
Currency Management

One of the core central banking functions enjoined on the Reserve Bank is the regulation and issue of bank notes and the keeping of reserves, with a view to securing monetary stability in the country and operating its currency and credit system to the country's advantage. The public's impression of the Bank is largely based on its perception as to how best this responsibility is discharged.

The main responsibilities of the Reserve Bank during the period 1967–81 included: (i) finalization of the design, form and material of the new denominational bank notes and reviewing the design, etc., of existing bank notes for the purpose of suggesting to the government, the necessary changes to be incorporated in the new notes to be issued; (ii) establishment of new issue offices and branches or agencies in India for efficient management of the currency system; (iii) ensuring smooth distribution of notes and coins to meet the requirements of government departments, banks and the public; (iv) withdrawal of defaced or excessively soiled notes and their eventual destruction; (v) prescribing from time to time the conditions under which the value of any lost, stolen, mutilated or imperfect currency notes would be refunded as a matter of grace, and formulating rules for the purpose with the sanction of the central government; (vi) establishment and inspection of currency chests; and (vii) security arrangements in the issue offices of the RBI.

The Bank had to function in an environment of short supply of notes from the presses owned and managed by the government against its indents. The lack of availability of note paper hampered the production capacities of printing presses and severely impacted on the note supply position; the shortage was particularly acute in the lower denomination notes. While the Reserve Bank as well the government recognized the need for augmenting the production of notes and coins as a long-term solution, it was not possible to do so mainly due to foreign exchange and budgetary

constraints. The Bank had to grapple with problems arising from accumulation of soiled notes, limited vault capacity, space shortage in chests, chests being choked with soiled notes, etc., for which short-term solutions were not possible. On the positive side, however, the government went ahead with modernization of the security paper mill at Hoshangabad, besides augmenting the production capacities of the two currency note Presses at Nasik Road and Dewas to meet the ever-increasing demand for notes. It was expected that with the issue of more and more of Re 1 and Rs 2 coins (in substitution of notes) the burden on the presses would be reduced. A beginning was made in 1982 by the issue of Rs 2 coins, on the occasion of the IX Asiad Games. But even on the coin front, the picture was one of recurrent shortages due to a number of reasons, namely, inadequate supplies from two of the four mints, poor performance of the mints on account of labour problems and temporary closures, negligible return flow of coins from circulation, and the pre-occupation of the mints with the minting of Asiad commemorative coins and medals till November 1982.

A DIFFICULT YEAR

From the beginning of 1973, the Reserve Bank faced the grim prospect of the currency note press (CNP) not supplying note forms in full against the regular indents. The CNP had its own difficulties that came in the way of it working to full capacity and increasing the production levels.

In January 1973, the Reserve Bank, while placing the indent for note forms for the first half year of 1973 (i.e. indent no. 1973-A), was dismayed to learn that the CNP would be able to supply only a much reduced quantity (that is, as against 3,275 million pieces indented in various denominations, only 2,300 million pieces were to be supplied). In a letter dated 25 January 1973, the Bank pointed out that, 'owing to the continuous inadequate supplies' made by the CNP during the previous years, its reserve stocks stood considerably depleted. It feared that even this reserve stock might be completely wiped out, 'exposing the Bank to a vulnerable situation' in the face of increasing normal requirements of note forms. Moreover, the Bank had been compelled to curtail supplies to currency chests and to banks to the extent of 50 per cent of their indent/demand for fresh notes, which had resulted in growing resentment and criticism from the public. The Bank hoped that with the installation of two imported super simutan machines, the press would be in a position, by June 1973, to increase output per annum.

As the CNP would not be in a position to meet in full the periodical

indents, the Reserve Bank advised its offices to mitigate the situation by resorting to maximum reissue of notes. In a circular letter dated 12 February 1973 to the managers of offices, the chief accountant suggested various steps to conserve the stock of fresh notes: by larger 'reissue' of notes, by discontinuing the practice of discarding soiled notes as non-issuable merely because they bore some writing (political slogans excepted), impressions of stamps, etc. The managers were asked to arrange a meeting with the concerned officials and explain to them the urgency to sort and cancel only those notes that were badly soiled and could not stand further handling, and thereby accumulate larger quantities of reissuable notes to make up for the shortfall in the supply of fresh notes against indents from the press. To ensure that maximum reissuable notes were sorted, treasurers were asked to closely supervise the performance of the note examiners; assistant treasurers in charge of the sections were to go round each group several times each day during the course of the work and suitably advise the note examiners; in addition, the treasurer was to not only pay his usual surprise visits to each section at least once a day but also ensure compliance with the above instructions. Likewise, assistant currency officers were instructed to pay surprise visits to the sections allotted to each of them at least once a week. The central office desired that currency officers should pay periodical visits and also supervise the visits of other officials to each of the note examination sections at least once a week.

Further instructions were issued with a view to retrieving a larger number of reissuable notes through a circular dated 16 March 1973. To reduce frequent replenishment of the balances at various chests from the offices of the Reserve Bank, chest officers were asked to build up a sizeable stock by sorting out maximum reissuables from their receipts, and to keep a careful watch on the performance of each chest in regard to the sorting of notes. The central office also made it clear that frequent demands made by offices for additional supply of notes over and above the supply of fresh notes allotted to them from the Nasik press during the 'indent period' would not be entertained since the supply of notes from the press had become restricted.

In an internal note prepared in the chief accountant's office (dated 23 May 1973), the difficult position was reviewed. It was noted that there had been an aggravation in the situation because, in addition to the requests from offices for additional supplies of fresh/reissuable notes or to advance the date of despatches by the Nasik press during the months of May and June 1973, the nationalized banks that were operating currency chests had been making frequent demands for provision of additional amounts.

