ROLE OF RBI IN DEMONETISATION: SOCIO-LEGAL ISSUES

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Abstract: This research paper analyzes the role of the Reserve Bank of India (RBI) in the 2016 demonetization drive and its socio-legal implications. The paper explores the concept of demonetization and its history, the rationale behind the Indian government's decision to demonetize high-value currency notes, and the role played by the RBI in the entire process. This study sheds light on the importance of the RBI as the central bank of India and its core responsibility to maintain the stability of the country's monetary and financial system. The study evaluates the legal framework surrounding demonetization, including the laws and regulations related to the circulation, exchange, and withdrawal of currency notes. Further, the paper examines the socio-legal impact of demonetization. The paper concludes that demonetization was a massive policy experiment with mixed results.

Index Terms - Demonetisation, 2016 Demonetisation, Reserve Bank of India, Currency Regulation, Legality of Demonetisation.

I. Introduction

On November 8, 2016, our Honourable Prime Minister Shri Narendra Modi announced that all 500 and 1,000 Mahatma Gandhi Series banknotes would no longer be legal tender. The main reason was that the action would put an end to the "shadow economy" and stop people from using illegal or fake cash to pay for illegal activities like terrorism. The decision was a big one because, according to RBI estimates, there were 16.5 billion 500-rupee notes and 6.7 billion 1000-rupee notes floating around in the economy, and the costs of printing them cannot be ignored. But the government expected to collect a lot more black money than that, since almost 86% of the cash was in notes of Rs.500 and 1000.¹

At first, the Reserve Bank of India gave people until 30 December 2016 (fifty days) to put the devalued banknotes in their bank accounts as credit. The banknotes could also be traded in at bank branches, up to a certain limit that changed from day to day. RBI had a lot of problems, but one of the biggest ones was that

¹ Amartya Lahiri, The Great Indian Demonetization, JOURNAL OF ECONOMIC PERSPECTIVES, Volume 34, Number 1, Winter 2020, Pages 55–74.
the ATMs needed to be re-calibrated because the sizes of the new notes didn't work with the old calibration. Finance Minister Arun Jaitley said that ATMs had not been calibrated before it was announced that Rs 500 and Rs 1,000 notes would no longer be legal tender. This was done to keep the news secret. "It's a big job that will take time to do." ATMs had to be re-calibrated, which was a complicated process that required a lot of coordination between banks, ATM manufacturers, the National Payment Corporation of India (NPCI), Switch Operators, and other groups. It decided to set up a Task Force under the leadership of Shri S. S. Mundra, Deputy Governor of the Reserve Bank of India, in order to give direction and advice in this area. After it was announced that Rs 500 and Rs 1000 banknotes would no longer be legal tender as of midnight on November 8, 2016, the Reserve Bank of India made plans for these notes to be exchanged or deposited at the counters of the Reserve Bank, commercial banks, Regional Rural banks, and Urban Cooperative Banks\(^2\).

**Review of Literature**

- Mandeep Kour Bansal in an article namely “Role of Reserve Bank of India in Indian Economy”, stated that the Reserve Bank of India is India's central bank. It has a number of different jobs to do. It does important things with money, like issue currency notes and make sure the country's money is stable. The Reserve Bank of India used to be a private company that was taken over by the government in 1949. The Central Board of Directors, which was chosen by the Government of India, runs its business. Since the beginning, the Reserve Bank of India has been an important part of the country's economic growth and monetary stability. This paper tries to find out what the role, functions, and contributions of RBI are to the Indian economy\(^3\).

- Sandeep Kaur (2016) in paper "Demonetization and its impacts in India”. Both the good and the bad effects of demonetisation were highlighted. According to the research, the value of real estate fell since the volume of cash transactions in the market dropped during the demonetisation era. The demand for consumer durables, luxury items, stones, and jewellery all decreased as the need for digital payment systems rose dramatically. From an equity market standpoint, the author believes that the banking and infrastructure sectors will benefit tremendously from demonetisation in the medium to long term. The analysis concluded that the government's move to demonetize had negative repercussions on the economy in the short term. But in the end, it would prove fruitful\(^4\).

- Dr. Pratap and Virender Singh in their Research paper “Impact of Demonetisation on Indian Economy” discussed that Demonetization means the RBI has revoked Rs 500 and Rs 1000 notes as legal tender. Demonetization removes a currency's legal tender status. India had Rs. 17.77 lakh crore (US$260 billion) in circulation on Oct. 28, 2016. According to the Reserve Bank of India's annual report for 31

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\(^3\) Mandeep Kour Bansal, “Role of Reserve Bank of India in Indian Economy”, INTERNATIONAL JOURNAL OF BUSINESS ADMINISTRATION AND MANAGEMENT, ISSN 2278-3660 Volume 7, Number 1 (2017).

March 2016, total bank notes in circulation were worth Rs.16.42 lakh crore (US$240 billion), of which 86% (or Rs.14.18 lakh crore (US$210 billion)) were 500 and 1000 rupee notes. 24% (2,203 crore) of the total 9,026.6 crore banknotes were in circulation, according to the report\(^5\).

- Vijay Kumar Gupta and Dr. Ajay Kumar in their article namely “Five Years Of Demonetization In India: What Has Changed In The Economy” Illustrated that Demonetization means that a country takes back its legal money. Demonetization has occurred in India, Ghana, Nigeria, Australia, the Soviet Union, and Pakistan. 8 November 2016 demonetization occurred in India. Demonetization reduces black money, phoney currency, and corruption. Demonetization affects several parts of the Indian economy positively and negatively\(^6\).

