THE CURIOUS CASE OF DEMONETISATION IN INDIA

Sahil SK, George School of Law, Calcutta University

Introduction

The term '***demonetisation***' can be stated to be the **withdrawal of notes, coins, or any other precious metal from use as legal tender**. It can also be conversely stated to be the act of stripping a unit of currency of its status as legal tender. If we care to drop a peek into history, one of the earliest instances of demonetisation was **observed in the United States in the late 19th century**, where the **Coinage Act of 1873** mandated the removal of silver in favour of adopting gold as legal tender. This, however, did not yield the expected results and instead caused a contraction of the money supply and a 5-year economic depression.

The process of demonetisation is generally implemented to fulfill certain objectives, namely:

- Tool to counter inflation

- Facilitate trade and deal with adverse balance of payments

- Improve cash-based economy

- Fight corruption and criminality

On **November 8th, 2016**, the **Bharatiya Janata Party government** led by **Prime Minister Narendra Damodardas Modi**, shook the country by issuing a notification out of the blue, which **declared all ₹500 and ₹1000 notes to be invalid** henceforth, thereby discontinuing their circulation. The Union justified the decision by claiming it to be a step in **curbing the circulation of black money**, i.e., any illegally obtained and unregistered income, and mark the shift towards a cashless society.

Brief History of Demonetisation in India

The decision undertaken by the Modi-led government in 2016 however, is **not the first time this country has witnessed demonetisation**. Before this, two other times, the said government

in power, had demonetised the high currency in India, through deriving power from Section 26 of the Reserve Bank of India Act, 1934 which provides the Union power to declare specific currency notes invalid.

The first demonetisaton took place back on January 11, 1946, when the government declared that notes of ₹500, ₹1000, and ₹10000 would no longer be a legal tender from the following day. With the country being recently independent, this news came as a huge shock to most of the citizens, with people losing lives in shock, and needing to wait for hours in long lines banks.

The old notes were sold at 60-70% of their price in the market and were held to be a death blow to black marketeers. In a bizarre set of events, however, a rumour was spread that even ₹100 notes were to be demonetised, which further aggravated the unrest.

The second demonetisation occurred in January 1978, when the newly elected Janata Party, after defeating the Indira Gandhi-led Congress by a landslide for the obvious reasons of imposition of national emergency by the latter, demonetised high currency notes of ₹1000, ₹5000, and ₹10000, with the view to curb black money transactions.

And the third, i.e., the most recent demonetisation, took place in 2016, when the Bharatiya Janata Party undertook similar steps to that of the Janata Party in 1978, invalidating ₹500, and ₹1000 notes within the economy.

However, one significant difference in the two situations was that notes of high values like that of ₹1000 or beyond, were almost impossible for the common man to possess, and thereby did not significantly affect the general population, unlike this time, where the middle class faced severe repercussions.

Other than these aforementioned situations, **the Reserve Bank of India withdrew all banknotes before 2005, and again in 2023, withdrew every note of ₹2000 from circulation.**

Background of 2016 Demonetisation

After the declaration of demonetisation on November 8, 2016, the following weeks noticed huge rush and unrest among the general public. Citizens experienced crowds in their nearest banks to exchange the invalidated notes and withdraw new cash from their accounts. This

caused huge strain on the banking systems, and the available cash flow in the economy. Seeing these onslaught of people, **the Reserve Bank of India (RBI) restricted the District Cooperative Central Banks (DCCBs), thereby worsening the access to banking and exchange of demonetised currency in the rural areas.**

On the following day, **advocate Vivek Narayan Sharma challenged the constitutional validity** of the scheme as well as its application in the Apex Court of the country. The Supreme Court thereafter **constituted a three judge bench**, comprising of the then ***Chief Justice T.S. Thakur, Justice A.M. Khanwilkar, and Justice D.Y. Chandrachud.***

After an extensive hearing for more than a month, the bench **passed a stay order on all challenges made to the High Courts** in respect to the demonestisation scheme and transferred the said cases to the Supreme Court. The order also **referred the challenges made against the scheme to a constitutional bench of 5 judges.**

4 primary questions were determined to be in contention by the three-judge bench, to determine the validity of the scheme, namely:

1. Can the Supreme Court review the Union's 2016 Demonetisation Scheme?
2. Was there a proper implementation of the RBI's mind before carrying out the demonetisation exercise or was it flawed?
3. Can the Union demonetise 'all' currency notes of a denomination through a notification under Section 26(2) of the RBI Act? If yes, does it grant excessive power to the Union?
4. Was the demonetisation scheme, disproportionate to the objectives of the Union?

