

ROLE OF RESERVE BANK OF INDIA AS AN ISSUER OF CURRENCY NOTES: A STUDY

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Abstract

The Reserve bank was incorporated under the Reserve Bank of India Act, 1934, in 1935. The multifaceted function is delegated to the Reserve Bank of India. It plays a very important role as issuer of currency notes and the distribution of banknotes within the country. This study is an attempt to analyze the background of currency notes, Reserve Bank of India's activities that contribute as an issuer of currency notes in the Indian economy, current circulation of bank notes in India, security mechanisms of Indian banknotes, penalties for counterfeit notes, and virtual currency condition in India. This article also addresses about the different kinds of money, functions of money and significance of money in a modern economy.

Keywords: Reserve Bank of India, Currency Notes, Counterfeiting, Virtual currency, Money etc.

1. Introduction

Since ages, Currency in any form have always acted like a wheel to run the economic chariot of a country. Currency notes play a significant role in every country, and supply of money reflects the global monetary market. But before the emergence of money, people rely heavily on barter system, which indicates the exchange of one good or service for another. Each nation has its own structure of coins and paper money which is distributed for transaction related matters of items & services and is also taken into consideration as country's official medium of exchange. An exclusive institution to publish paper currency is now in the shoulders of the reserve bank only. **Vera Smith** recognised it "as the single most important function of the Central Banking and considered it to be the essence of Central Banking". Another reason for giving right of note issue with the Central Bank recognised by **Kisch and Elkin**, i.e. Political intervention should be eliminated in the subject of note-issue. To quote them, "if the government itself has the right of note-issue, political considerations and the peculiar needs of the state rather than considerations of sound monetary economy are likely sooner or later to become the determining factors".¹ There will still be a nation in the world which does not obtain its own money system. Although in the period of modernisation, the most of the nations are looking to introduce E-banking. According to some economists "money as anything commonly accepted by people for the exchange of goods and services".²

1.1 History of Currency Notes in India

The genus name 'rupee' is discovered in the *sanskrit* language 'rupyakam', that further assume a silver coin. This also considered that its beginning actually relate from 'rupiya' granted by Sher Shah Suri in 1540-45.³ The current rupee icon is an integration from both Devanagri letter 'Ra' and Roman letter 'R' with a stripe chopping at the center to portray the tricolour.⁴ Historically speaking, During, (c 340-290 BCE) Chanakya in his 'Arthashastra', addressed gold coins as *Suvarnarupa*, silver coins as *Rupyarupa*, copper coins as *Tamrarupa* and lead coins as *Sisarupa*.⁵ During 18th Century, the Bank of Hindostan, General Bank in Bengal and the Bengal Bank became the first banks in India to issue paper currency.⁶

¹ R.K. Sharma and Shashi k. Gupta, et.al., Banking and Insurance 6.3 (Kalyani Publishers, Ludhiana, 5th edn., 2011).

² Editorial "Who invented money?" available at: <https://www.wonderopolis.org/wonder/who-invented-money> (last visited on 16/04/2020).

³ Editorial, "History of Indian currency: How the rupee changed", *The Economic Times*, 28/11/2016, available at: <https://economictimes.indiatimes.com/wealth/save/history-of-indian-currency-how-the-rupee-changed/articleshow/55635259.cms> (last visited on 17/03/2020).

⁴ Editorial, "The National Insignia" *Manorama Year Book 2020*, page no.387.

⁵ *Supra* note 4 at 393.

⁶ Shikha Goyal, "The History of the Indian Currency Notes and its Evolution", available at:

<https://www.jagranjosh.com/general-knowledge/the-history-of-the-indian-currency-notes-and-its-evolution-1472803179-1> (last visited on 17/03/2020).