- R. Venkatesh and P. Sathiya Priya in their Research paper namely “Impact of Demonetization on Retail Outlets – An Analytical Study” , authors illustrated that Demonetization removes a currency's legal tender status. It's also called removing currency from circulation. The government eliminated the use of the previous Rs 500 and Rs 1,000 notes from circulation. Prime Minister Narendra Modi's unusual action has affected e-commerce and consumers' online buying behaviour. Demonetization's impact on e-commerce must be studied. The study's major goal is to investigate and assess demonetization's influence on consumers' online shopping frequency and payment methods\(^7\).

**Statement of Problem**

While the financial consequences of demonetisation have received much attention, the legal concern surrounding it does not apparently attract much attention. There have been many legal challenges to demonetization, including the challenges before the Supreme Court. A gazette notification cancelling the legal tender status of a “Specified Bank Notes” in any denomination is within the governmental power as per Section 26(2) of the RBI Act, which may be issued at the recommendation of the RBI's central board. Case before the Supreme Court challenges the constitutionality of Section 26(2) of the RBI Act on the grounds of 'excessive delegation'.

The manner in which the demonetisation policy was implemented in actuality does not manifest an active and independent application of mind by the RBI, which it should have so applied in the capacity of currency regulator. RBI cannot be said to have discharged its functions as per law which requires it to render proper recommendations to the central government to implement the policy.

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\(^6\) Vijay Kumar Gupta and Dr. Ajay Kumar, “Five Years Of Demonetization In India: What Has Changed In The Economy”,ACADEMIC SOCIAL RESEARCH, ISSN No. 2456-2645, Vol.-7, No.-1(2021).

Objectives
1. To study the concept and identify various reasons of demonetisation.
2. To study both the positive and negative effect of demonetisation.
3. To study and analyse the socio-legal-economic implications of demonetisation.
4. To evaluate the role of RBI in the implementation of demonetization.
5. To understand the constitutionality of demonetisation.

Questions identified for research:
1. What is the purpose and policy behind demonetisation?
2. What is the process of implementation of demonetisation?
3. What are the affirmative and negative implications of demonetisation.
4. Socio legal economic implications of demonetisation have been a cause of concern since its implementation. What are these implications?
5. RBI acts in the capacity of currency regulator. What is its role in execution of policy of demonetisation?
6. Constitutionality of any law or policy decision is checked by testing whether these are in line with the constitutional provisions. Is the policy decision to demonetise the specified bank notes of specified denominations constitutional?

Hypothesis
Government has the power to cease any series of the denomination as legal tender according to the RBI act 1934. Thus, this act of government affect society at large as it has various socio-legal-economic consequences to it.

Research Methodology:
Data collection: The secondary data was collected from RBI Portal, RBI ACT, 1934 and various internet resources including articles, journals etc. This study is Descriptive and Qualitative.

II. UNDERSTANDING THE CONCEPT

2.1 Demonetisation
The process by which a country's economic unit of exchange loses its ability to be used as legal tender is known as demonetization. Terminated currencies are no longer regarded as exchanges by law and have no market value. Demonetisation is the process by which nations decide to reintroduce obsolete currencies as acceptable forms of payment.

According to the definition of demonetization, demonetisation is the process of removing a monetary unit’s legal acceptance status. Every time the official currency is changed, it occurs. The circulated forms...
of money are removed, and new money is introduced in their place. On occasion, a country will completely replace its outdated currency with a newer one.

2.2 Legal Tender

Legal tender is anything that the law recognises as a way to pay off a public or private debt or fulfil a financial obligation. This includes tax payments, contracts, legal fines or damages, and so on. Almost every country accepts the national currency as payment. A creditor is required by law to take legal tender to pay off a debt.

The coins minted by the Indian government under Section 6 of The Coinage Act, 2011, are legal tender in payment or on account if they are not damaged and have not lost weight. Any one-rupee coin is lawful currency for up to 1,000 rupees. Half-rupee coins are legal currency up to ten rupees. While anyone cannot be forced to accept coins beyond the limits mentioned above, voluntarily accepting coins for amounts exceeding the limits mentioned above is not prohibited.

2.2.1 Forms of Legal tender in India

Every banknote issued by the Reserve Bank of India (2, 5, 10, 20, 50, 100, 200, 500), unless it has been taken out of circulation, is legal tender anywhere in India for the amount written on it and is backed by the Central Government, as long as it doesn't violate Section 26(2) of the RBI Act of 1934. ₹1 notes issued by Government of India are also Legal Tender. The 500 and 1000 banknotes from the Mahatma Gandhi series that were printed up to November 8, 2016, are no longer legal tender as of November 8, 2016, at midnight.

The printing of banknotes worth 2 and 5 Rupees has stopped, and these amounts have been turned into coins. This is because the cost of printing and maintaining these banknotes was too high for how long they would last.

2.3 History of the Legal Tender in India

India is a relatively new country compared to the rest of the world. It got its independence in 1947, which is not that long ago. Before the Indian National Rupee, the British government was in charge of the currency. Before the British took over, silver was the most common way for people to trade with each other. In fact, rupee comes from the Sanskrit word for a silver coin. In 1861, when the British government passed the Paper Currency Act of 1861, the exchange rate changed. Before 1861, only the Bank of Bengal, the Bank of Madras, and the Bank of Bombay had the right to make notes in India. In circulation, 50 million

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11 Ibid.
rupees were held by these three private banks. By the middle of the 1840s, most people started to think that the government, not private institutions, should be in charge of the currency. In 1860, an act was launched stating that the government would possess a monopoly and would issue new notes in different denominations to meet financial obligations for all. In 1867, the Victoria series of bank notes came out with a picture of Queen Victoria on them. The Reserve Bank of India (RBI) was established in the year 1935. The RBI took over the job of making bank notes. In 1950, when India became a Republic, it made its first paper money since getting its independence. The Lion Capital of Ashoka became the sign for money. In 1996, the RBI finally said that the Mahatma Gandhi Series would be a legal form of payment in the country. Since 1996, the form of money has not changed and has stayed the same.