Alongside these, two questions were raised regarding its implementation as well, namely:

1. Was the 52-day window provided to exchange demonetised notes unreasonably short?
2. Does the RBI have the authority to exchange demonetised currency after the 52-day time period?

Since the determination of the key issues by the 3-judge bench, numerous other petitions were also filed challenging the scheme, but surprisingly no hearing was conducted **until the end of September 2022**, when finally a **5-judge bench of *Justice B.R. Gavai, Justice Abdul Nazeer, Justice A.S. Bopanna, Justice V. Ramasubramanian, and Justice B.V. Nagarathna*** started hearing the case.

At the very commencement of the proceedings, **Justice Nazeer highlighted** the ***passing of a significant amount of time since the filing of the petitions and a huge possibility that the issue by then had become outdated.***

Verdict of the Supreme Court

On the second of January, 2023, the **5-judge constitutional bench, through a 4:1 split decision**, **upheld the 2016 demonetisation** scheme of the Union, in the case of **Vivek Narayan Sharma vs Union of India (WRIT PETITION (CIVIL) NO.906 OF 2016.)**

Majority Opinion:

The concurring opinions of ***Justice A. Nazeer, Justice B.R. Gavai, Justice A.S. Bopanna, and Justice V. Ramasubramanian*** answered **6 different questions** pertaining to the issues raised in the case; 4 regarding the validity of the scheme itself, and 2 in respect to its implementation.

A. 1. On the issue of whether the Union could demonetise 'all' currency notes through a notification under Section 26(2) of the RBI Act:

The judges stated that the phrase in the said section, **'any series of bank notes' refers to 'all series' of bank notes.** This in itself is a clear indication of the authority of the Centre to enforce such a scheme.

2. On the issue of whether Section 26(2) of the RBI Act empowering the Union to demonetise 'all' currency notes, grants excessive power to the Centre:

The concurring opinion spoke in the negative of the said question and held that **no excessive power was exercised by the Union when it demonetised all ₹500 and ₹1000 currency notes under the said provision.**

3. On the issue of whether the implementation of the 2016 scheme was flawed:

The judges did not believe that the scheme of demonetisation was flawed. They adjudicated that **proper procedure was followed as both the Union and the Reserve Bank of India deliberated for 6 months** before putting the scheme into effect. It also concluded that ultimately it is the Union who has the final say over economic policies, after consultation with the RBI and considering the advice tethered by the latter.

4. On the issue of whether the scheme of demonetisation was disproportionate to the objectives of the Union:

The majority bench concluded in the negative and established a reasonable connection between the measures undertaken and the objectives of the Union.

B. 1. On the issue of whether the time period of 52 days to exchange demonetised notes was unreasonably short:

The judgement stated disagreed and v**alidated the duration based on previous similar situations in history**. For instance, **in 1978, a constitution bench upheld the period of 8 days** for facilitating the exchange of invalidated currency notes. The current bench, thus derived reasoning from this judgement and considered the current time frame in contention to be sufficiently reasonable.

2. On the issue of whether RBI had the authority to exchange demonetised currency after the said 52-day window:

The bench finally held that RBI had no discretion or power to exchange the invalidated notes beyond the said time period.

Minority/Dissenting Opinion:

Justice B.V Nagarathna, who if the seniority principle is followed would be the **first female Chief Justice of the Apex Court in 2027,** provided the sole dissenting opinion in the judgement.

1. On the issue of whether the Supreme Court had the authority to review the

Demonetisation Scheme:

The government initially contented that the demonetisation being a matter of economic and monetary policy of the country, was beyond judicial scrutiny. It argued that such a scheme was the prerogative of the government after consultation with the required set of experts, and therefore its merits or demerits were not within the purview of the Supreme Court.

