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THE FUNDAMENTAL VALUE OF THE RUPEE

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A shopkeeper counts 2,000 notes at a jewellery shop in Mumbai. | Photo Credit: PTI

The first thing that comes to mind when speaking of the value of a currency is the exchange rate it commands in international transactions. For instance, we may ask how many cents is the rupee worth. Another is its purchasing power within an economy, i.e., whether it can buy the same basket of goods over time. Inflation erodes the value of a currency over time. But there is a more fundamental sense in which the value of a currency is to be understood, and it has nothing to do with prices. It has to do with the confidence that citizens have in its continued acceptance as a medium of exchange and store of value. This confidence is based on the trust that they repose in their monetary authority, which is the central bank.

On May 19, the Reserve Bank of India (RBI) announced that the 2,000 note is being withdrawn from circulation but that it will remain legal tender. At the same time, it advised the public to hand over their 2,000 notes, to be exchanged for lower denomination notes, by September 30. This advice is pregnant with the suggestion that the note would cease to be legal tender after that date. The explanation for the move is that it is part of a 'Clean Note Policy'. This does not wash, for if the objective was to remove soiled notes from circulation, the existing 2,000 note should have been made convertible into a fresh note of the same denomination. Economists who align with the government of the day have rushed to support the RBI's latest move. One argument is that a note of such high denomination is used only by a miniscule section of the population. The other is that it will ensure that black money hoards will be extinguished. Actually, these arguments do not enhance the RBI's reputation. First, it should not have taken much for the RBI to recognise in 2016 that the 2,000 note, issued after notes of much lower denominations had been demonetised, was likely to be used by few people for the majority of transactions in India are of far lower monetary value. With hindsight, it is believable that at the time there were not enough new currency notes to be exchanged for the demonetised notes, i.e., there was an unconscionable lack of preparation. The government had likely wanted to demonstrate that it had restored the money stock quickly. The hardship that high denomination notes cause to a very large section of the population needing to transact in notes of much lower value seems not to have been considered. At the time of demonetisation, the official argument had been that it was a way to end counterfeit currency. We now know that this did not happen, as almost all the demonetised notes were returned to the banks. If now the government's economists say that black money hoards will be extinguished with the 2,000 note withdrawn, they must accept as folly the printing of these very notes immediately after the demonetisation in 2016. The Harvard Professor Kenneth Rogoff had lashed out at high denomination currency notes for their role in enabling illegal economic activity, money laundering and terrorism. The RBI, which mostly mimics economic ideas from the West, seems to have missed this one. If the chosen form for hoarding unaccounted wealth today was indeed the 2,000 note, then it can be said that the RBI facilitated its accumulation by issuing a higher denomination note in 2016.

The demonetisation of 2016 had led to a slowing of growth within half a year. It is unlikely that the withdrawal of the 2,000 note will result in anything similar, for it is still legal tender. But surely the uncertainty it gives rise to cannot be good for business. People undertake economic activity with a view to incurring a gain, whether in the form of profits or wages. When some part of the currency in circulation is suddenly withdrawn for no convincing reason, it has a dampening effect, for economic actors are kept guessing about the money value of their future earnings. India has witnessed a stagnant private investment rate for close to a decade. This could hardly have been a good moment to tamper with the currency.

A central bank sits at the pinnacle of a country's financial system. The public expects of it the highest standard of probity. But apart from probity, the central bank must also convey competence, transparency and fairness. For over 50 years, the RBI had mostly lived up to this expectation. In particular, the public saw it as having transitioned from being a handmaiden to Britain's colonial interest in India to being a relatively independent central bank of an independent country with high economic ambitions. The demonetisation of 2016 dented this reputation. And now, within just a few years, the RBI has come up with another action of dubious worth. By undoing its own action of introducing the 2,000 note, it draws attention to poor judgment on its part.

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In 2016, the government amended the RBI Act of 1933 to redefine monetary policy as the control of inflation. The RBI has not had great success in its new avatar. It has missed the targeted inflation rate of 4% for 14 quarters in a row. Its relentless messaging however gives the impression that it is singularly devoted to the task of controlling inflation. Perhaps it is. But by casting a shadow on the public's perception of what is legal tender in India it destabilises their confidence in the rupee. In *The Importance of Being Earnest,* Oscar Wilde spoke of how the cynic knows the price of everything and the value of nothing. We have been given proof of it.

Pulapre Balakrishnan is an economist

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