



Constitutional validity of demonetization in India

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Abstract

The Government of India has taken a policy decision that the Bank notes in the denomination of Rs. 500 and Rs. 1000 shall cease to be a legal tender 8th November, 2016 onwards. Simultaneously, bank notes of Rs. 2000 were also introduced, possibly to carry a larger value of money with fewer notes.

The Reserve Bank of India Act, 1934 [hereinafter referred to as "RBI Act"] has been enacted inter-alia to regulate the issue of bank notes and keeping of reserves with a view to secure monetary stability in the country and generally to operate the currency and credit system of the country to its advantage. The RBI is the sole note issuing authority and has the obligation to exchange those notes when demanded except when, and to the extent, it is relieved of the obligation by the Central Government. The current article highlights the constitutional validity of demonetization in India.

Keywords: RBI, demonetization, law, section

Introduction

Hon'ble Prime Minister Sh. Narendra Modi has announced a war against black money and corruption. In an emboldened move, he declared that the 500 and 1000 Rupee notes will no longer be legal tender from midnight, 8th November 2016. The RBI will issue new currency of Rs. 500 and Rs. 2,000 notes which will be placed in circulation from 10th November 2016. Notes of 100, 50, 20, 10, 5, 2 and 1 Rupee will remain legal tender and will remain unfazed by this decision. This measure has been taken by the PM in an attempt to address the resolve against corruption, black money, terrorism and counterfeit notes. This move is expected to cleanse the formal economic system and discard black money at the same time.

One of the reasons that prompted the Government to demonetize Rs. 500 and Rs. 1000 notes is that their circulation was not in line with the Economic Growth. As per the Finance Ministry, during 2011-2016 periods, the circulation of all notes grew 40% but the circulation of Rs. 500 and Rs. 1000 notes went up by 76% and 109% respectively. Relatively speaking, the economy has grown only by 30% which is way below the money circulation.

Every bank note shall be a legal tender in payment or on account of the amount mentioned therein and shall be guaranteed by the Central Government^[1]. By notification in the Gazette of India, any series of bank notes of any denomination shall cease to be legal tender from a date and in a manner as specified in the said notification^[2].

Bank notes shall be of denomination values of different amount not exceeding Rs. 10000. The Central Government had withdrawn the legal character of bank notes of certain denomination values at least on two earlier occasions^[3].

In the year 1978, the Parliament avoid the menace of unaccounted money which had resulted not only in affecting the economy of the country but had also deprived the Public

Exchequer of its revenue to a great extent. The constitutional validity of the Demonetization Act was challenged before the Supreme Court of India^[4].

A Constitutional Bench comprising of 5 (five) Judges in *Jayantilal Ratanchand Shah vs. Reserve Bank of India & Others*^[5] upheld the constitutional validity of the Demonetization Act. The Preamble of the Demonetization Act makes it clear that where the availability of high denomination bank notes facilitate illicit transfer of money for financial transactions and which are harmful to the national economy or which serve illegal purposes, the Reserve Bank of India can demonetize high denomination bank notes in public interest. Thus, when the Constitutional Bench of the 5 Judges of the Supreme Court has upheld the constitutional validity of the Demonetization Act, this policy decision of the government can only be considered by another Constitutional Bench comprising of more than 5 Judges.

Decision of Demonetization is Arbitrary?

The present legal tender of Rs. 1000 and Rs. 500 was withdrawn on 8th November 2016 without bringing any specific legislation as was done earlier. This action of the government was challenged before the Supreme Court as well as various High Courts. The question that the legal tender character of bank notes can be withdrawn without bringing legislation is a debatable issue which can only be settled by judicial pronouncements. The scope of testing the decision to demonetize the current legal tender of bank notes is very limited.

The Supreme Court doesn't interfere in the policy making of the Government with respect to financial matters. Since it has come in public domain that the reasons for demonetization is to curb the illicit financial transactions which is affecting the economy including terrorist and naxal activities and to stop

¹ Section 26(1) of the RBI Act, 1934

² Section 26(2) of the RBI Act, 1934

³ Section 24 (1) of RBI Act, 1934

⁴ High Denomination of Bank Notes (Demonetization) Act, 1978

⁵ JT 1996 (7), 681 1996 SCALE (5)741

money laundering which is primarily done in high denomination notes. The growing menace of use of high denomination bank notes in betting, hawala transactions, corruption, black money, drug money will be significantly curtailed including circulation of fake currency notes ^[6] The reasons given by the Government are certainly reasonable and cogent one.

If the legal tender character of Rs. 500 and Rs. 1000 bank notes can be withdrawn without legislation, why did the government enact law on earlier occasion? The legality will certainly be examined by the Supreme Court/High Courts in the pending matters. Therefore, to avoid any legal lacuna, it would be appropriate for the government to bring legislation and justify its actions. The Government of India has been promoting electronic transactions which are cashless to achieve the goal of transparency in trade/dealing and include majority of the population within the tax net.