Justice Nagarathna, however, stated that since the demonetisation was facilitated through the provisions of a particular statute, and this **power exercised under Section 26(2) of the Reserve Bank of India Act, 1934 was a matter of interpretation of the law**, it is well within the purview of the Supreme Court to review.

2. On the issue of whether the application of the scheme was flawed due to non-application of mind by the Reserve Bank of India:

Justice Nagarathna in this matter held that there was a **lack of independence of the RBI in determining the application of the demonetisation** scheme. This can be vividly comprehended from the records stated by the Reserve Bank, which consist of statements like, ***"as desired by the Central Government."***

She determined that the **RBI had merely given its opinion, at the instance of the Union**, and therefore it could not be considered to be a recommendation by the Central Board of the RBI. She observed that such a situation clearly implies that the proposal to carry out the 2016 demonetisation originated from the Union, and not from the RBI.

Also highlighting the fact that the entire exercise of demonetisation was carried out within 24 hours, Justice Nagarathna concluded that the **RBI had not applied its mind before carrying out the said scheme in question.**

3. On the issue of whether the Union could demonetise 'all' currency notes through a notification under Section 26(2) of the RBI Act, and whether such power is excessive:

Justice Nagarathna, while upholding the unrestricted power of the Union to demonetise all currency notes, **contrarily stated that such power can only be exercised through the law-making power of the Parliament**, as granted by the Constitution. She held the current

application of the scheme of demonetisation to be invalid, as **section 26(2) of the RBI Act,** under which the said scheme was carried out, **did not grant such powers to the Union.**

She further enunciated that this **2016 demonetisation would still be unlawful, even if the RBI initiated the proposal** to carry out the scheme in question. She justified her statement through the very wordings of Section 26(2), which allows only particular denominations to be demonetised, and does not provide an allowance for 'all series of denominations.'

Shedding light on the **mere 24-hour time period for implementation of the scheme**, Justice Nagarathna stated that if it was pertinent for the Union to maintain secrecy to achieve the objectives of demonetisation, such **scheme should have been implemented through an ordinance,** which could have later been backed by parliamentary legislation. She concluded that a matter as serious as the 2016 demonetisation could not be carried out by mere issue of notification, as it had been done by the Union in this scenario.

Thus, she ultimately stated that though the 2016 demonetisation had its fair share of noble objectives, on purely legal grounds the exercise of the said scheme was unlawful.

Undisclosed Material Facts

In the affidavits provided to the Supreme Court during the hearing of petitions against demonetisation, the government recurrently stated that the implementation of the scheme was a well-considered and well-thought decision, after undertaking needful consultation with the RBI. The RBI too readily accepted such contention by the government, in its affidavit. It also stated that it was ultimately the RBI that recommended the demonetisation, and in its application due process of law was followed.

While several factors were discussed and issues were raised in contention, a **lot of important facts pertaining to demonetisation were kept under a veil by the government as well as the Reserve Bank of India in the affidavits.**

Firstly,

Some months **before the 8th of December, 2016**, when this scheme was implemented, the **Reserve Bank of India had strongly opposed the idea of invalidating ₹500 and ₹1000 notes**, days before the date of action, when the Prime Minister, Finance Minister and the

Governor of the RBI were addressed in a letter by an anti-corruption committee of Karnataka, recommending he banning of ₹500 and ₹1000 notes to inhibit the circulation of black money in the country.

The RBI, in response, **highlighted the fact that about 85% of the total currency circulating in the country consists of the said notes** which the committee sought to ban, and therefore play a critical role in the day-to-day lives of the general public. Thus, keeping all those problems in mind, RBI stated such a scheme of demonetisation which **invalidated notes of higher denomination, was not feasible then.**

Even when the centre was convinced, **RBI under the governance of Raghuram Rajan had actively rejected such contention**. However, after only **two months of his resignation,** the government immediately with the **assent of Urjit Patel**, the deputy governor who succeeded Rajan, went ahead with the policy of demonetisation.