During that year the demand for lower denomination notes, in particular, had increased considerably due to: (i) the government's programme for procurement of foodgrains; (ii) the nationalization of collieries; (iii) the payment for scarcity/drought relief works in several states; and (iv) the cumulative effect of putting more reissues in circulation in the past two to three years when the supply of fresh notes from the press was short of demand. The situation was further compounded when the press advised the Bank that, as against its commitment to supply 1,150 million pieces, it was in a position to supply only 1,004 million pieces during April to June 1973.

An attempt was made to work out the actual quantum of shortage of notes by estimating the gap between the demand and the stock available for distribution, when the proposals for the 1973-A indent were being finalized. The findings were 'very much alarming' as the total requirement for notes indented by offices was nearabout 5,180 million pieces for the half year, as against the production capacity of the press of 2,300 million pieces. The Reserve Bank's efforts to close the wide gap between the demand and supply of notes by salvaging the maximum number of reissues and maintaining a tight supervision in the note examination sections did not prove adequate. The offices were generally in a position to meet only 40 to 50 per cent of the actual demand made on them by the chest officers. The situation became more and more critical, as was evidenced by the frantic calls made by the offices for increasing the allotments of lower denomination notes.

On the supply side, the installation of two super simultan machines at Nasik press, which was expected to be commissioned in June 1973, had been further deferred. In the assessment of the government, the Dewas press was scheduled to be commissioned by December 1973, but the Bank felt that the prospect was bleak. The office note concluded that, in the circumstances, some ad hoc arrangements for meeting the needs of the offices had become imperative. J.X. Lobo, chief accountant, while conceding that the availability of small denomination notes was becoming 'precarious', stated that National and Grindlays Bank had informed the Reserve Bank that due to the acute supply position their branches were facing agitated customers and even demonstrations.

The Kanpur office of the Reserve Bank had sent an urgent request for additional allotment of fresh notes and, according to the information received from the Bangalore office, some of the chests had expressed their inability to make Government payments unless immediate supplies were made. The chief accountant admitted that the efforts towards retrieving reissuable notes from inward remittances were not sufficiently encouraging, and

that the Bangalore and Madras offices had reported a decrease in the percentage of reissuable notes salvaged during March and April 1973 as compared to the earlier period. Another alarming development was that practically no reissues were being taken out from the chest remittances of 1 and 2 rupee notes, due to the wrong interpretation of the general instructions given for sorting notes of these denominations. The respective offices had not been putting to judicious use the provision that permitted the rate of examination of pieces to be reduced up to 8,000 pieces (as against the limit of 10,000 pieces), if there was a possibility of salvaging reissuable notes in large numbers. Lobo proposed issuing suitable instructions to the currency officers to make liberal use of the discretion vested in them. To reduce the pressure on stocks of Re 1 and Rs 10 notes, the Bank proposed to instruct all the offices to meet the demands for these denominations in Rs 2 and Rs 20 notes.

The general manager of the India Security press was also sounded as to whether, in the current indent, production of Rs 2 notes and Rs 20 notes could be stepped up by the corresponding reduction in Re 1 and Rs 10 notes. The objective was that while the production of the number of notes by the press remained unchanged, there would take place a substantial increase in the monetary value of the notes put into circulation to meet increasing demands. The press, after ascertaining the position from the Security Paper Mill, Hoshangabad, replied that the latter was in a position to supply paper for Rs 2 notes. Lobo was frank enough to admit that the problem was not likely to be solved by this, and that more drastic steps were called for, such as getting a portion of the requirements for the next twelve months printed abroad till the presses in India were in a position to meet the demand for notes. Executive Director Seshadri recorded, after nearly four months, that the government had arranged for the import of certain limited supplies of paper from the portals, and that he was writing to the government in detail pointing out that a critical position might be reached if there was any more delay in the implementation of the various suggestions made by the Reserve Bank.

The RBI had been continuously impressing upon the India Security press, the need to maintain the supplies as per the indent. In June 1973, the press unequivocally informed the Bank that unless certain minimum infrastructure requirements were put in place, the position was unlikely to improve. N.D. Prabhu, general manager of the press, in a letter dated 23 June 1973, explained that for meeting the increased requirements, more machines and more space would have to be arranged, and that it was up to the government to sanction the necessary funds and foreign exchange for additional

machinery besides extra space in the former distillery area owned by the government of Maharashtra as part of the Fifth Plan budget.

Prabhu commiserated with the Reserve Bank's predicament arising from the continuous short supply of notes but expressed helplessness until machinery and more space were made available. With the press already working eleven hours per shift (including an eleven-hour night shift) there was no immediate scope for augmenting the supply. There was further delay in the installation of the two super simultan machines and they were to come into operation only in April 1974. An additional critical factor highlighted by Prabhu was that, after the printing stage, complex control operations had to be gone through, like examination, counting, etc., which impacted on the time taken for rolling out the final output. The limited space available with the press precluded employment of more men on the control part of the operations to increase the output.

Another important point he made was regarding adequate supply of paper from the Security Paper Mill, Hoshangabad. The press was not in a position to commit any increase in the supply of Rs 2 and Rs 20 denomination notes by proportionate reduction in the printing of Rs 1 and Rs 10 denominations since it depended on the supply of necessary paper by the paper mill. To add to its woes, the currency note press had not received any supply of paper during April 1973, only 8,000 reams were received in May as against the normal requirement of 12,000 reams, and for the month of June they had been promised only about 3,000 reams of paper. Due to the uncertainty in the timely supply of paper, the press had already cut down the hours of working on the printing side to nine hours and a further cut might have to be resorted to if the situation at Hoshangabad did not improve by 1 July 1973.

Finally, the press cautioned that the supply of notes could be curtailed further during August and September 1973 if the situation did not improve beyond 1 July 1973. In the circumstances, the press indicated its ability to supply only 2,300 million pieces against the 1973-B indent, and that too, provided the Security Paper Mill, Hoshangabad, functioned normally from the next month and supplied about 13,000 reams per month.

