

The short history of a large note

The withdrawal of the ₹2,000 note from circulation by the Reserve Bank of India (RBI), which it announced on May 19, 2023, marks the end of a sordid chapter in the tragi-comic demonetisation saga. The presence of the ₹2,000 note in circulation was a constant reminder of the horrors of a "nation in the queue". The note was also an object of ridicule, particularly due to bizarre claims at the time of its introduction, of a nano chip implanted in it. For the beleaguered government, the chapter on the ₹2,000 note had to be closed. With fresh printing of the note stopped after 2018-19, its eventual withdrawal was expected.

Many errors

In 2016, the ₹2,000 note had emerged as the centrepiece of demonetisation, a policy that was illogical in conception and mismanaged in execution. The note had to be printed in larger numbers because the government had not checked whether it had enough notes to replace what was withdrawn. On November 8, 2016, the total stock of notes of ₹2,000 – with the Reserve Bank of India (RBI) and currency chests – was 473.3 million pieces worth ₹94,660 crore. This amount constituted just 6% of the value of Specified Bank Notes (SBN) withdrawn. People were dying in the queues, and the realisation dawned that more ₹2,000 notes were required for faster redenomination.

However, the RBI printed the new ₹2,000 notes in a new size. Normally, an automated teller machine (ATM) contained four cassettes; two cassettes held ₹500 notes and the other two cassettes held ₹1,000 and ₹100 notes. The new ₹2,000 note would not fit into any of these cassettes. Consequently, every one of the 2.2 lakh ATMs in India had to be "re-calibrated". Re-calibration was a massive and complex exercise that required coordination across banks, ATM manufacturers, the National Payments Corporation of India, and switch operators. Engineers had to personally visit each ATM and spend between two to four hours with an ATM to complete the re-calibration.

The re-calibration crisis led to another ad hoc measure. Banks packed all the cassettes with



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available notes of ₹100. If all four cassettes of an ATM were filled with ₹100 notes, one ATM could store currency worth ₹2.1 lakh. The maximum withdrawal allowed per person per day was ₹2,000. In other words, one ATM could, at the maximum, meet the needs of only 105 people per day. But there were thousands queuing up in front of every ATM.

When the stock of ₹100 notes was quickly exhausted, banks demanded more from the RBI. The RBI had no option but to supply old and soiled notes that banks had returned to the RBI earlier. Soiled notes often jammed the ATMs, which only added to the chaos.

The quality of the new ₹2,000 note was also a problem. Many notes were poorly printed: some notes had a shadow of Mahatma Gandhi's face in addition to the photograph of his face; some others had uneven borders; while others were of varying colour shades and sizes. In the villages, farmers were cheated by criminals as they were paid in fake ₹2,000 notes – they were just high resolution photocopies of the original note.

Finally, even when people managed to get a ₹2,000 note, most of them were unable to spend it; no one would offer change or a balance payment over transactions. In effect, the problem of a short supply of notes was exacerbated by the release of the ₹2,000 note.

The need for a larger note

All this while, the public was stuck with one basic question: if, as the government claimed, most illegal transactions and stocks of cash were in notes of ₹500 and ₹1,000, why did the government release new notes of ₹2,000? No credible explanation was ever provided. In fact, the RBI had suggested to the government, on October 7, 2014, that new notes of the denomination ₹5,000 and ₹10,000 be introduced in view of rising inflation and problems of managing currency logistics. However, the government declined this request on May 18, 2016 and advised the RBI to introduce new notes of ₹2,000.

As on March 31, 2023, the ₹2,000 note accounted for only 10.8% of all notes in circulation – down from 37.3% as on March 31, 2018. Its impact, then, is likely to be relatively

small as compared to the withdrawal of more than 86% of notes in circulation in 2016.

Yet, what is undeniable is that India's monetary system has taken a serious credibility hit due to frequent changes and U-turns in currency management. The RBI Governor's statement that he cannot unambiguously predict the status of the ₹2,000 note after September 2023, has made a bad situation worse. Those looking for stability will see holding assets in the Indian rupee as a liability.

What next?

The highest denomination note in an economy serves as a store of value and is scarcely used in day-to-day transactions. But as per capita incomes and inflation rise, the highest denomination note sheds value and becomes a note for day-to-day transactions. Typically, the economy would then need a new higher denomination note to act as a store of value. This was why the RBI had requested the government to let it issue ₹5,000 and ₹10,000 notes in 2014.

Now, with the ₹2,000 note being withdrawn, can a growing economy have the ₹500 note – the next highest denomination – serve as a store of value? The cash-to-GDP ratio in India was 12% in 2015-16, but rose to 14.5% in 2020-21 and 13.3% in 2021-22. So, more cash is circulating, the value of notes is eroding with inflation, and real interest rates are falling. In such a context, can the RBI manage currency logistics efficiently without introducing a new ₹1,000 note, or even a ₹5,000 or ₹10,000 note? It may be difficult to escape such an eventuality.

Alternatively, would a digital currency, an e-rupee, be a perfect substitute for a larger denomination note? To be a stable and acceptable store of value, a digital currency must meet the properties, among others, of anonymity, general purpose use, and exchangeability. But the RBI has stated that anonymity can be assured only "to a certain degree" in e-rupee transactions. Other properties too are still evolving and in a stage of infancy. Thus, it is very unlikely that a digital currency will emerge as a new store of value anytime soon.

