example would help. Suppose a road connecting two towns is estimated to cost Rs 1,000 crore but due to a bottleneck, say land acquisition, it is presently not possible to construct. So the government chooses to construct a flyover at a cost of Rs 6,000 crore. Just when about three-fourths of the flyover is complete and Rs 4,500 already spent, the land acquisition becomes possible, making it viable for the road to be

constructed. Should the government now stop the construction of the flyover and revert to construction of the road? The answer is yes, since net saving from road construction instead of the remaining part of the flyover is Rs 500 crores. Nonetheless, the fact that Rs 4,500 crore has already been spent on the flyover makes it difficult to abandon its construction.

In quite the same vein, as simple as it seems logically, the public will receive remonetisation with intense hostility. Why did the government put the masses under such hardship and in the end bring back the same old notes. And what about those “deadly” fake counterfeit notes? And the thought of a remaining few black money holders laughing their way back into existence would unleash deep resentment. Sensing such an adverse political backlash as well as the rhetoric that went into this whole experiment, the government will obviously dismiss the faintest thought of remonetising old notes. To me it seems that we are in the midst of a game akin the prisoner’s dilemma, where our inability to ignore sunk costs, will take the economy and people as well as the government into greater despair rather than resurrecting the situation at the fastest and to the fullest extent possible.

But for a moment think of it objectively; the ultimate purpose of demonetisation was to get people to declare their wealth by depositing it in a bank account and that job having been done, it makes little difference whether we have “old” or “new” notes in circulation. What is important is to now ensure that a recession and disruption of production does not take place on account of a lack of availability of currency notes. It is logical, economically speaking, to consider the first phase of the demonetisation exercise until December 30, 2016 as a “sunk cost” and thereafter take a rational decision solely with respect to the future. Those who understand the essence of money will realise that there is no real difference between an “old” and a “new” note. And finally, about the fake notes; I guess the counterfeiters would already be expending their resources on duplicating the new notes rather than the old ones.

📁 **Categories:** [Demonetisation](https://thewire.in/category/demonetisation/) (<https://thewire.in/category/demonetisation/>), [Economics](https://thewire.in/category/economics/) (<https://thewire.in/category/economics/>), [Economy](https://thewire.in/category/economy/) (<https://thewire.in/category/economy/>), [Featured](https://thewire.in/category/featured/) (<https://thewire.in/category/featured/>), [Government](https://thewire.in/category/government/) (<https://thewire.in/category/government/>)

🏷️ **Tagged as:** [currency reform](https://thewire.in/tag/currency-reform/) (<https://thewire.in/tag/currency-reform/>), [currency swap](https://thewire.in/tag/currency-swap/) (<https://thewire.in/tag/currency-swap/>), [demonetisation](https://thewire.in/tag/demonetisation/) (<https://thewire.in/tag/demonetisation/>), [economic circulation](https://thewire.in/tag/economic-circulation/) (<https://thewire.in/tag/economic-circulation/>), [rational course of action](https://thewire.in/tag/rational-course-of-action/) (<https://thewire.in/tag/rational-course-of-action/>), [remonetisation](https://thewire.in/tag/remonetisation/) (<https://thewire.in/tag/remonetisation/>), [Rs 1000 note](https://thewire.in/tag/rs-1000-note/) (<https://thewire.in/tag/rs-1000-note/>), [Rs 500 note](https://thewire.in/tag/rs-500-note/) (<https://thewire.in/tag/rs-500-note/>), [Sashi Sivramkrishna](https://thewire.in/tag/sashi-sivramkrishna/) (<https://thewire.in/tag/sashi-sivramkrishna/>), [sunk costs](https://thewire.in/tag/sunk-costs/) (<https://thewire.in/tag/sunk-costs/>), [value of money](https://thewire.in/tag/value-of-money/) (<https://thewire.in/tag/value-of-money/>)

3 Comments

The Wire

Login 1

Recommend 1

Share

Sort by Best



Join the discussion...

Sahil Kumar • 4 hours ago

But the banks are shredding the old notes. Remonetisation isn't possible in this scenario.

1 ^ | v • Reply • Share ›

Gau Mata • 6 hours ago

Why only Rs 500? Even the Rs 1000 note should be remonetised immediately to give us relief from this doomed experiment which would put Mohd bin Tughlaq to shame. This crazy war on cash should end if the economy is to be saved. Only thing is that it would destroy the political careers of Modi and co.

1 ^ | v • Reply • Share ›

whizkid_no1 • 7 hours ago

Superb idea

They should bring back the old 500 and ban the new 2000

1 ^ | v • Reply • Share ›