Seshadri requested the government to accord top priority to the planning and erection of a second security paper mill, if necessary, by including it in the Fifth Five Year Plan. Assuming that imported paper was made available, the Reserve Bank hoped that there would be no delay in erection and commissioning of the super simultan presses at Nasik by the end of March 1974. Commencement of production at Dewas as scheduled on 1 April 1974 was considered critical. The Bank wrote to all the state

governments asking them to urgently consider the question of extending the system of payment by cheques in all the larger cities and towns to begin with. The Bank also took up with the Department of Revenue the question of withdrawing some of the exemptions that had been granted permitting payment in cash.

The supply position of currency notes from the presses did not improve in the months that followed; in fact, it turned precarious enough for Governor Jagannathan to address a letter directly to Y.B. Chavan, Finance Minister, on 9 October 1973. Pointing out that the problems faced were more important and critical than apparent at first glance, Jagannathan averred that 'the maintenance of satisfactory quality of currency notes supplied to the public and adequate in all the desired denominations was the need of the hour'. At the outset of the letter, he focused on the peculiar set-up prevailing in the manufacture, supply and distribution of currency notes to the public. The government was directly in charge of the production of currency note paper at Hoshangabad and the printing of currency notes at Nasik, whereas the Bank was responsible for the issue of currency as also the withdrawal of soiled notes and their replacement with new notes. 'In the public mind therefore the Bank is naturally thought of as the agency concerned with currency notes.' The fall in the level of production of currency note paper at Hoshangabad had aggravated the situation.¹

¹ To drive home the point, Jagannathan enclosed a letter received by him from a disgruntled member of the public. The letter read as follows:

N. Akhileshwar
9, Parekh Niwas, 135-Telang Road
Matunga, Bombay-19

The Reserve Bank Governor
Bombay-1

Damn Your

You and your officers deserve to be shot dead for your bungling. For our convenience we bank our money in nearby banks. They give me soiled and torn notes. They say the money has been got from Reserve Bank. So they won't give good notes. If we go to shop or hotel, we cannot exchange the notes for our necessities. What the hell do you want me to do with the notes? Neither the bank which gave me would accept them nor shopkeepers. So we have to come all the way to your stupid office and wait in queue?

Why the hell can't you withdraw old notes at source itself, i.e. in your office itself.
For your mismanagement, you should be given a garland of torn notes.

Sd: N. Akhileshwar

He then reiterated some of the important recommendations made in the past by the Reserve Bank, such as import of currency note paper, minting of rupee coins of higher denominations, resin coating of currency paper enabling them to retain good condition for a longer time, and establishment of another paper plant in a different geographical region. Jagannathan strongly advocated increased use of coins to ease the situation. He referred to the case of the United Kingdom issuing a coin of the value of 50 new pence—equivalent to the old 10-shilling note after decimalization. It was a cupro-nickel coin, and not unduly heavy or big.

In India, too, it was the smallest denomination notes (1, 2 and 5), which accounted for the highest percentage of notes in circulation, that were the most quickly soiled and damaged (more than 60 per cent of the circulation). Jagannathan pointed out that the average life of a currency note in circulation in India was less than a year and, consequently, the maintenance of paper currency in smaller denominations cost much more than coinage if one took into account the overall cost involved in withdrawing soiled notes from circulation, examining and replacing them. Further, it was envisaged that minting of Re 1 coins and coins of higher denomination (even if they were only up to Rs 5) would be sufficient to make up at least for the annual increase in circulation of currency, and would thereby immensely diminish the extent of burden on commercial banks and the Reserve Bank for the replacement of rupee notes and notes of smaller denominations.

The Bank's expenditure on note examination was already above Rs 4.25 crore per annum and this could be curtailed by adopting the steps suggested by the Bank to control this expenditure from rising to spectacular and unreasonable levels. Concluding the letter, Jagannathan stressed that the main recommendations listed above were 'very important and urgent', not the least the recommendation for a new paper plant; a second plant was inescapable and it took four to five years to plan and get such a plant operating in full production. A copy of the letter was endorsed to M.G. Kaul, Economic Secretary, Ministry of Finance. The government responded promptly.

M.G. Kaul, in his reply of 27 October 1973, outlined the various measures initiated by the government to improve the situation. Since 10 October the Security Paper Mill (Hoshangabad) had recommenced production and for the present the outlook was 'reasonably bright'. An import order for note paper had already been placed with the portals and the shipment was expected to commence from the end of October 1973; additional imports to augment the supply of security paper was under active consider-

ation. The question of minting of one rupee coins in cupro-nickel alloy was under examination. And, during the Fifth Five Year Plan period, a new security paper mill with a capacity of about 2,000 tonnes per year was proposed to be set up.

Regarding the Governor's suggestion of resin coating of currency paper, he pointed out that the results of similar experiments in some foreign countries were not satisfactory. He expressed the view that, despite limitations, the currency note press at Nasik was doing its utmost to meet the Bank's indents for fresh currency notes, and its annual production capacity had been enhanced from 3,600 million pieces in 1970-71 to 4,600 million pieces. The printing capacity was expected to be further increased to 500 million pieces annually when the new super simultan printing machines (then on their way to Bombay) were installed, and the government was making arrangements to provide two additional examination bays in the spare land available with the press. The Governor seemed to be satisfied with the reply.

The supply position did not improve much during the remaining part of the period of our study. In November 1978, in view of the deteriorating situation, the government was requested to consider replacement of old machines at the Nasik press with sophisticated machines of higher capacity; introduction of an additional shift at the Dewas press, operationalized at the end of December 1974 on the Bank's proactive proposal of 1964 for setting up a second currency note printing press using the direct plate (intaglio) process instead of the existing offset lithographic method; and setting up an additional press, if necessary. The matter was also discussed with the Finance Secretary by Governor I.G. Patel and Deputy Governor Ramakrishnayya on 27 August 1980. The government, on its part, hoped that, with the introduction of a second shift at the Dewas press and some improvements at the Nasik press, the demand for notes could be fully met in the next four to five years.