III. POLICY OF DEMONETISATION

3.1 Analysis and implementation of Demonetisation in India

This plan to get rid of old currency started on November 9, 2016, and ended on December 30, 2016. The period of demonetisation was dark because it made the lack of cash last longer, which hurt the economy and slowed down economic output. After midnight, the prime minister said that the 500 and 1000 rupee notes were no longer valid and that they would be replaced with new notes that could be exchanged until December 30, 2016. The day after the announcement, the BSE SENSEX and NIFTY 50 stock indices fell by more than 6%, which caused severe shortages and bad effects across the economy. After demonetisation, economists thought that the GDP growth for the whole year would be 7.1%, which was less than the 8% growth of the previous year. In April–June 2017, the growth rate of GDP dropped from 7.9% to 5.7%. In the same time period the year before, the growth rate was 7.9%. This drop in GDP was the lowest since 2014, and it was thought to be because of the demonetisation. So, India lost the title of fastest-growing economy to China in March 2016, when China's GDP grew by 6.1%.

Demonetization was implemented poorly, causing widespread inconvenience. Most problems arose from the poor implementation. The majority of the public applauded the change, expecting it would provide more openness to the system and aid with wealth distribution by limiting illegal currency hoarding. However, the challenges faced by the people were tremendously disruptive and could not be ignored. To keep the exercise covert, not enough new cash was issued for the turmoil. To ease cash shortages, banks limited cash withdrawals. Small denomination notes were scarce, and the new Re 2000 notes were incompatible with older ATMs. Poor and elderly people stood in lines all day despite not hoarding illicit money. Several elderly died in lines to alter old notes. There was a shortage of cash at banks and ATMs. Initial weeks saw major deflation. While the underprivileged spent nights in ATM lines, black money hoarders invested in gold, property, shares, and offshore accounts.

14 Ibid.
15 Yugantar singh and sara Ruhela, A Study On The Objective And Implementation Of Demonetisation, GLOBAL JOURNAL FOR RESEARCH ANALYSIS, Vol-6, Issue-12, Dec2017, ISSN No 2277-8160.
3.2 Reasons Behind Demonetisation

The decision to implement demonetisation in 2016 was made by the government in discussions with the RBI in order to address the following issues:

- **Black Money**: Black money can come in many different forms, such as cash, investments in property and real estate, luxury goods like jewellery, or through private financiers and foreign currency traders. The goal was to let people know about black cash so that it would stop being a secret and be accepted by most people. Also, once this kind of money is out in the world, it can't be invested in a sneaky way because doing so would mean paying a lot of taxes. Because illegal currency is so common in the world today, the government is losing real tax money that could be used to improve social services.

- **Counterfeit Currency**: Counterfeit currency, also known as fake currency, was a significant problem that was encouraged by our international rivals with the intention of weakening the economy of India. The counterfeit was rendered useless once the old currency was removed from circulation. It is also unable to deposit it in any of the banks\(^\text{17}\).

- **Terrorist Financing**: The majority of the terrorist financing for nefarious actions in Jammu and Kashmir as well as maoist and naxalite activities in the central area was carried out with cash. After the currency was demonetized, the money that these groups had been hoarding would become worthless and they would no longer be able to use it for their illegal activities.

- **Corruption**: Bribery in public life, the practise of receiving an improper payment in exchange for legitimate assistance, is almost always conducted in cash. When there is no longer a source of revenue, corrupt practises like these will cease to exist automatically. Also, the cash that these individuals keep is rendered useless, and if it is deposited in a bank, the currency loses its anonymity, and the individual may be required to pay taxes on the amount that was deposited\(^\text{18}\).

- **Digitization and Formalization of the Economy**: A significant portion of the Indian economy was still being operated on the cash system, which does not get caught by the tax department because it does not leave any trace. However, these transactions are now being digitised and made more official. Because of this, the government has been considering ways to encourage the formalisation and digitisation of the economy through the use of online transactions, electronic wallets, and a variety of payment instruments such as PayTM, Rupay cards, and the BHIM app for payments. The fact that these instruments are able to record all aspects of economic activity is one of their many attractive features. It would boost revenue collection while also reducing tax evasion. Additionally, the level of currency that is now in circulation was intended to be decreased from around 12 percent to 9 percent, which is a more sustainable level.


It is said that the government also hoped that a portion of the currency that was demonetised would not return to the banking system. In such a condition, the Reserve Bank of India (RBI) would have to give dividend to the government of an equivalent amount as its liability to that extent would cease, and such an amount may be used by the government for purposes related to social welfare.  

3.3 Advantages and Disadvantages of Demonetization

Advantages:
- Reducing fraudulent activity: The country's fraud has decreased the most since the country's currency was demonetised. People with black money would fear prosecution for these crimes during the process, hoarding cash for exchange with banks because they couldn't exchange black money with banks. Consequently, it is a great way to combat terrorism or other crimes involving currency fraud.
- Modern investment system: The banking system will significantly improve as a result of demonetisation. In the long run, better access to credit in the economic system is made possible by the economy's shift away from cash. The remaining white money will be handled by the government. Therefore, banks and other financial institutions can use the recently legalised money to grant loans to deserving borrowers and help the banks generate interest.
- Decreased liability: Handling liquid cash can be handled with fewer risks if demonetisation is permitted. In the event that anyone decides to turn in their income, the value of all notes currently in circulation would be lost. Because of this, it is much simpler for the government to manage the nation's economy in the form of demonetization.
- Reduced instances of tax evasion: If successfully implemented, the sudden, severe movement can significantly lower tax avoidance. The Indian economy can benefit greatly from tax avoidance. The government may be able to implement public welfare measures thanks to the increased flow of taxes.
- GDP growth: Greater tax revenue collection allows for the possibility of lowering bank loan interest rates; as a result, reducing tax evasion can inject clean money into the currency system and raise the economy's disposable income.