Due to large scale prevalence of cash transactions, the revenue collection of the government is significantly reduced. The World Bank in July, 2010, estimated the size of the shadow economy to be about 23% of the GDP in the year 2007. The shadow economy deprives the government of its legitimate revenues which the government could have used for welfare and development activities. It is expected that the decision of withdrawing legal tender character of Rs. 500 and Rs. 1000 bank notes will bring a significant change in all aspects in the country.

Judicial Approach on Demonetization

A PIL challenging the Government's decision on demonetization was heard in the Chief Justice's court. The court did not grant a stay on the government's notification. Court also of the view that it will not interfere with the economic policies of the government. However, it did take notice of the inconvenience caused to the common man and asked the government to, on the next hearing (on 24th or 26th Nov), apprise it of the measures taken by it to alleviate this inconvenience.

The Centre had submitted an affidavit last week on the demonetization move in the Supreme Court, saying it is an attempt to unearth black money stashed over the last seven decades. Attorney General Mukul Rohatgi said that the Centre had filed a reply in the Supreme Court in compliance with the top court's earlier order on the issue.

The Centre in its affidavit told the apex court that demonetization is a step to reduce ratio of cash transactions, adding the objective is to unearth illegal parallel economy.

Constitutional Validity of Demonetization in India

Legal Issues

- **No legislative mandate:** The present demonization was carried out without any law passed by legislature. In 1978 the government demonetized the notes through ordinance.
- **Misuse of RBI Act 1934:** Although Section 26 of RBI act allows Central government to demonetize any series of notes, it has been contended by petitioners that government the power cannot be exercised to declare all series of notes as no legal tender.
- **Violation of doctrine of legitimate expectation:** Govt. is frequently changing the rules. E.g. Deadline of currency

exchange was preponed to 25 November with a short duration notice despite of clearly stating the deadline of 30December earlier.

Constitutional Issues

- **Violates Article 300A:** Article 300A guarantees that no one can be deprived of his property without any authority of law. Demonetization lacks legislative mandate & restricts people in withdrawing money from banks.
- **Violates Right to Equality:** The demonetization notification discriminates between holder and non-holders of bank account.
 - **Violates Right to life:** Poor people are unable to earn their livelihood due to cash crunch.
- **Violates freedom of trade & occupation:** Freedom to trade & occupation have suffered after demonetization. Businesses of many small vendors and sellers are affected due to currency shortage.

The demonetization notification by the government took out 86% of the high denomination currency out of the economy. The move has come under the scrutiny of legal practitioners as explained below.

Legality of Demonetization through Notification

Section 26 of the Reserve Bank of India Act, 1934 has empowered the government, to declare "any series" of notes of any denomination to no longer be legal tender.

Petitioner's argument

- a) The government is not empowered to declare "all" series of notes to be illegal.
- b) The government has to issue an ordinance passed by competent legislation and not just a petition.
- c) Under the present demonetization exercise, there is no legal prohibition against accepting or tendering Rs 500 and Rs 1000 notes.

Right to Property and Legitimate expectation

The recent demonetization puts limits on withdrawal of cash from bank accounts and exchange of the notes. This is deemed a severe violation of the right to property protected under Article 300-A of the Constitution.

Rule of Law

Post Demonetization there have been daily changes in law, adhoc rules and provision introduced. This is seen as a blatant undermining of the rule of law in the constitution. Ethical questions on whether the government can go back on its promises (daily withdrawal of Rs 24000) have emerged.

The recent decision of the govt. to demonetize high denomination notes of Rs. 500 and Rs. 1000 have evoked mixed responses from different quarters-while some hail it as a revolutionary step, others have questioned the very legitimacy of it. This has raised the need to introspect the legal and constitutional issues raised.

Conclusion

As against the previous such exercises conducted which were through ordinances, this time the move has been brought only through a notification by the executive ^[7]. Act Section 26(2)

⁶ Section 26(2) of the RBI Act 1934

⁷ [Section 26(2)] of RBI Act 1934

allows the govt. to declare 'any series' of notes as illegal. A narrow interpretation has been made that the word 'any' cannot be inferred as 'all' and consequently, the entire denomination cannot be withdrawn. However, the General Clauses Act and various Court judgments have asserted the fact that 'any' can also mean 'all', unless specifically excluded by the Act.

The questions raised against the exercise are whether it contravenes the right to equality(Article 14), right to freedom of speech, trade etc(Article 19), right to protection of life (Article 19) and a legal right 'right to property'(Article 300-A) of the constitution.

The claims of the incompetence of executive for such ordinance without approval of parliament are untenable as Article 73 gives the powers to executive to regulate matters accorded in "7th Schedule" and in case where Parliament has not passed a pertinent law it gives a free hand to the Union.

Also section 26(2) of the RBI Act grants Union, ancillary powers to enable it to carry the demonetization smoothly. It too has been held that regulating the use of Property does not itself contravenes the right to property itself.

At the end it can be said that though the act of demonetization is arbitrary but done with peculiar purpose to curb the corruption and black money from the society, which require the secrecy, prior disclosure or making law on demonetization or discussion in the parliament would have defeated the purpose of demonetization.

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