SOME RELATED ISSUES

Some issues relating to currency distribution, coinage and replacement of notes by coins, security features, note paper quality and design also came up during the period of the study. On 20 August 1969, after fourteen commercial banks had been nationalized, the Reserve Bank informed I.G. Patel, Special Secretary, Ministry of Finance, that a large number of currency chests (and in some places more than one currency chest) would need to be opened, as the volume of transactions had risen sharply. The Bank proposed that

the nationalized banks be allowed to be appointed as agents of the RBI. The government did not immediately respond to the Bank's proposal but, after a few reminders, agreed to it. By April 1971, the Bank formulated its policy regarding placing some currency chests at the disposal of the nationalized banks.

From 1975, currency notes were considerably redesigned incorporating new security features that would make forging or counterfeiting difficult. The Re 1 note was reduced in size and issued in 1966, followed by Rs 2, 5, 10 and 100 notes in April 1967. The reduction in size yielded an annual saving in paper costs of almost 17 per cent. The currency notes not only served as a medium of exchange and represented fiat money, but also (through the motifs printed on the obverse of the notes) acted as a powerful medium to make known among the masses the country's rich cultural heritage, the diverse flora and fauna, and achievements in economic and scientific sectors. The motifs on the notes were therefore largely retained with some modifications. The table on the following pages gives the changes in the pattern of notes that took place during the period of this study.

In 1973–74, Government of India decided to reintroduce the Rs 50 note, as it was expected to reduce the relative demand for other denominations such as Rs 10 and Rs 100. The government agreed to the Bank's recommendation to bring out a Rs 20 denomination note around the same time. The Rs 20 note was released in March 1975 and the Rs 50 note in May 1975. The currency notes released after the mid-seventies carried motifs that highlighted India's progress on the agricultural front and advances in science and technology. The Ashoka pillar as the watermark and the thread running through the notes continued to be the main safety features of the currency notes issued during the period. Besides, there were watermarks denoting the RBI monogram and the denomination.

Apart from the short supply of currency notes, the Reserve Bank had to fight with some irregularities and frauds within its offices. A group supervisor in the note examination section of the Kanpur office of the Bank was found in possession of a punched Rs 100 note on 27 June 1974. The employee was arrested and the hearing scheduled in the Kanpur court on 1 September 1977. The Bank suspended five other employees, while five more were chargesheeted. Disciplinary proceedings were initiated against the employees concerned.

In August 1974, an assistant treasurer, in charge of one of the note examination sections in New Delhi was found to have passed some cut/mutilated notes in a fraudulent manner in excess of the authority granted to him. Enquiries revealed that, in collusion with some professional dealers in

defective notes, he was bringing in torn/mutilated notes, substituting them for good notes in the course of note examination and taking out good notes. It was found that even though there was no actual loss to the Bank and the notes in question were otherwise payable under the relevant rules, the conduct of the concerned official was not in keeping with the Bank's service rules and regulations. He was, therefore, dismissed from the Bank's service on 27 September 1976.

In regard to coinage, so far as the Bank was concerned, three interesting issues arose during the period of the study: the question of treating ten-rupee coins as eligible assets of the Issue department, the estimation of requirement of small coins, and the policy about change-over from notes to coins. There was also a proposal for introduction of thirty-paise coins, about which the Bank's views were sought.

TEN-RUPEE COINS AS ASSETS OF THE ISSUE DEPARTMENT

Government of India issued the Mahatma Gandhi Centenary one-rupee and ten-rupee coins on 3 October 1969. The Reserve Bank (its Legal Department) had to, occasion on this consider whether the ten-rupee coins should be treated as 'assets' in the Issue Department for the purpose of note issue. The confusion arose because rupee coins were defined differently under the Reserve Bank of India Act and the Indian Coinage Act, 1906.

Examining the question from the legal position as it stood at the time when the RBI Act was passed, the Legal Department took the view that the one-rupee coin and the new ten-rupee coin would be 'rupee coin' under Section 33 (1) of the Act and hence eligible to be held as an item of asset of the Issue Department. When the RBI Act was passed, 'rupee coin' was defined as 'silver rupees', which was legal tender under the provisions of Indian Coinage Act. Section 4 of the Coinage Act provided that only 'a rupee to be called the Government rupee', 'half rupee' and 'a quarter rupee' shall be coined at the mint and that a rupee and half rupee shall be legal tender in payment or on account; the quarter rupee was to be legal tender in payment of any sum not exceeding one rupee.

Moreover, the standard weight of the government rupee was to be 180 grains troy. In other words, under the Indian Coinage Act the term 'rupee' was applicable only to the one-rupee coin. The RBI Act defined a 'rupee coin' as a silver one-rupee coin of standard weight of 180 grains. After 1949 the aforesaid provisions underwent extensive changes and as the Indian Coinage Act stood in 1969, it did not refer to a rupee, half rupee or quarter rupee but only to a 'rupee coin', half-rupee coin and any other coin.