Disadvantages:
- Demonetisation is inconvenient for citizens: If the government removes some currencies from circulation but keeps others, it can be confusing. When smaller coins are removed from circulation and banks fail to give minor changes, depositing or exchanging currency at most institutions can be inconvenient.
- Standstill in Economic Growth: For at least some time after the implementation of the demonetisation process, business interruptions and other such problems might halt economic progress in a country.
- Bill-paying problems and trading disruptions: Suppose someone sent current banknotes via mail before demonetisation and experienced a delay; this can lead the bill to lose its value after the

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19 Ibid.
implementation of the new currency. The bureaucratic implementation system could cause trading disruptions. This process may disrupt routine trading because suppliers and traders need time to adjust to the new transfer and exchange system.

- The government must remoldy ATMs to give customers the new money. It will cost banks and bother bank customers.
- If the newly adopted currency system fails, the poor will face a short-term economic disaster. Minute adjustments in ordinary things or confusion regarding money legality can cause hardships and distress among disadvantaged populations.

3.4 What concerns or negative effects does demonetisation raise?

- **Poor Planning:**
  The high-value notes account for 87.5% of the value of the currency at the time of demonetisation, which is a significant proportion of the cash in circulation. Therefore, before the demonetisation exercise began, the same amount of cash should have been created and prepared for circulation in the economy. However, India proceeded with demonetisation without doing so, which had serious consequences.

- **Effects on the Economy:**
  Many people have lost their employment because consumers simply ran out of money and were unable to make payments, which in turn hindered economic activity and disrupted supply chains, especially in the informal economy. Approximately 50 lakh individuals have lost their jobs after demonetization was introduced in November 2016, according to analysis by Azim Premji University. In terms of gross domestic product, several businesses shut down during Demonetisation since consumer demand dropped. This is what caused a drop from September 2016’s 7.5% growth rate to June 2017’s 5.7% growth rate in the country. This means that the demonetisation has reduced India’s GDP by 1.5%.

- **Shortage of Cash Among Indians**
  The Indian Government seemed unprepared, and most Indians had trouble getting cash for daily requirements. Rural locations most affected by lack of digital transactions and internet access. In urban India, consumers switched from paying cash to making online payments using debit/credit cards and Apps like PayTM and Mobikwik.

Most Indians didn't have bank accounts or internet, thus they didn't use plastic or digital wallets. Most people feared digital theft and avoided debit cards and smartphone apps. Long, never-ending lines of patient and angry Indians formed outside bank branches. Most Indians were patient and supported demonetisation to eliminate black money.

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21 Ibid.
23 Ibid.
IV. ROLE OF RBI IN IMPLEMENTATION OF DEMONETISATION

4.1 RBI

Reserve Bank of India (RBI) is the central bank of India. The RBI is responsible for a variety of tasks, such as administering monetary policy and issuing currency. India's gross domestic product (GDP) growth rates are among the highest in the world. It is also considered one of the four most strong developing market nations, together with Brazil, Russia, India, and China, which comprise the BRIC nations. The bank situated in India's financial hub, Mumbai, with assets worth $5.93 billion.

4.1.1 RBI - Issuer of Currency

The sole authority for issuing notes in the country is the Reserve Bank. It is tasked with designing, producing, and managing the country's currency in conjunction with the Government of India in order to guarantee a sufficient supply of clean and authentic notes.

The Reserve Bank receives coins from the Government of India, which also issues coins on demand. Coins are released into circulation on behalf of the Central Government by the Reserve Bank. RBI constantly strive to improve the integrity of banknotes through new design and security features in collaboration with the Government of India in order to maintain trust in the currency.

4.2 Relevant provisions of the RBI Act

The status of bank notes issued by the RBI as legitimate forms of payment is guaranteed under Section 26(1) of the RBI Act. In addition, the Act's Section 26(2) gives the Central Government the authority to declare a bank note to be invalid as a form of legal tender through the use of a notification. This authority is granted on the suggestion of the Central Board of the RBI. This announcement that notes will no longer be accepted as lawful money can be contingent on meeting specified requirements. The present plan for the demonetization of currency was first announced by the Central Government under this particular area.

Section 39 of the RBI Act is another important provision since it mandates that the RBI must fulfil its statutory commitment to exchange currency notes and coins. According to the provisions of subsection (1), the RBI is required to, upon request, convert any notes provided to it for rupee coins and vice versa. In addition, subsection (2) mandates that the RBI must, when given a bank note, trade it in for coins or notes of a denomination that is lower than the one it was given in exchange.

As an illustration, the Reserve Bank of India (RBI) is required to provide 2,000 one-rupee coins to a customer who walks in with a note for 2,000 rupees and asks for change in the form of coins of the same denomination.

27 Section 26, Reserve Bank of India Act.
29 Section 39, Reserve Bank of India Act.
denomination. The RBI has no choice but to comply with your request. It is an express statutory obligation that has been placed on the bank by the RBI Act, and it cannot be cancelled except by the passage of another piece of legislation.

4.3 RBI Role in Implementation of Demonetisation

According to RBI estimates, there were 16.5 billion of 500- and 6.7 billion of 1,000-denominated notes in circulation, and the whole cost of producing them had already been taken care of. Nearly 86% of the cash was in the notes of Rs. 500 and 1000, but the amount the government was expecting to receive from black money was undoubtedly far more than that. The demonetised banknotes had to be deposited as credit in bank accounts by the 30th of December 2016, which was the original deadline set by the Reserve Bank of India. There was a daily maximum amount that may be exchanged for bills at a bank's counter, but the limit was usually much lower. From November 8-13, the cap was established at 4,000. From November 14-17, this restriction was raised to 4,500 per individual. From November 18th, the limit dropped to 2,000 per person. On November 25, 2016, the banking system unexpectedly ceased all currency transactions. From the information at hand, it is clear that RBI revised their regulations multiple times throughout the course of this whole operation.