In the world sense, the inception of paper currency is primarily associated to the token money that developed around the tenth century in China and the Western countries began use of paper currency during 17th century. In India, the excited attempt by Muhammed Bin Tughlaq in the fourteenth century to issue token money and substitute silver taka with copper, though a real monetary test, turned into a disaster.⁷ Since decades, coins of various style, form and material, are being used as a means of trade in India. All through 18th century, paper currency made its first appearance in India. Section 23 of the RBI Act, 1934, state that the task of issuing of paper currency is also to be carried by the RBI via a different department named the Issue Department. The entire administration is dealt by the Department of Currency Management (DCM) situated at its Central Office in Mumbai. In India the very first time, paper currency was launched by the Bank of Hindostan (1770-1832), the General Bank of Bengal and Behar (1773-75), the Bengal Bank (1784-91), the Commercial Bank, etc. Through the codification of Paper Currency Act, 1861, the Indian government formally assumes the burden of issuing of bank notes which was divided among the private and presidency banks in India. After that, the monopoly for the issue of paper currency continued to remain with the Government of India. In 1935, Reserve bank was set up as per the requirements of the “Reserve Bank of India Act 1934” and it took over the role of note issue from the Controller of Currency which was constituted in 1913.⁸

1.2 Reserve Bank of India Act, 1934

Previously, there was no Central Bank in India but with the changes financial conditions there has been required a Central Bank that would take the responsibility of overall financial system and it also treated as the highest financial institution of the country. In 1934, a bill was enacted to create a central bank for India.⁹ As a matter of fact, the Reserve Bank of India began to appear after 1 year i.e. 1 April 1935 as the highest financial institution and regarded as India's Central Bank.¹⁰ From the year 1926, the “Royal Commission on Indian Currency and Finance” strongly suggested for India's central bank. Nevertheless, an unique bill was proposed and accepted on Sept. 8, 1933, obtaining the approval of the Governor General on March 6, 1934, and the Bank officially opened on April 1, 1934.¹¹ The preamble of the Reserve Bank India Act 1934, describes its main functions as “.....to regulate the issue of Currency Notes and maintain reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage”. This preamble indicates the two core functions of the Reserve Bank: (i) issue of currency notes; and (ii) to maintain monetary authority.¹² Although the Reserve Bank of India preamble specifically stated that the central bank's core responsibility is to generate banknotes and preserve monetary authority objectives.

1.2.1 Contribution of Reserve Bank of India as an issuer of currency notes

The Reserve Bank of India, plays a very vital role as publisher of coins and notes. RBI's core purpose as a Central Bank of India is to distribute notes and coins. RBI is the country's principal source of capital that serves a significant role in the economy. To achieve this mission, the RBI formulates and implements an effective monetary policy for achieving specified targets. The RBI also taken multiple steps to fulfil the goal of managing the credit channels according to the country's economic needs. Distribution of money is not limited to banknotes only but also includes certain 'realisable assets.' The word "realisable assets" means assets which can be turned into cash at will, i.e. assets that have full or almost ideal liquidity.¹³

The RBI is solely responsible for providing banknotes apart from one-rupee notes or coins. As per Section 22 of the 1934 Reserve Bank of India Act, the RBI is the absolute decider for issuing banknotes. The currency notes in India popularly

⁷ Duvvuri Subbarao, *Some Issues in Currency Management*, the Foundation Stone laying function for the Bank Note Paper Mill, Held on March 22, 2010 at Mysore, p. no. 2 available at:

<https://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/GDND220310.pdf> (last visited on 23/05/2020).

⁸ RBI Publication, “RBI's Function and Working: Impacting Every Sector of the Economy & Touching Every Life” p. no.131-132 (Nov. 2017).

⁹ Duvvuri Subbarao, *Central Bank Governance Issues: Some RBI Perspectives*, the Central Bank Governance Group in Basel, page no- 863, Held on May 9, 2011 at Mumbai, available at:

<https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/01SP080611F.pdf> (last visited on 23/05/2020).