Secondly,

There was an **assumption of around 400 crores of black money** being in circulation, **in comparison to the total quantum of 17 lakh crore** in currencies. This ratio was **not very significant at that time.** However, there indeed was a steep rise in the circulation of the ₹500 and ₹1000 notes for the last five years, prior to 2016, and such rise of the two highest denominations in comparison to the overall size of the economy, was inexplicable, and was rightfully termed by the government as black money, which was presumed to have been facilitating terrorism.

However, what did not add up to these permutations and combinations is that **most of the black money was held in the form of real-sector assets like that of gold and real-estates and not in the form of cash**. Therefore, ultimately, the scheme of demonetisation would not have any material impact on these assets.

Lastly,

RTI Activist Venkatesh Nayak, who gained access to the 561st meeting of the RBI Board through an RTI (Right to Information) Application, derived from the 4.4th paragraph that the **Board was not aware of the scheme of demonetisation even by the smallest of margins**

until Urjit Patel had tabled the issue. This, however, was **less than six hours before the announcement** of the decision to implement demonetisation in the country.

Subsequently, **on March 15, 2019,** when Nayak had yet again filed an RTI application concerning RBI, where he **asked for a photocopy of any notable study** commissioned or undertaken by the latter before the denomination of ₹500 and ₹1000 notes was announced by the government, the **RBI replied in the negative, expressing it had no such information available.**

Validity of the judgement

Though news editorials of reputed publications noticed both the benefits and the shortcomings of the aforementioned judgement of the Apex Court, a number of legal scholars highlighted the latter.

For instance, **Indira Jaising in the National Herald** concluded the scheme of demonetisation to be **against the cardinal principles of the rule of law and lacked legislative backing**. She also highlighted how the scheme was a **direct violation of the precedent** set by the Supreme Court in **Jayantilal Shah vs RBI (AIR 1996 SCW 3736),** where the Apex Court had held that any **act extinguishing the currency in circulation must be backed by an act of the parliament** since the nature of such currency is that of a public debt owned by the government. She while upholding Justice Nagarathna's dissenting opinion, stated that **in this scenario there was neither an act nor any ordinance passed.**

Alongside, **Pratap Bhanu Mehta**, in his **article in the Indian Express,** also questioned the basis of the judgement of the Supreme Court along with the supporting opinion of Alok Prasanna Kumar, who sought the practical interpretation of section 26(2) of the RBI Act, thereby allowing the term 'any notes' to be read as 'all notes.'

Advocate Kaleeswaram Raj as well as **the Hindu**, both highlighted the significantly different approaches of the Supreme Court in public matters, where in one hand during the COVID-19 vaccination drive, the SC reviewed the whole policy of the government; in this scenario, the **SC only investigated the improperness of the announcement process**. The Hindu especially criticised the **over-yielding attitude of the Apex Court** towards the widespread hardships and adversaries faced by the general public as well as the economy as a whole.

Lastly, **Gautam Bhatia** while writing for the Wire, rightly **highlighted internal contradictions within the majority judgement** of the Supreme Court itself. He stated how on one side the court rejects the possibility of excessive delegation by the Parliament because of the advisory presence of RBI, but on the other hand also gives a clean chit to the Union, with the reasoning that it is the highest executive body of the Parliament. This, as rightly stated, **confuses separation of powers with the democratic legitimacy** of the decision of the Union.

Conclusion

As of now, however, the **decision of the Supreme Court stands tall** over all criticisms and questions that are being raised against the validity of the scheme. The existence of a **strong dissent** in the form of the opinion **of Justice Nagarathna does provide an allowance for contesting the validity** of the judgement, and potentially overturning it if the court deems it necessary. Such a situation **wouldn't be the first time** when a dissenting opinion paved the way for fresh petitions in the future, the most prominent of such opinion being that of **Justice Hans Raj Khanna's dissent in ADM Jabalpur vs Shivkant Shukla (AIR 1976 SC 1207).**

However, the only big fear that remains is, that by the time a fresh batch of petitions are filed, it will be a **little too late to facilitate change or establish accountability.**