TABLE 1 Motifs on Currency and Bank Notes: Major Changes, 1967–81

Denomination	Pre-1967		1967		Changes subsequent to the Gandhi Commemorative issue, 1969 up to 1981
	Size (mm/ inches)	Motif	Size (mm)	Motif	
Re 1	63x101	Coin on the reverse	63x97	Coin on the reverse	'Sagar Samrat' year 1981 on the one-rupee decimal coin design and authentic rendering of value in fourteen Indian languages on the reverse
Rs 2	63.5x114.3 2.5x4.5	Tiger facing right	63x107	An illustration of a tiger standing near a waterfront displayed prominently	Tiger standing near a waterfront Aryabhata orbiting the earth 1976
Rs 5	2.2/8"x5"	Buck and doe	63x117	Family of bucks displayed prominently	Family of bucks (motif varied). The picture of a farmer operating a tractor against the background of the setting sun, 1975
Rs 10	3.25x5.75"	Indian sailing boat	63x137	An illustration of a seascape with a country craft in the centre	Seascape with a country craft. Circular design containing a picture of two peacocks perched on the branches of a tree. This circle is flanked by pictures of deer, horses, a bird in flight and designs of the lotus, 1975
Rs 20	—	—	—	—	Parliament House, New Delhi, 1972 (Size: 14.7 CMs.X 6.3 cms) subsequently. The chariot wheel of Konark Sun Temple 1975
Rs 50	—	—	—	—	Parliament House, New Delhi 1975 (Size: 147 mm X 73 mm)
Rs 100	107.9x 171.4 mm 4¼x6¾"	Hirakud Dam with reservoir power	73 x157	The illustration of the Hirakud Dam	Change to incorporate white vertical panel in 1970 A composite vignette appears below depicting a

TABLE I (contd)

Denomination	Pre-1967		1967		Changes subsequent to the Gandhi Commemorative issue, 1969 up to 1981
	Size Mm/ inches	Motif	Size Mm	Motif	
		house and switch yard			sheaf of corn in the centre of the note and stylised reproductions of agricultural operations, a tea plantation and a hydro-electric power project 1975
Rs 1000	8" x 5"	Tanjore Temple	—	—	Demonetised on 16 January 1978
Rs 5000	8" x 5"	Gateway of India	—	—	Demonetised on 16 January 1978
Rs 10000	8" x 5"	—	—	—	Demonetised on 16 January 1978

Note: Gandhi Commemorative notes issued in October 1969 were discontinued subsequently and the earlier notes with the then existing designs were brought back.

After a detailed examination of the provisions of Section 39 of the RBI Act (obligation to supply different forms of currency) and Section 13 of the Indian Coinage Act (legal tender characteristic of the rupee coin), the Legal Department was of the opinion that the term rupee coin in the RBI Act referred to the coin that was unlimited legal tender as distinct from other coins that were not such legal tender, and the proposed ten-rupee coin being unlimited legal tender fell within the term 'rupee coin' under the Act and was hence eligible to be classified as an asset of the Issue Department.

ESTIMATE OF REQUIREMENTS OF SMALL COINS

In May 1973, the Ministry of Finance requested the Reserve Bank to provide a projection of the requirement of small coins till the end of the Fifth Plan. R.K. Seshadri, Deputy Governor, in a letter dated 1 August 1973 to A.K. Mukherjee, Deputy Secretary (referred to earlier), outlined the various factors and assumptions taken into account in evaluating the likely demand for small coins from the public, the necessity for putting into circulation more metallic rupee coins, and, finally, the need to augment the

capacity of the mints. Seshadri observed that, contrary to the general impression that coin shortage had virtually disappeared, there were still complaints being received from some important cities, the state of Jammu and Kashmir, and remote, underdeveloped districts in Uttar Pradesh and eastern India. Seshadri added: 'It has also been proved by recent experience that in a situation in which there is shortage of small coins, unscrupulous middlemen corner such supplies as may be available and create a psychology of scarcity, leading to increased additional demands for small coins.' The Reserve Bank felt that the only effective method of dealing with such a situation would be to flood the concerned area with supplies of small coins, if necessary by creating small coin depots at all places where currency chests had been sanctioned for the nationalized banks. The Bank proposed, as a matter of policy, to increase the number of currency chests and, as a corollary, the number of small coin depots, which called for additional production by the mints.

The Reserve Bank's projection showed that at the end of February 1973, the effective circulation of small coins might be only Rs 76.90 crore as against the value of Rs 148.23 crore net (by value) issued by the mints on the basis of the following assumptions.

- (i) Allowing for a further increase in the price of nickel, copper and brass in the next six years, it would be desirable to replace entirely the nickel 50 and 25 paise, the cupro-nickel and aluminium-bronze 10 paise, the cupro-nickel 5 paise, the cupro-nickel 2 paise, and the bronze and nickel brass 1 paisa coins.
- (ii) The other coins in metal of a lower value needed to be replaced, to the extent that normal wear and tear and wastage had to be provided for. For this purpose, it was assumed that 3.33 per cent of the cupro-nickel 50 paise and 25 paise coins, and 10 per cent of the aluminium magnesium 10, 5, 2 and 1-paise coins in circulation would have to be replaced every year.
- (iii) The total replacement requirements (on the above assumptions) would be of the order of Rs 44.67 crore and Rs 15.23 crore, respectively, by value.
- (iv) The additional demand for small coins owing to the growth of the economy was estimated at Rs 98.77 crore.
- (v) In addition, a provision was made for Rs 15.38 crore worth of small coins to be supplied in areas where shortages were still reported, and for Rs 43.91 crore worth of coins to be added, partly to replenish the depleted stocks at offices and partly to provide for additions to these

stocks as and when the circulation of small coins increased in accordance with the Bank's projection.

- (vi) The Bank's projection should normally provide for 1, 2 and 3-paise coins to be minted in the ratio of 0.5 per cent and 1 per cent of the total circulation of small coins, but lower denomination coins might not be actually needed to this extent. While small-value coins might still be used for balancing the value of transactions or for giving away, the projection could be too high and an ad hoc provision of just 500 million pieces of 1-paise coins, 1,000 million pieces of 2-paise coins and 500 million pieces of 3-paise coins were seen to be adequate, in which case a total reduction of 3,652 million pieces in all these three denominations could be made, reducing the total number of pieces to be minted to that extent.
- (vii) The Bank assumed that the government would accept its proposal to meet the entire increase in the circulation of one-rupee notes every year in the future by minting whole rupee coins that would be put into circulation side by side with one-rupee notes.