The RBI has a significant problem on its hands because the sizes of the new notes were not compatible with the previous notes and the ATMs needed to be recalibrated. The secretive decision to demonetize the Rs 500 and Rs 1,000 notes meant that, according to Finance Minister Arun Jaitley, the ATMs were not calibrated before the announcement. Since, there were so many parties involved in the re-calibration of ATMs (banks, ATM makers, National Payment Corporation of India (NPCI), Switch Operators, etc.), extensive coordination was essential. The Reserve Bank of India's Deputy Governor, Shri S. S. Mundra, was tasked with leading the Task Force, he established to provide such direction and advice. As a follow-up to their announcement that Rs. 500 and Rs. 1000 banknotes would no longer be legal tender as of midnight on November 8, 2016, the Reserve Bank of India also made arrangements for the exchange and/or deposit of such notes at the Reserve Bank and commercial banks, Regional Rural banks, and Urban Cooperative Banks' counters.

Almost all of the demonetised currency has been deposited into banks, with a total of 14.97 trillion ($220 billion) having been received by banks as of December 30. This is in contrast to the government's original prediction, which predicted that just 1 trillion rupees would be returned to the banking system. As of 10 January 2017, two months after the demonetization, Rs. 9.2 trillion in the form of 500 and 2000 bank notes of the Mahatma Gandhi New Series had been re-circulated. This was down from the 15.4 trillion that had been demonetised in the form of 500 and 1000 bank notes of the Mahatma Gandhi Series.

By what authority did the government ban the legitimate currency?

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31 Ibid.
These authorizations come from Section 26 (2) of the RBI Act: The Central Government may, on the recommendation of the Central Board, declare, by notification in the Gazette of India, that any series of bank notes of any denomination shall cease to be legal tender [except at such office or agency of the Bank and to such extent as may be specified in the notification] as of a date specified in the notification33.

4.4 The Reserve Bank of India's Preparedness

On November 8, 2016, Modi demonetized 500 and 1,000 rupee bills. The Board of the Reserve Bank of India met earlier that evening to review a letter from the Ministry of Finance and a document from a deputy governor urging demonetization. The government letter gave two grounds for the proposal: (1) Between 2011 and 2016, 500- and 1,000-rupee notes grew by 76 and 108 percent, while India's economy grew by 30 percent; (2) currency encouraged "black money." The board was told the action will help boost financial inclusivity and economic digitisation.

The board approved the motion but made some pointed remarks. It highlighted that the proposal may not affect black money because most people don't have undeclared cash. It worried about short-term growth impacts. The most damaging observation was that the government's main claim, that 500- and 1,000-rupee bills had outpaced economic development, was inaccurate. The board criticised the government for comparing actual GDP growth to nominal currency supply growth. In actuality, nominal GDP growth was above 80% between 2011 and 2016, matching the rise of the demonetized bills34.

The minutes reveal the board was informed that the RBI and the government had discussed demonetization for the previous six months. Raghuram Rajan, whose term ended on August 31, 2016, confirmed this. He stated the RBI has counselled against demonetization (as reported in Hindu Business Line 2018).

The Reserve Bank of India's readiness for this large operation became clear almost immediately as ATMs ran out of cash across the country, including in major cities. When ATMs received fresh money, most of it was in 2,000-rupee notes, which was inconvenient for daily transactions with lesser cash values. Remonetizing the economy with new currency notes was slow and disruptive to business35.

Multiple circulars published by the Reserve Bank of India following the original demonetization notifications raised concerns about its preparation. Between November 9 and December 31, 2016, the RBI issued 57 formal circulars amending the criteria for demonetized currency deposits, withdrawals, and exchanges. Over-the-counter demonetized money exchange was limited to 4,000 rupees each day. This daily limit was raised to 4,500 rupees, then lowered to 2,000 rupees, and ultimately eliminated on November 24. Over-the-counter bank withdrawals were initially capped at 10,000 rupees per day and 20,000 rupees per week. The weekly limit was raised to 24,000 rupees and the over-the-counter limit was removed. Initially, ATM withdrawals were limited to 2,000 rupees per card per day, then 2,500, and eventually 4,000.

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33 Section 26, Reserve Bank of India Act, 1934.
Deposit rules were also frequently updated. Initially, there was no cap on account credits for clients with current Know-Your-Customer or KYC documents. Non-KYC account holders could deposit 50,000 demonetized rupees. The Reserve Bank of India declared on November 16, 2016 that any cash deposits over 50,000 rupees were to be accompanied by a copy of the taxpayer identification card number (PAN card).

The sluggish stocking of ATMs with new cash, the flurry of amended notifications, the restricted quantity of new 500-rupee bills, and the excess of new 2,000-rupee bills, which were less useful for transactions, revealed that the organisation tasked with executing the policy was unprepared. The RBI was forced to implement the policy as best it could36.

V. SOCIO ECONOMIC IMPACTS AND LEGAL ISSUES OF DEMONETISATION

5.1 The RBI and the Economy of India

As in every economy, the central bank is in charge of and keeps an eye on the monetary policies that affect both business and personal finances as well as the banking system.

The bank demonetized the Indian rupee (INR) in 2016, taking out of circulation Rs. 500 and Rs. 1000 notes. The move was made to stop fake money, hoarding, and things related to terrorism. Another big reason was to stop people from not paying taxes in a country where only 1% of people paid income taxes in 2013.

The analysis that came after this decision shows that there were both wins and losses. The demonetization of the listed currencies led to a lack of cash and chaos, and the RBI had to spend more money to print more money. On the other hand, more consumer reporting transparency led to more tax money being collected.