¹⁰ James Chen, “Reserve Bank of India (RBI)” available at: <https://www.investopedia.com/terms/r/rbi.asp> (last visited on 21/01/2020).

¹¹ *Supra* note 1 at 7.1-7.2.

¹² *Supra* note 9.

¹³ D.N. Dwivedi, “*Macroeconomics: Theory and Policy*” 224 (MC Graw Hill Education, Chennai, 4th edn., 5th Reprint, 2018).

recognised as 'bank notes,' while the central government issued one-rupee note are identified as 'Currency Notes'.¹⁴ Bank notes are published in India under the signature of Reserve Bank of India Governor. These often bear a conditional pledge or commitment, made by India's Reserve Bank Governor. Each paper currency released by the Reserve Bank hold a contractual obligation by India's Reserve Bank Governor - "I Promise to Pay the Bearer A Sum Of Rupees". The 'sum' here applies to one-rupee currency coins and notes released by the Indian Government and RBI banknotes of all other currencies.¹⁵ Moreover, one-rupee notes or coins are produced by India's central government required to be signed by the finance minister.¹⁶ In term of RBI affairs of note issue and its general banking business both are separate from each other.¹⁷ As per Section 38 of the RBI Act of 1934, indicates that the Government of India shall only allocate or transmit its rupee coins and one-rupee bank notes via the Reserve Bank.¹⁸ These are the places where the Government of India minted coins i.e., Mumbai, Alipore (Kolkata), Saifabad (Hyderabad), Cherlapally (Hyderabad) and Noida (Uttar Pradesh).¹⁹ In India, the notes which issued or circulated by the RBI are called as "Bank Notes" while, the notes which are issued by the Central Government e.g., one-rupee notes etc. are known as "Currency Notes". In accordance with section 24 of the RBI Act, 1934, currency notes shall have the denominational worth of Rs. 2/-, Rs.5/-, Rs.10/-, Rs.20/-, Rs.50/-, Rs.100/-, Rs.500/-, Rs.1000/-, Rs.5000/-, and Rs.10,000/- as well as other denominational values will not exceed of Rs.10,000/- as may be determined by the Central Government on the suggestion of the RBI Central Board.²⁰ The currency of every nation has continuously sought to portray its rich and vibrant culture and struggle for independence and proud achievements as a country.²¹ In India, the liability of note-issue is vested upon the Issue Department of the Reserve Bank of India. The RBI issued new banknotes in return for the following security such as rupee coins, gold coins and bullion, foreign securities, Government of India rupee securities, and the bill of exchange and promissory notes payable in India as are required for purchase by bank.²²

As per Section 28 of RBI Act, 1934, individual are not allowed to recover the worth of any lost, stolen, mutilated or defected bank notes from the RBI or Central Government.²³ Under Section 31 of the RBI Act, 1934, no person is allowed to draw, receive, or issue any bill of exchange or promissory note payable to bearer on demand except that the RBI and Central Government.²⁴ Section 27 of the RBI Act, 1934, prohibits the Banks to reissue banknotes that are lost, broken or overly damaged.²⁵ Under section 29 of the RBI Act, 1934, the RBI is not obliged by the Indian Stamp Act to bear any stamp duties on currency notes produced under it.²⁶ However, RBI plays very crucial role to maintain proper circulation of currency notes as well as bank notes.

1.2.2 Recent Circulation of Currency in India

The countries' central bank is authorized to issue, mint, and circulate currency. Currency is perhaps the most acknowledged means of trade in global economy. Currency could take the shape of banknotes or coins in printed form. This is not utilized merely as a means of purchasing products and services. The Reserve Bank of India has played a prominent part throughout the distribution of banknotes in India since its establishment. With the economic growth, individuals need much more currencies as well as other means of payment to complete their transactions. However, as with other developing economies, many developments have been implemented in the field of payment and settlement, but the ordinary people are still using paper currency for their daily monetary operations in our nation.²⁷ However according RBI data during the week ending March 15, 2019, the volume of money in circulation aggregates approximately Rs 21,41 lakh crore, measuring 17.5 percent growth on a Y-o - Y basis.²⁸ In 2016-17, 762,072 pieces of

¹⁴ S. R Myneni, *Law of Banking and Negotiable Instruments* 39 (Asia Law House, Hyderabad, 4th edn., 2019).