The Reserve Bank advised that the total requirement of coins of all descriptions, including small coins, on the basis of the above assumptions, would be about 13,995 million pieces during the six years from 1973-74 to 1978-79, i.e. a yearly average of about 2,332 million pieces, and that a production programme undertaken in the light of this projection could be considered realistic. It added that it was unlikely there would be a glut of small coins in the near future.

CHANGE-OVER FROM ONE-RUPEE NOTES TO ONE-RUPEE COINS

To Mukherjee's query whether the Reserve Bank would succeed in pushing the metallic one rupee into circulation, Seshadri responded that cupro-nickel, being lighter, should be more acceptable than the pure nickel rupee, and that it was not possible to say at that stage how popular the metallic rupee would turn out to be. But the labour, delay and inconvenience involved in examining and disposing of one-rupee notes returning from circulation were so considerable that a serious attempt would have to be made to meet at least a part of the demand for one-rupee notes by metallic coins.

The prevailing shortage of bank note paper was another strong reason cited by the Bank for issue of a lightweight cupro-nickel metallic rupee side by side with the one-rupee note. In view of the increase anticipated in the circulation of notes, the consequent increase in the demand for bank note paper and the recent unsatisfactory experience about the production of

paper at Hoshangabad, the Bank was doubtful if its requirements of paper would always be met in full. In fact, currently, the presses were importing paper. In the circumstances, the Bank did not find it worthwhile to draw any plan on the premise that the entire demand for the one-rupee denomination would necessarily be met in the form of notes, and suggested that production programmes at Hoshangabad and Nasik and the three mints would need to be considered together. The inadequate supply of one-rupee notes at any given time was to be supplemented, if necessary, from the Bank's stocks of coins or *vice versa*, depending on whether there was shortage of paper/printing capacity or metals/minting capacity.

The Reserve Bank's perception was that its estimate of 13,995 million pieces till 1978-79 (or 2,332 million pieces per year on average) juxtaposed against the capacity of the mints, which stood at about 2,165 million pieces per year and capable of being raised to about 2,350 million pieces with a second shift introduced at the Hyderabad mint, would be 'more or less adequate'. Moreover, the Bank suggested certain interlinkages in the working of the three mints at Calcutta, Bombay and Hyderabad, if overtime working in the Calcutta mint had to be discontinued for any reason. The exercise showed that the Bank's view of the supply of notes and coins was comprehensive, and was based on technical considerations and other economic criteria.

PROPOSAL FOR INTRODUCTION OF A 30-PAISE COIN

The Ministry of Finance sought the views of the Reserve Bank in September 1973 on a suggestion made by the Department of Communications, Posts and Telegraphs Board, for introduction of a 30-paise coin for operating coin-collecting boxes at telephone booths. The Bank was averse to the proposal as it created a misfit in the decimal series, and the coin was likely to become redundant if telephone call charges were raised. The Bank stated, in its reply to the Ministry of Finance in November 1973, that, although an exception had been made in introducing a 3-paise coin (which did not fit in the decimal series) with a view to reducing the demand for 2-paise and 1-paise coins, the current proposal bristled with two incongruities. First, it was a misfit in the decimal series, adding to the multiple denominations already in circulation; second, no other country had till then introduced a coin for such an odd denomination. The Posts and Telegraphs Board wanted one coin in the denomination of 30 paise in place of three 10-paise coins of an aggregate weight of 6.9 grams being used in coin-collecting boxes at telephone booths. The Bank pointed out that the new coin should ideally

weigh approximately 6.9 grams (for being accepted by the machines), which was not practicable because the cupro-nickel 25-paise and 50-paise coins weighed only 2.5 grams and 5 grams, respectively. A cupro-nickel 30-paise coin having a weight of approximately 7 grams was also ruled out, as the value of the coin in relation to its weight would be disproportionate to that of the 50-paise coin. If the new coin were to be minted, it would necessarily have to weigh between 2.5 and 5 grams, which would necessitate recalibration of the coin-collecting boxes.

In fact, the government had already been apprised of the need to demonetize the existing cupro-nickel 25 and 50-paise coins, as the prices of copper and nickel (needed for the minting of these coins) were expected to reach a value level at which it would be profitable to have these coins melted, and necessitating their replacement with a cheaper alloy. The Bank also highlighted the fact that, as 10-paise coins were being minted in very large quantities, they were more freely available for meeting the demands of the public, and, therefore, the impression (of the Posts and Telegraphs Board) that 10-paise coins were not being minted in sufficient quantities to meet the demand was not correct.

CHANGE-OVER FROM NOTES TO COINS

As mentioned earlier, the Reserve Bank was concerned about the disruption in manufacturing operations at the Hoshangabad paper mill and the looming shortage of bank note paper and printed notes in 1973. The matter was taken up by Seshadri with the government in January 1973 and again in October 1973, suggesting the replacement of one-rupee notes with a metallic rupee, at least to the extent of the annual increase in the circulation of one-rupee notes. Governor Jagannathan thereafter followed it up with the Finance Minister, Y.B. Chavan, and strongly advocated a change-over from notes to coins, at least in the case of lower denominations. As the availability position did not show any improvement, Seshadri, in a letter dated 19 October 1973 to M.G. Kaul, Finance Secretary, again raised the issue and requested early action.

The main reasons put forward for substitution of smaller denomination notes by coins were: the overall increase in the cost of manufacture of notes on account of the hike in the wages of the staff producing bank note paper; the cost of printing bank notes and the cost involved in examining and disposing of soiled notes; and, finally, the much shorter life-span of notes, which had to be replaced very frequently. Therefore, in spite of the increase in prices of coinage metals, it was still economical to replace notes with

coins. The Bank argued that because of the above reasons and the prevailing inflation levels in many countries of the world, it had steadily become less economic to handle paper currency as compared to coins in the case of smaller denominations.