The central bank also has to deal with an inflation rate that changes a little bit. The RBI Act of 1934 says that the bank and the federal government must work together to set a good inflation target. As of April 2021, the RBI said that the target rate was 4%, with a high of 6% and a low of around 2%. This goal will stay the same from April 1, 2021, to March 31, 2026, a span of five years37.

5.2 Demonetisation cost for RBI

When demonetisation was announced, the Reserve Bank of India (RBI) and the printing machines were not ready to replace the quantity of recalled currency notes. The currency-making machines had to put in extra hours so that the objectives could be met. The Reserve Bank of India (RBI) remonetised the Indian money market after demonetisation, at a cost of over Rs 13,000 crore over the subsequent two years. New 500 and

36 Ibid.
2,000 rupee (Rs) notes have been released. Due to upgraded functionality, printing has become more expensive.

The Reserve Bank of India estimated that it cost Rs 7,965 crore in 2016-17 to print new notes in both the existing and new denominations. In 2017–18, it cost Rs 4,912 crore to issue currency. It took a long time and a lot of money to print new notes after the demonetization. The Reserve Bank of India (RBI) spent Rs 3,421 crore on currency note printing in the fiscal year, 2015-16.

The RBI's profit was affected by the government decision because of the large cost of issuing new currency notes. The RBI gave the government a total of Rs 65,876 crore (about $9.5 billion) in surplus funds in the 2015-16 fiscal year. In contrast, dividends fell by more than half after demonetisation was implemented in 2016–17. Reserve Bank of India shareholders received a dividend of Rs 30,659 billion. It rose again in 2016–17, but it was still lower than the peak year of 2015–16. It appears that the biggest risk to the RBI's income comes from the recent demonetisation.

5.3 Modernizing Bank Systems and Demonetisation

Additional difficulties have been thrown upon Banks as a result of demonetization. Both near-term and far-sighted perspectives contributed to the outcomes. Short-term, it caused chaos and added more pressure to manage banking services, but long-term, it enabled banks pool deposits at no extra expense. Take a look at these four ways that demonetization has affected banks.

Increased Deposits: Deposits in banks have surged as a result of the demonetization policy. The size of deposits has grown as a result of the influx of untraceable cash in the form of Rs.500 and Rs.1000. The banks were able to grow their deposits as a result of this.

Fall in cost of funds: the price of funds has decreased because deposit levels have risen. This factor contributed to banks maintaining a sizable portion of customer deposits in the form of cash. There has been a significant decrease in the cost of funding for PSU banks because of the increase in deposits that they receive.

Demand for Government Bonds: Government Bonds Are in High Demand Since the Demonetization, Banks Have Been Lending Excess Deposits to the RBI Using Reverse Repurchase Agreements In instance, PSU Banks invested their surplus funds in government bonds. Bank profits could rise by 15% to 20% due to interest earned on bond investments.

Sluggish lending: even after demonetization and its effect on the growth in the amount of public deposit, banks are still growing their loan portfolios at a much slower rate. Banks have lowered their interest rates in an effort to lend to the group, but the fund has decreased over the past several months.

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39 Ibid.
40 Gurjit Singh, Demonetization and its effect on Banking Sector, INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS, Volume 5, Issue 4 December 2017.
41 Ibid.
5.4 Social Impact of Demonetisation

The information on the demonetization was suddenly made public, and the person who was most negatively impacted was the common man. The social impact was extremely significant, as a result of which marriages were placed in a precarious position, and cash transactions within marriages came to a complete halt. People who are performing marriages are required to provide the invitation to the marriage in order to withdraw 2,50,000 or more. This has resulted in a significant amount of inconvenience for the general people.

The majority of hospitals refused to accept the previous currency, which had a significant and negative influence on the health care industry. In Bengaluru, the problem arose for Union Minister Mr. Sidharamaiah when the hospital administration refused to take the old cash in order to recover the body of his brother, who had passed away. The average person had a difficult time making transactions in hospitals with older forms of currency, and a number of deaths have been recorded as a result of medical personnel failing to attend to patients because of the demonetization.

During the process of demonetization, long lineups ranging from approximately one to two kilometres in length were seen at a variety of localities. In other cases, the queues were even longer. Despite this, there was no guarantee that the person would get any money from either the automated teller machine or the bank. A few individuals got an early start on their trip to the bank by going there the previous evening. There was a substantial deficit in the amount of money that was available.

The common people have profited favourably from the demonetization in the sense that they are now using digital currency at a higher rate than they did previously. This is in comparison to the situation before the demonetization. Because of this, individuals do not need to move physical money to any locations, which contributes to the overall reduction in the rate of crime. There was a reduction in price across the board for the vast majority of the essential goods.

5.4.1 Impact on Social Development

The current experience of demonetization in India has exposed the country’s stark digital financial divide, which has had negative repercussions for the country’s social growth. There are millions of people rushing to deposit cash before the deadline, demonstrating that India still has a ways to go before it has a fully digitised financial economy. Despite the widespread availability of digital banking services, only a tiny fraction of the population has been able to get by without making frequent trips to the ATM or bank. Lower levels of digital financial literacy are to blame in part for this phenomenon. As a result, more people may become literate as they gain an understanding of how banks work, which is good for the economy as a whole.

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Demonetisation has the potential to have a profound impact on corrupt behaviours, which is one of its main advantages. That means no more smuggling, bribery, or aiding terrorists or naxalite movements. Because of the increased likelihood of detection and punishment, anyone in possession of black money will be in a difficult position. Class-I and Class-II government jobs in particular were awarded less on the basis of merit and more on the basis of economic and political connections. Young people nowadays have a better chance of realising their aspirations and gaining access to government positions on the basis of their merit. There could be significant shifts in Indian culture as a result of this position. The first is that people prefer investing to hoarding their cash, and the second is that this preference encourages the use of digital payment methods rather than cash. In the future, we might expect to see a shift away from a cash economy and toward a digital one.