¹⁵ R. K Bangia, *Banking Law and Negotiable Instruments* 3-4 (Allahabad Law Agency, Haryana, Reprint 2016).

¹⁶ R.N. Chaudhary, *Banking Laws* 438 (Central Law Publication, Allahabad, 4th edn., 2018).

¹⁷ *Supra* note 1 at 7.4.

¹⁸ *Supra* note 14.

¹⁹ *Supra* note 4 at 394.

²⁰ *Supra* note 14.

²¹ Reserve Bank of India Publication, "Know Your Bank Notes", available at: <https://paisaboltahai.rbi.org.in/> (last visited on 10/04/2020).

²² *Supra* note 16.

²³ The Reserve Bank of India Act 1934 (Act 2 of 1934), Section 28.

²⁴ *Supra* note 14 at 40.

²⁵ *Supra* note 16 at 439.

²⁶ *Supra* note 14 at 40.

²⁷ N. Gregory Mankiw and Mark P. Taylor, "Macroeconomics" 147 (Cengage Learning India Pvt Ltd., Delhi, 4th edn., 2019).

²⁸ *Supra* note 19.

fake currency notes have been found in the financial system; 522,783 pieces in 2017-18; and 317,389 pieces in 2018-19, Sitharaman stated. She claimed that demonetization helped to stop the falsified notes from circulating in the market. In September 2018, the finance minister announced that the rise in price of electronic transfers climbed to Rs 188,07 lakh crore from Rs 112,27 lakh crore in November 2016 and during post-demonetization phase.²⁹

1.2.3 Legal provisions against counterfeiting

In each nation the counterfeiting of coins and notes is indeed a raging challenge. Every nation took numerous steps to fix this issue since it disrupted social and economic development in the nation. Money forgery issues aren't a recent issue because it existed prior since ancient times. It was already assumed as a serious crime against society in olden days and was capable of giving to punishment to death.³⁰ Governments are therefore introducing specific actions to strengthen efforts to curb counterfeiting and to enforce tougher and harder penalties.³¹ Forged money refers to false or counterfeit notes manufactured with either a view to deceiving customers and it continuously represents a threat to the economic development of a nation. Ordinary people are the biggest victims of fake currency.³² Under the Indian law, if any individual attempted to print bank notes or even possessing counterfeit bank notes and knowingly circulate it to the general public for wrongful gains then he or she shall be liable for fine or imprisonment or both under Sections 489A to 489E of the Indian Penal Code, 1860.³³

1.2.4 Security features of Indian Bank Notes

The greatest challenge facing the economies in recent days is fake currencies. The financial sector taken a high percentage of the counterfeit currency. To mitigate the issues of counterfeiting the Reserve Bank of India has taken numerous steps to strengthen the safety features of its denomination and to increase consciousness among the citizens.³⁴ To restrict the flow of fake notes, the RBI reportedly implemented multiple innovative safety measures of currency notes to prevent counterfeiting, in coordination with the Government of India. The RBI recently adopted a range of actions to tackle the counterfeiting challenge. Those are as follows;

- i. Enhances consumer awareness via promotions and additions and so on.
- ii. Display of "Know Your Bank Note" posters in local banks, ATMs etc., to keep reminding people regarding currency notes safety features. Along with that, RBI also launched a website known as "www.paisaboltahai.rbi.org" to provide information about genuine notes.³⁵
- iii. introducing note sorting machines for all major branches to handling cash.
- iv. ATMs which are fitted with sensors to detect falsified notes.
- v. Creation of Forged Notes Vigilance Cells in banks.
- vi. Formation of security committees in every state, involving police, banks, etc., to combat counterfeiting.³⁶ However, increased public awareness about counterfeiting would be one of the most effective measure.