A comparative study of the costs of importing note paper and coinage metals (copper, nickel, etc.) at current prices revealed that the latter was appreciably lower. Furthermore, it was recognized that, in actual practice, the foreign exchange outlay on the import of coinage metals might turn out to be much lower than the theoretical cost worked out. The life of a one-rupee note was assumed to be six months, entailing recurring foreign exchange expenditure in the import of paper. In contrast, the foreign exchange outgo on import of coinage metals—assuming the life of the cupro-nickel rupee to be forty years—could turn out to be much lower than the notional cost adopted for the purpose of calculations, because it was not necessary that all the copper and nickel had to be imported for the mints were recycling the cupro-nickel already available in the current coinage.

The Reserve Bank was of the view that, as and when the 25 and 50-paise cupro-nickel coins were demonetized (before the prices of copper and nickel reached a level at which these coins were likely to be melted), the cupro-nickel alloy available in the demonetized coins could be utilized for producing cupro-nickel whole rupees or other coins in higher denominations. It was expected that, taking into account the metal retrieved by recycling cupro-nickel in the coins withdrawn from circulation, the import bill would not be higher than Rs 1 crore per annum, as against the vast sums being spent on the import of copper, stainless steel, etc., each year for industrial and domestic uses. Second, the mints could benefit from long-term contracts for nickel, if India decided definitely on a programme for minting one-rupee coins and ordered nickel supplies accordingly. Third, as world supplies improved and production picked up in Chile, Zambia and Canada, and internally within India, the prices and availability of copper could become much easier. The Bank was also influenced by the possibility of the metal value of the cupro-nickel whole rupee being contained within its face value for a reasonable period of time—in the US, between 1961 and June 1973 nickel prices had risen by a little less than 100 per cent. In the case of copper, the factors governing future movement of prices indicated that it would be at least ten to fifteen years before copper prices, which were then at an all-time peak, doubled.

The metal value of a cupro-nickel whole rupee weighing 8 grams, assuming that 17 paise was the effective cost to the government in foreign

exchange (and about 25 paise at the ruling Indian prices for nickel–copper in the market, after allowing for import duty at 45 per cent), would not go up at least for the next ten to fifteen years to such levels as to make melting of the cupro-nickel whole rupee coin worthwhile. The Reserve Bank presumed that long before melting of the cupro-nickel whole rupee became profitable due to a further increase in copper and nickel prices, it would recall the cupro-nickel rupee and replace it with one made of a cheaper alloy. In its final recommendations, the Bank reiterated that minting of the metallic coin in the quantities estimated should commence without any delay, and that, in view of the increase in metal prices, the weight of the new cupro-nickel rupee could be reduced to 8 grams. The Bank did not anticipate any difficulty in pushing the whole rupee coins into circulation, or in receiving them back from circulation. The net result would be that the coins would continue to circulate, and the burden on both the government and the Bank in servicing a growing volume of note issue would correspondingly reduce.

Interestingly, Deputy Governor Seshadri, in a letter of 19 October 1973 to J.S. Baijal (Joint Secretary), raised the specific issue of switching over to the minting of a cupro-nickel whole rupee and to freeze the circulation of one-rupee notes more or less at the prevailing level. Starting with about 100 million pieces per annum and going up to about 250 million pieces every year thereafter, the strategy was expected to take care of the annual increase in the demand for one-rupee notes. As for the issue of the prices of coinage metals rising all over the world (although the difference between the face value and the metal value of the cupro-nickel whole rupee was still unlikely to be great), it was assumed that this metallic coin, once introduced, would be in circulation at least for ten to fifteen years. The Bank stressed that it would be desirable for the government to prepare ‘a long-range plan’ for coinage for the next ten or fifteen years, taking into account, among other things, (i) that the Bank’s demand projections for notes and coins up to March 1979, and for one-rupee and other notes up to the value of, say, Rs 5 in the five years ending March 1984 were approximately double the requirements for the previous five years; (ii) that the production of bank note paper within the country had to be augmented and supplemented it by imports till the second security paper mill was established and (iii) the expected increase in the prices of coinage metals, particularly nickel and copper. By preparing a perspective plan the government would be better placed to anticipate any increase in the metal value of the cupro-nickel coins after they had been introduced, to withdraw and demonetize these coins with a view to reissuing them in a cheaper alloy, to recycle the

cupro-nickel alloys for use in new and higher denomination coins, and to enter into contracts abroad for fairly long periods for the import of nickel and copper whenever the opportunity arose.

Seshadri, in his letter, also outlined a scheme for the minting and issue of the cupro-nickel one rupee to be merged into the long-range plan. He suggested that the Government should ask the mint master, Bombay, to contact all the mints and leading suppliers of nickel, copper and other coinage metals, and some research organizations in India and abroad, in order to obtain the technical information on the basis of which a long-term plan for coinage could be prepared. This plan could be drawn up with particular reference to the coinage metals to be used, the phased withdrawal and demonetization of existing coins as soon as their metal values approached their face values, the introduction of new coins and recycling of metals for purposes of minting the new coins. In Seshadri's words:

A little time and effort and even some extra money if it is to be spent on preparing this perspective plan will be very much worthwhile. It would enable us to anticipate new developments as and when they occur and to avoid ad hoc decisions which have proved to be unsatisfactory in the past.

Thus, the Reserve Bank tried to envision the shape of things to come and to prepare well ahead to meet the challenge, before the situation went out of control.