5.5 Legality of Demonetisation

The legal questions were arises on the Reserve Bank of India Act, 1934. The RBI Act says that only the RBI can run the country's money and credit system. It gives the RBI the sole right to print banknotes\(^46\) and gives the central government and the RBI the power to decide whether or not to print banknotes\(^47\). The Finance Ministry's decision to stop accepting 500- and 1000-rupee notes on November 8, 2016 was based on the Reserve Bank of India Act, 1934, Section 26 sub-section (2). The section says that "on the recommendation of the central board of the RBI, the central government may, by notification in the Gazette of India, declare that any series of bank notes of any denomination shall cease to be legal tender with effect from a date specified in the notification."

Demonetization is not new; similar measures were implemented in 1946 and 1978 to deal with untraceable cash. Unlike the 2016 demonetization, which was enacted unilaterally, the demonetization that took place in 1946 and 1978 was the result of official ordinances. According to Article 300A of the Indian Constitution, the only way the government can take away someone's property is if they have legislated on it through an Ordinance or an Act of Parliament. During the 2016 demonetization, the issue emerged that the government's inability to enact an Ordinance extinguishing its obligation to the people, so unlawfully depriving the people of their property, violates Article 300A of the constitution\(^48\).

The 1946 and 1978 demonetizations were challenged on various grounds as being illegal. The policy was challenged in a number of petitions. Moreover, fundamental rights claimants filed PILs alleging that the policy violated their rights under international law. For this reason, the essay also delves into the legal means by which this Demonetization programme is being implemented, such as

- 1946: In 1946, the following three arguments were made against the Demonetization Ordinance. One issue is whether or not the RBI is required to exchange old notes for new ones. It was decided the

\(^{45}\) Ibid.
\(^{46}\) Section 22 of the Reserve Bank of India Act, 1934.
\(^{47}\) Section 24(2)) of the Reserve Bank of India Act, 1934.
same way in both the 1946 case of JM D'souza v. RBI\(^{49}\) and the 1952 case of Dominion of India v. Manindra Land and Building Corporation Ltd\(^{50}\). Second, it addressed Right to Property, a contentious issue at the time. The case B. Ramlal v. State\(^{51}\) made the ruling. And third, there were lawsuits brought to challenge the temporary nature of the Ordinance has been upheld in a number of court cases, most notably Sridhar Achari v. Emperor\(^{52}\) and Hansraj Moolji v. State of Bombay\(^{53}\).

- 1978: The President issued the High Denomination Bank Notes Ordinance\(^{54}\) in January 1978, however it was replaced by a new law in March of that same year. The case, Bimaldevi v. Union of India\(^{55}\), addressed the question of whether or not the RBI was obligated to exchange old currency for new. There were further challenges filed, such as Bimaldevi v. Union of India and Jayantilal Ratanchand Shah v. RBI\(^{56}\), that argued the Demonetization programme was a violation of Article 19(1)(f), Article 21, and Article 31.

- In 2016, the Ministry of Finance (MoF) Gazette Notification was one of several instruments used to promulgate Demonetization, along with two announcements issued by the Reserve Bank of India (RBI). A subsequent RTI\(^{57}\) also revealed that RBI's official consent wasn't taken before the Demonetization move.

In contrast to the previous two occasions—1946 and 1978—demonetization was carried out through the issuance of notifications (Notification Nos. So 3407 [e] and 3408 [e]) in accordance with Section 26(2) of the Reserve Bank of India Act, 1934. In accordance with this section, the central government may declare "any series" of notes of any denomination to be no longer legal tender after consulting with the Reserve Bank of India (rbi)\(^{58}\).

The constitutionality of the government's demonetisation move has gotten little attention. The question isn't the desirability or economic viability of the decision's public and national interest. Demonetizing 500 and 1,000 rupee notes by executive fiat seems unprecedented and raises questions about the Executive's ability and jurisdiction to do something the Legislature has not authorised.

There's another perspective. Article 300A declares, "No person's property can be taken without legal authority." A person's movable and immovable property cannot be taken except with the authority of law.

In Jayantilal Shah Vs RBI\(^{59}\), the Supreme Court upheld the High Denomination Bank Notes (Demonetisation) Act, 1978, saying that demonetisation resulted in extinguishing a public debt, which amounts to loss of property and hence may only be done by legislation.

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\(^{49}\) JM D'souza v. RBI, (1946) 48 BOMLR 365.

\(^{50}\) Dominion of India v. Manindra Land and Building Corporation Ltd, AIR 1954 Cal 174.

\(^{51}\) B. Ramlal v. State, AIR 1954 All 758.

\(^{52}\) Sridhar Achari v. Emperor, AIR 1948 All 182.


\(^{55}\) Bimaldevi v. Union of India, 1983 (4) DRJ 236.

\(^{56}\) Jayantilal Ratanchand Shah v. RBI, JT 1996 (7).


\(^{58}\) Alok Prasanna Kumar, Demonetisation and the Rule of law, ECONOMIC AND POLITICAL WEEKLY, VOL. 51, NO. 50 (DECEMBER 10, 2016), PP. 19-21.

\(^{59}\) Jayantilal Shah v. RBI, AIR 1997 SC 370.
It would appear that the Notification of November 8, 2016, falls completely outside of the legal parameters established by the Supreme Court. It is totally unconstitutional and violates every law in existence.