India's RBI and government have developed a variety of fascinating additional features in latest paper money. The preceding are Indian banknote security features, like Water Mark, Security Thread, Latent Photo, Fluorescent Mark, Bleed Lines, Identification Mark, Micro-littering, Optical Variable Ink, See-through Register, Intaglio.³⁷

1.3 The Kinds of Money

²⁹ Editorial, "Currency in circulation rises 22% in May over pre-demonetisation level" *The Economic Times* 26/06/2019 available at: <https://economictimes.indiatimes.com/news/economy/finance/currency-in-circulation-rises-22-in-may-over-pre-demonetisation-level/articleshow/69945821.cms> (last visited on 17/03/2020).

³⁰ *Supra* note 7 at 5.

³¹ *Ibid* at 6.

³² Editorial "How spot a fake bank note" *The Guardian* 19/10/2013, available at: <https://www.theguardian.com/money/2013/oct/19/how-spot-fake-banknote> (last visited on 12/04/2020).

³³ The Indian Penal Code, 1860 (Act 45 of 1860). Ss. 489A, 489B, 489C, 489D, 489E.

³⁴ *Supra* note 7 at 7.

³⁵ Anandha Krishanan Ghsat, "Security Features of Currency Notes" available at: <https://www.slideshare.net/anand8095/security-features-of-currency-note> (last visited on 17/04/2020).

³⁶ *Supra* note 7 at 7-8.

³⁷ *Supra* note 19.

In the era of the 21st century, many nations used current money system with metallic coins and paper currency existing. Bank deposit is also a kind of capital. Credit card is the latest member to the banking system, which is used as a means of payment instead of using the cheque platform. These are the following kinds of money;

- Metallic Coins made from iron, copper, silver and gold but now produced of alloys and aluminum as well. The actual date of the metallic coins is introduced remains uncertain. Some analyst thought that metallic coins circulated in India around 2500 years ago.
- Paper Money composed of banknotes printed, certified and distributed in collaboration with the government by the country 's central bank. It produces the bulk of the total circulated money in any nation. In India, there seems to be a double method of releasing banknotes e.g., the government issues one-rupee bank notes and coins and rest by the RBI. Higher denomination banknotes are released by Reserve Bank of India. Each currency note issued by the Reserve bank holds the RBI Governor's pledge, e.g., "I PROMISE TO PAY THE BEARER A SUM OF RUPEES."
- The third sort of money is bank deposits. Different kinds of deposits are included: current account, savings account, and time deposits. Current account deposits are accessible and used for the cheque method as a means of trade.³⁸

In present society, plastic money has become a common term in the global economy because more and more emerging economies prefer plastic alternative to paper since there are many underlying benefits. Recently, the Indian parliament plans to using 'plastic money' on polymer technique as such technology has been used in more than 20 nations namely China, Australia, Brazil, New Zealand, Sri Lanka, Mexico, Romania and Singapore etc. India even slowly moves from conventional cash to digital money.³⁹ Plastic money was first launched in Australia around the year 1988. Many other countries have begun using it because it is expected to be a little more stable, water resistant and tougher to falsify, being composed of non-porous polymer with such a unique protective covering that removes absorption of moisture. This also assisted to address the problem of dirtied notes especially in small currency.⁴⁰

1.4 Virtual Currency: Are they different from Crypto-currency?

There is no collectively acknowledged meaning of virtual currency. As indicated by some specialists, "it is a method of exchange value; a few specialists have considered it a merchandise thing, product or commodity". The term 'virtual currency' incorporates all types of non-fiat currency which are being traded in form. It is a form of currency which is mostly created, distributed and acknowledged by means of local virtual networks. Crypto currencies, on the other hand, have an additional protection of security as encryption algorithms. To make currency secure as well as the network via which currency are being exchanged it adopted cryptographic methods. Many crypto currencies currently run via blockchain and laser-appropriate technology that has continuously enabled everyone on the network keep a record of international transactions. The Financial Task Force (FATF) released a ground-breaking study that outlined both legitimate benefits and possible risks related to virtual currency. Another study, FAFT reported once again that the use of these virtual currencies by terrorist funding groups increasing day to day.⁴¹

