

# **Supreme Court should Frame an Eleventh Question on Demonetisation\***

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The three judge bench of the Supreme Court headed by the Chief Justice has recorded ten questions to adjudicate on the basis of the petitions filed against the November 8, 2016 notification issued by the Ministry of Finance (Department of Economic Affairs), withdrawing the legal tender status of bank notes of Rs. 500 and Rs. 1000 denominations. The ten questions framed by the Supreme Court mostly pertain to the constitutional validity of the November 8 notification, especially with regard to Articles 14, 19 and 300A of the Constitution and also whether it is congruent with the provisions of the Reserve Bank of India Act, 1934.

One of the ten questions recorded by the Supreme Court bench reads: “What is the scope of judicial review in matters of fiscal/economic policy?” Appearing for the Central Government, the Attorney General has strongly argued that judicial review of the demonetisation scheme is “impermissible” since the courts cannot interfere with economic and fiscal policies of the Government. The Supreme Court had ruled in the BALCO Employees Union vs. Union of India and Ors. case (10.12.2001) that:

Wisdom and advisability of economic policies are ordinarily not amenable to judicial review unless it can be demonstrated that the policy is contrary to any statutory provision or the Constitution. In other words, it is not for the Courts to consider relative merits of different economic policies and consider whether a wiser or better one can be evolved. For testing the correctness of a policy, the appropriate forum is the Parliament and not the Courts.

**But does the demonetisation scheme declared through the November 8 notification qualify as a fiscal or economic policy?** This vital question merits the attention of the Supreme Court. Besides the ten questions that have already been recorded, this eleventh question can also be framed for adjudication.

## **Demonetisation: Fuzzy Objectives**

The cornerstone of an economic policy within a democratic set-up is that it should have clearly defined objectives and that there should be transparency in how the procedure of implementation can meet those policy objectives. A basic problem with the demonetisation scheme is that the objectives and procedures stated in the November 8 notification and those being cited in the subsequent period, through the affidavits filed by the Central Government in the Supreme Court as well as the pronouncements of the Prime Minister, Finance Ministry, the Reserve Bank of India and other senior functionaries, have not been the same.

The November 8 notification states the following as reasons behind the decision to withdraw the legal tender status of banknotes of Rs. 500 and Rs. 1000 denominations: (i) large circulation of fake currency notes of the specified denominations, (ii) use of high denomination bank notes for storage of unaccounted wealth and (iii) use of fake currency for subversive activities like drug trafficking and terrorism. Let us closely examine the economic rationale behind demonetisation on the basis of the arguments and data provided in this regard, by the Government’s own affidavit.

## No Alarming Proliferation of Fake Notes

The affidavit filed by the Central Government in the Supreme Court cites data from the study conducted by the Indian Statistical Institute in 2016, commissioned by the Ministry of Home Affairs. According to this study, the face value of FICN (Fake Indian Currency Notes) in circulation was found to be around Rs. 400 crore. This value has remained roughly constant for the 4 years, from 2011-12 to 2014-15. The face value of banknotes in circulation in March 2015, as per the RBI Annual Report, was Rs. 14.28 lakh crore. Hence the proportion of FICN in total currency was not more than 0.028%, i.e. 28 pieces out of 1 lakh pieces of banknotes.

To proscribe 1 lakh pieces of banknotes in order to nullify only 28 pieces of fake notes is an irrational and arbitrary course of action. No democratically governed country in the world resorts to such excesses. Such a small amount of fake notes could have been detected through greater vigilance or more importantly, if the Government could have succeeded in neutralising the original sources of such counterfeit currency.

Moreover, the data of FICNs actually detected, as provided by the RBI Annual Reports, does not show any secular rising trend, let alone a sharp rise (Table 1). While the number of fake Rs. 1000 currency notes has seen a minor increase, the number of counterfeit Rs. 500 currency notes detected has declined in the recent years.

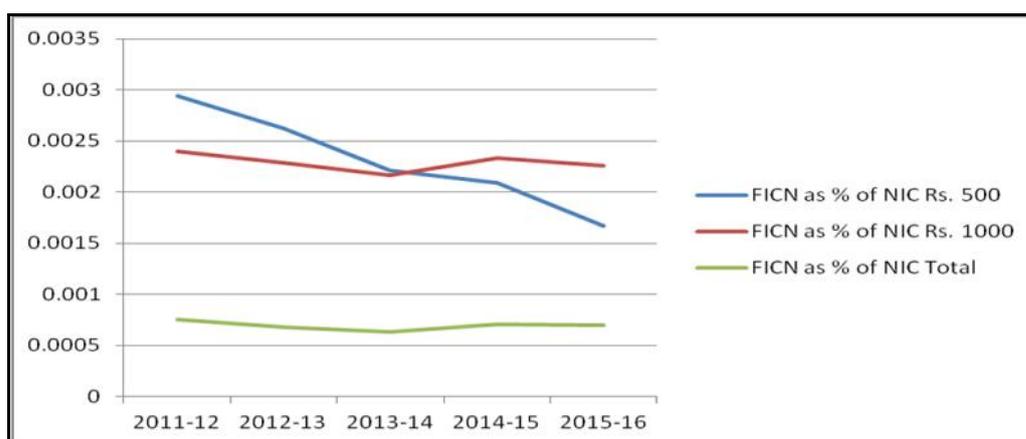
**Table 1: Number (Pieces) of FICN Detected**