In addition, the restrictions placed on the withdrawal of legal cash by the Notification are wholly unsupported by the authority of the law in every respect. By any stretch of the imagination, Section 26(2) of the RBI Act does not provide the Executive the authority to restrict the rights of citizens to withdraw their own money from banks, which they have paid for with their own taxes. Therefore, it would appear that the Notification has no legal jurisdiction to place the limits it does on a person's right to withdraw money from a bank.\(^\text{60}\)

### 5.5.1 Demonetisation valid or not? (current scenario)

In 2016, the Central Government of India demonetized the Rs 500 and Rs 1000 notes. A Constitution Bench of the Supreme Court considering the petitions contesting this action. Constitution Bench had been listening to batch of 58 petitions in which considering the leading case i.e Vivek Narayan Sharma v. Union of India\(^\text{61}\) that disagree with the Union Government's decision to get rid of Rs 500 and Rs 1,000 notes in November 2016. The five-judge Bench, which is made up of Justices S. Abdul Nazeer, B.R. Gavai, A.S. Bopanna, V. Ramasubramanian, and B.V. Nagarathna, was considering, among other things, the legality of the November 8 circular that started the policy, which shocked the country six years ago\(^\text{62}\).

Legal issues have arisen in the matter are:

- Whether the issues have arisen in this matter regarding demonetisation are legal or academic issues?
- In 1978, demonetisation was done through a separate Act of the Parliament, which was not the case in 2016. So, the legal question of whether Sections 24 and 26 of the Reserve Bank of India Act can be used to get rid of currency notes is still very much alive. If the problem isn't solved, the government could do the same thing again.
- Whether the withdrawal of 86 percent of bank notes from circulation necessitates a separate law by the Parliament\(^\text{63}\)?

The constitutional bench of the Supreme Court in the case Vivek Narayan Sharma v. Union of India\(^\text{64}\) has rendered a ruling on the issue by majority of 4:1. According to the majority, the Central government notification dated November 8, 2016 is lawful and passes the proportionality test. Lone Justice Nagarathna gave her Dissent opinion.

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\(^{60}\) Demonetisation—Strictly, the PM didn’t go by the law, https://www.nationalheraldindia.com/news/demonetisationstrictly-the-pm-didnt-go-by-the-law

\(^{61}\) WRIT PETITION (CIVIL) NO.906 OF 2016 (supreme court case) (last visited June 1, 2023).


According to Justice BR Gavai, Demonetization, had a reasonable connection to the goals that were intended to be attained (such as ending black marketing and funding for terrorism). Whether or not the goal was accomplished is irrelevant.

Bench stated that just because the suggestion came from the Central Government did not mean that the decision-making process was flawed. In terms of economic policy, tremendous caution is required. The executive's wisdom cannot be replaced by the court's wisdom. The bench further ruled that the entire series of currency can be demonetized under Section 26(2) of the RBI Act, which gives the government the authority to do so for any series of bank notes of any denomination.

In Section 26(2) of the RBI Act, the word "any" cannot have a restrictive interpretation. The current trend is one of practical interpretation. Avoid interpretation that results in absurdity. When interpreting the Act, the purposes must be taken into account. The bench continued, noting that there are inbuilt-in safeguards, that Section 26(2) cannot be declared unconstitutional due to excessive delegation.

5.5.2 Dissenting opinion of Justice BV Nagarathna

In her dissenting opinion, Justice Nagarathna argued that the Centre could not demonetize the entire series of Rs. 500 and Rs. 1000 currency notes simply by making a gazette notification since it would cause widespread economic disruption. She stated that, while the measure's goals are noble, the law must find it to be unconstitutional (and not on the basis of objects).

"The central government's decision to demonetize all series of notes is a considerably more pressing matter than the bank's demonetization of select series. Therefore, legislation is needed to make the change."

The judge continued by saying that the RBI had merely agreed with the Centre's plan for demonetization rather than using its own discretion. "The RBI's records clearly show there was no independent application because they include the words "as desired by the Central Govt." The entire drill was finished in approximately 24 hours."

On the issue of the authority of the Central Government under Section 26(2) of the RBI Act, she also dissented from the majority opinion. She first ruled that "Any series" under Section 26(2) of the RBI Act cannot be interpreted as "all series." Section 26(2) states that it can only apply to a certain series of currency notes and not to all series of a given denomination.

She claimed that Section 26(2) required the central board of the RBI to make the proposal for demonetization. In addition, Justice Nagarathna ruled that the central government must exercise its authority to begin demonetisation by legislation or an ordinance drawn from Entry 36 of List I of the Constitution, which deals with money, coinage, legal tender, and foreign exchange. Demonetization proposal from the Central Government is not covered by Section 26(2) of the RBI Act. If confidentiality is required, it will be done so by legislation and an ordinance.
VI. CONCLUSION

The Reserve Bank of India is the most important financial institution in the Indian banking sector. It serves as the nerve centre for all of the financial and monetary operations in India. Since its inception, the Reserve Bank of India (RBI) has been responsible for directing, monitoring, administering, controlling, and promoting the predetermination of India’s monetary and financial system. The RBI reports are ambiguous on the question of whether or not demonetisation was successful. Nonetheless, it does highlight the fact that the overall amount of currency in circulation (CIC) dropped significantly after the demonetisation.

The poor and common people were the worst hit by demonetization. Cash deficit prevented salaried class from withdrawing salaries from banks and ATMs. Modi has supported mobile and electronic financial transactions. India is embracing a cashless economy. This leads reduce black money, but educating the public on mobile money transactions is difficult. As a relief to the poor, the GOI declared that black money recovered after demonetization will be placed for four years without interest on Kalyan Yojana to aid the underprivileged in marriage. Long-term, this will benefit the social sector.

The abrupt adoption of the policy led to confusion regarding the many different instructions and notifications that were issued. In addition to this, it cast a significant light on the unreadiness of the government. The fact that the government did not obtain RBI's formal clearance before the demonetization also disregards the respect that the legislative has for the autonomy of institutions such as RBI. There are several gaps in knowledge that require more investigation. The issue regarding the legality of the demonetisation had been challenged in the supreme court with a batch of 58 petitions and on January 2nd of 2023 the matter has been decided and bench by majority of 4:1 held that notification dated on 8th November of 2016 demonetizing the currency notes of Rs. 500 and 1000 is lawful and it passes the proportionality test.