DEMONETIZATION OF HIGH DENOMINATION NOTES

Demonetization of high denomination notes is one of the radical measures normally resorted to by governments to counter forgery and illegal printing of notes by unauthorized sources. The Wanchoo Committee on Black Money had recommended demonetization many years ago. This suggestion was not acted upon, partly because the very publicity given to the recommendation resulted in black money operators getting rid of high currency notes. The Committee had observed that black money should be regarded largely as a flow, not as a hoard, and different members of the Committee held different views on how much black money was in circulation. The government resorted to demonetization of Rs 1,000, Rs 5,000 and Rs 10,000 notes on 16 January 1978 under the High Denomination Bank Notes (Demonetization) Ordinance, 1978 (No. 1 of 1978). The Finance Minister, in his budget speech of 28 February 1978, announced that demonetization was part of a series of measures that the government

had taken for controlling illegal transactions and against anti-social elements. The purpose of the Demonetization Ordinance was stated in the preamble thus:

The availability of high denomination bank notes facilitates the illicit transfer of money for financing transactions which are harmful to the national economy or which are for illegal purposes and it is therefore necessary in the public interest to demonetize high denomination notes.

According to the Ordinance, all high denomination bank notes ceased to be legal tender in payment or on account at any place after 16 January 1978. The Ordinance further prohibited the transfer and receipt of these notes between persons after 16 January 1978 so as to make itself operationally meaningful.

The demonetization of 1978 was the second such exercise in India, the first one having been conducted in 1946. Governor I.G. Patel was not in favor of this exercise. According to him, some people in the Janata coalition in the government saw demonetization as a measure specifically targeted against the allegedly 'corrupt' predecessor governments or government leaders. Patel recalled in his book, *Glimpses of Indian Economic Policy: An Insider's View*, that when Finance Minister H.M. Patel informed him about the decision to demonetize high denomination notes, he had pointed out that:

such an exercise seldom produces striking results. Most people who accept illegal gratification or are otherwise the recipients of black money do not keep their ill-gotten earnings in the form of currency for long. The idea that black money or wealth is held in the form of notes tucked away in suit cases or pillow cases is naïve. And in any case, even those who are caught napping—or waiting—will have the chance to convert the notes through paid agents as some provision has to be made to convert at par notes tendered in small amounts for which explanations cannot be reasonably sought. But the gesture had to be made, and produced much work and little gain. (p. 159)

Demonetization was a sensitive issue and secrecy was imperative. R. Janakiraman, a senior official in the chief accountant's office in the Reserve Bank, was asked by some officers of Government of India over the telephone on 14 January 1978, to go over to Delhi immediately on 'some urgent work'. When he enquired the purpose of the visit so that he could go

prepared, the officials stated that matters relating to exchange control would need to be discussed and that he should leave for Delhi on his own. Janakiraman, however, took along with him M. Subramaniam, a senior official of the Exchange Control Department. On reaching Delhi, it was revealed that the government had decided to demonetize high denomination notes and he was required to draft the necessary Ordinance within twenty-four hours. During this period, no communication was allowed with the Bank's central office in Bombay, since such contacts could give rise to speculation. Janakiraman and Subramaniam made a request for the 1946 Ordinance on demonetization to get an idea of how it was drafted, and the request was acceded to by the Finance Ministry. The draft Ordinance was completed on schedule; it was then finalized and sent for the signature of the President of India (N. Sanjiva Reddy) in the early hours of 16 January 1978. The news was to be announced on All India Radio's news bulletin at 9 am the same day; it was given as a flash towards the end of the news bulletin.

The Ordinance provided that all banks and government treasuries would be closed on 17 January 1978 for transaction of 'all business except the preparation and presentation or the receipt of returns' that were needed to be completed in the context of demonetization. For purposes of the Negotiable Instruments Act, 1881, 17 January 1978 was deemed to be a public holiday notified under the Act.

Issuing the Ordinance was one matter. Implementing it and working out the modalities to receive and exchange notes across the length and breadth of the country was another. The Ordinance contained comprehensive provisions for the exchange of notes held by banks and government treasuries as well as by the public; for exchange of notes after the time limit; and provisions related to offences and the power of the central government to make rules giving effect to the provisions of the ordinance.

Banks and government treasuries were required to submit information (in the form of data 'return') to the Reserve Bank of high denomination notes held with them as at the close of business on 16 January 1978. The notes held would be exchanged for an equivalent value by the Bank. The general public² was given three days to surrender high denomination notes for conversion. After 16 January, notes could be exchanged on tender of the high denomination notes in person by the individuals themselves or by

² The term public included the Hindu undivided family (HUF) where the *karta* was required to tender the notes, companies where directors were required to tender the notes, firms (managing partner), associations (principal officer), etc.

a person competent to act on his/her behalf. They had to tender the notes at the Reserve Bank or at notified banks in the prescribed format with full particulars giving, among other things, the source or sources from which the notes came into his/her possession and the reasons for keeping the amount in cash.

The arrangements for exchange of high denomination notes to be surrendered by the public at the Reserve Bank in Bombay required that the Bank open additional counters and mobilize manpower from other departments to meet the high demand. Long winding queues started forming in front of the Reserve Bank office right from the morning as also at the main office of the State Bank of India, to collect declaration forms. According to press reports on 18 January 1978, the day started with utter confusion over the issue of declaration forms at the Reserve Bank headquarters at Bombay and the working hours stretched to 6.30 pm. Enterprising city printers are said to have made quick money selling forms in sets of three for Rs 3. As expected, there were frayed tempers and a considerable hue and cry from the public as well as foreign tourists, especially those who did not have, or did not care to preserve, documentary proof to support the exchange of notes. Many tourists were reluctant to fill the forms, particularly tourists from the Gulf countries. Generally tourists who had a small number of currency notes of high denomination had their notes exchanged across the counter.

On the day following demonetization, two noted economists, Professor C.N. Vakil and Dr P.R. Brahmananda, expressed the view that the measure would not have any enduring effect on money supply, prices of necessities and problems like low savings, acute poverty, unemployment and industrial relations, as the high denomination currency notes formed only a small proportion of the total money supply. They were the authors of the memorandum titled 'Semibombla' submitted to the union government for tackling the inflationary situation in 1974.