Let us just say, "picture *abhi baki hai* [It's still not over yet]".

Unboxing the 'export turnaround' in India's toy story

India has recently turned a net exporter of toys, during 2020-21 and 2021-22, ending decades of import dominance. Between 2018-19 and 2021-22, toy exports increased from \$109 million (₹812 crore) to \$177 million (₹1,237 crore); imports declined from \$371 million (₹2,593 crore) to \$110 million (₹819 crore), official data show. These facts are indisputable. They can be cross-verified by mirror images of trade figures from corresponding importing or exporting countries.

The achievement is widely credited to the 'Make in India' initiative launched in 2014, and related policies, official press releases claim. Moreover, in 2020, the Prime Minister Narendra Modi reportedly spoke of promoting toy manufacturing, in his talk show, 'Mann ki Baat'. What can explain such a sharp turnaround in the toy trade? Does it represent a sustained rise in investment, output and efficiency gains nurtured by policy reforms? Or is it a short-term outcome of protectionism and COVID-19 pandemic-related global disruptions?

More imports than exports

India's toy industry is minuscule. In 2015-16 (the latest available figures combined for the organised and unorganised sectors), the industry had about 15,000 enterprises or establishments, producing toys valued at ₹1,688 crore using fixed capital of ₹626 crore at current prices and employing 35,000 workers. Registered factories – those employing 10 or more workers on a regular basis – accounted for 1% of the number of factories and enterprises, employed 20% of workers, used 63% of fixed capital, and produced 77% of the value of output. However, during the one and half decades between 2000 and 2016, industry output was halved in real terms (net of inflation) with job losses. Imports accounted for up to 80% of domestic sales until recently. Between 2000 and 2018-19, imports rose by nearly three times as much as exports.

India hardly figures in the global toy trade, with its exports at a mere half-a-percentage point. Between 2014-19, the Indian toy industry witnessed negative productivity growth. So, what explains the sharp turnaround in toy trade in just three years? Imports contracted as the basic

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India turning a net exporter of toys is mainly due to rising protectionism and less, perhaps, on account of expanding domestic capabilities

custom duty on toys (HS Code-9503) tripled from 20% to 60% in February, 2020. Numerous non-tariff barriers were imposed as well such as production registration orders and safety regulation codes, which contributed to import contraction (Press Information Bureau release July 5, 2022).

The question, therefore, to ask is: do net exports represent sustainable improvements in industrial capability and performance contributing to import contraction, or are these the mere short-term effects of protectionist measures? The question merits attention as toy making, a labour-intensive industry, has all along played a vital (and perhaps outsized) role in policy discourse.

The Asian scene versus India

Historically, Asia's successful industrialising nations promoted toy exports for job creation, starting with Japan about a century ago, China since the 1980s, and currently Vietnam following in their footsteps. However, India, followed an inward-oriented industrial policy in the Planning-era, which sheltered domestic production by providing a "double protection" – by imports tariffs and reservation of the product for exclusive production in the small-scale sector – known as the "reservation policy". The outcome? Toy manufacturing remained stagnant, archaic and fragmented, even as imports of modern, safe, and branded toys boomed. The industry is emblematic of all that was wrong with misguided industrial policy, as many critics of India's industrial policy have contended.

In 1997, in the wake of liberal reforms, the reservation policy was abolished. Expectedly, new firms entered the organised sector, but only for a while, and productivity growth improved. But the unorganised sector languished with job losses, even as a majority of workers remained there.

In a recent study ('India's Toy Industry: Production and Trade since 2000', *Economic and Political Weekly*, May 6, 2023) we re-examined the industry output and export performance, since about 2000, with a new firm-level dataset from the formal and informal sectors synchronised with a four-digit product-level trade data. In

particular, we looked into how more recent policy initiatives, such as 'Make in India', have a bearing on the toy industry.

We found that the annual value of output and fixed investment at constant prices (net of inflation) after peaking in 2007-08, have trended downwards with considerable fluctuations (except for 2019-20). Apparently, there is no evidence of 'Make in India' positively affecting these indicators on a sustained basis. The output of the informal or unorganised sector shrank, though it continues to account for the majority of establishments and employment.

Despite early positive trends, industry de-reservation (though it helped formalise the industry), failed to sustain output, investment, and productivity growth after 2007-08. Contrary to popular perception and official claims, 'Make in India' had a negligible effect in strengthening toy production and exports on a sustained basis.

Too premature to claim success

As the reported turnaround in toy exports is based on data from just two recent years, and during the COVID-19 pandemic, it is perhaps too premature to claim policy success. The potential for sustaining net exports appears slim as the industry has hardly made sustained investment to boost output and exports.

To sum up, India's export surplus in toys during 2020-21 and 2021-22, is a welcome change. However, it seems to be driven by a rise in protectionism, and the exceptional circumstances of the COVID-19 pandemic. The turnaround does not seem to be the outcome of strengthening domestic investment and production on a sustained basis. Since around 2000, the industry has shrunk with rising imports, until two years ago. Though minuscule, as the industry has an outsized role in policy discourse, the study seems to offer valuable lessons. Neither the reservation policy as during the Planning era, nor its abolition after the liberal reforms boosted the industry's performance. One should perhaps look beyond simplistic binaries – planning versus reforms – and examine the ground reality of industrial locations and clusters to tailor policies and institutions to nurture such industries.