1.4.1 Supreme Court of India views on Virtual currencies

The Hon'ble Supreme Court of India has set aside a prohibition on banks and other financial institutions from trading with and exchanging virtual currency owner. The Court held that the "proportionality" requirement was not met by the prohibition. The government's determination of the proportionality of any activity should meet the requirements of Article 19(1)(g) of the Indian Constitution, which states that all people shall have the freedom to exercise any profession or to pursue any occupation or business and trade. The Supreme Court's judgement will make the RBI to re-examine its approaches on virtual currencies. The Hon'ble Supreme Court of India observed that, "Every court which attempted to fix the identity of virtual currencies, merely acted as the four blind men in the 'Anekantavada' philosophy of Jainism, who attempt to describe an elephant, but end up describing only one physical feature of the elephant."⁴²

1.5 Functions of Money

Money is often used as a means of exchange, as well as a price index. It does conduct several activities too. The following are the principal economic activities of currency. Such are as follows;

³⁸ *Supra* note 13 at 224-226.

³⁹ *Supra* note 16.

⁴⁰ *Ibid* at 439-440.

⁴¹ Aashish Aryan, "What next for virtual Currency?" *The Indian Express*, March 4, 2020.

⁴² *Ibid*.

- i. It entails the process of transaction while buyers and sellers enter into a transaction.⁴³
- ii. It functions as a means of exchange whenever a seller receives cash in exchange for a product or service, the trader may keep the money and at a certain point becomes the purchaser of certain other products or services.⁴⁴
- iii. As a calculated money currently acts as a common factor, as account unit. The fundamental method of payment is to calculate the worth of the products and services.⁴⁵
- iv. Cash has overcome the deferred payment issue on its own qualities, because it is socially acceptable, legally sound and also has a remarkably stable worth.⁴⁶

1.5.1 Significance of money in modern economy

Money plays a very important role in global economy via its diverse mechanism. Several intellectuals described money as “**one of the most fundamental of all man’s inventions**”. There are a few significant contributions that money provides to the functioning of a global economy;

- i. Money eliminates barter-system problems;
- ii. Money also serves as a productive factor;
- iii. Money as a trade channel enables faster productivity level and socio - economic development;
- iv. An economy remains alive and working efficiently so long as money keeps circulating in the economy;
- v. This also stimulates the functioning of a global economy in distinct manners, as it enhances customer choice in several products or services.⁴⁷

2. Conclusion

It concludes that India's Reserve Bank played a crucial role in improving banknotes features and its consistency. This also assists by periodically implementing many safety features in paper currency to eliminate counterfeit money from the market. It's really significant in the currencies of each and every nation because it helps operate the nation's economy. Financial growth and stability rely on the market providing funds adequately. In the words of **Janet Flanner**, “Money is muscle in our society like that of a leg and arm of a man with a shovel and both muscles must have a wage”. Dutch proverbs define money in following way that, “A man without money is like a ship without sails”. Local people use currencies as a means of taking products and services for trade. The Indian government also implemented modern digital fund transfers such as “Real Time Gross Settlement (RTGS)”, “National Electronic Fund Transfer (NEFT)”, and “Immediate Payment Service (IMPS)”, and so on. Some economists have defined money as, “money is what money does”.

⁴³ *Supra* note 27 at 146.

⁴⁴ *Ibid.*

⁴⁵ *Supra* note 13 at 227.

⁴⁶ *Ibid.*

⁴⁷ *Supra* note 13 at 228-230.