YEAR	Number of Counterfeit Notes (FICN) (Pieces)		
	Rs. 500	Rs. 1000	Total
2011-12	301,678	83,280	521,155
2012-13	281,265	98,459	498,252
2013-14	252,269	110,035	488,273
2014-15	273,923	131,190	594,446
2015-16	261,695	143,099	632,926

Source: RBI Annual Reports

Detected counterfeit notes as a proportion of total currency in circulation has actually witnessed a decline, both for Rs 500 and Rs. 1000 denominations, between 2011 and 2016 (see chart below).

**Chart 1: FICN as % of Notes in Circulation (NIC)**



Source: RBI Annual Reports

Therefore, there is hardly any evidence of any alarming proliferation of fake currency in India, which can warrant the proscription of the entire denominations of Rs. 500 and Rs. 1000, which accounted for the face value of over 86% of currency in circulation.

### **Unaccounted Wealth in Cash Remains Undetected**

The exact mechanism through which the Central Government intends to recover unaccounted wealth (black money) through demonetisation of Rs. 500 and Rs. 1000 banknotes has remained fuzzy. The Revenue department's search and seizure statistics provided by the Government in its affidavit to the Supreme Court clearly show that total assets seized has ranged between 5.6% and 7.5% of admitted undisclosed income (black money) over the past four years (Table 2). Cash hoards of Rs. 500 and Rs. 1000 denominations would be an even smaller proportion of the total assets seized.

Thus, neither does the evidence point towards a significant proportion of unaccounted income/assets being hoarded in cash, nor does the data reflect any significant increase in the numbers of searches and seizures of undeclared assets in cash (or otherwise) under the present dispensation. Therefore, this cannot be considered as any basis for the demonetisation scheme.

**Table 2: Search and Seizure Statistics**

YEAR	Number of Groups Searched	Total Assets Seized (Rs. Crore)	Undisclosed Income Admitted u/s 132(4) of the Income Tax Act (Rs. Crore)	Proportion of Assets Seized to Undisclosed Income (%)
2012-13	422	575.08	10291.61	5.6
2013-14	569	807.84	10791.63	7.5
2014-15	545	761.7	10288.05	7.4
2015-16*	445	712.68	11066.24	6.4
*Provisional Figures				

Source: Department of Revenue, GoI Cited in Central Government's Affidavit to the Supreme Court

As per the information provided by the MoS, Finance in the Rajya Sabha (Answer to Unstarred Question Nos. 1533, 29.11.2016), the face value of Rs. 500 and Rs. 1000 notes proscribed on November 8 stood at around Rs. 15.44 lakh crore. Government spokespersons, most notably the chief economist of the State Bank of India, had provided estimates of not less than Rs. 2.5 to Rs. 3 lakh crore, which would not return to the banking system by December 30. They had contended that this unaccounted cash being held by unscrupulous persons, who would not exchange or deposit the cash for the fear of detection, would not return to the system and that this amount can then be considered as "extinguished liability" of the RBI, and transferred as dividend to the Government. Such estimates of a fiscal gain by the Government have been totally belied by subsequent events.

**RBI's latest press release (dated 13.12.2016) has reported that Rs. 12.44 lakh crore worth of old banknotes have already been returned to the RBI and currency chests as on December 10, 2016, which is over 80% of the face value of proscribed currency.** It is likely that almost the entire amount of proscribed currency would return to the system by the December 30 deadline. That is not to suggest that there was/is no unaccounted wealth being held in Rs. 500 or Rs. 1000 notes, but to point out that demonetisation was/is the clumsiest way of detecting it, given the myriad channels of money laundering that were/are available. **This totally shatters the Government's repeated assertions regarding the supposed need for "secrecy" before the demonetisation announcement.** Such secrecy, if at all it was maintained scrupulously as has been claimed, has utterly failed to checkmate the hoarders of unaccounted cash.

Moreover the RBI Governor has ruled out any possibility of any special dividend paid by the RBI to the Government. In the RBI press conference held on December 7, 2016 he said the following:

(Excerpts from edited transcript of Reserve Bank of India's Fifth Bi-Monthly Post Policy Conference Call with Media, December 07, 2016)

**"Supriya:** Governor Patel, there is a speculation about special dividend to be paid by RBI owing to extinguished current post demonetisation. What is your stance on this demand?

**Dr. Urjit R. Patel:** Actually, the withdrawal of legal tender characteristic status does not extinguish any of the RBI's balance sheet, and therefore there is no implication on the balance sheet as of now. So that question does not arise as of now.

**Supriya:** No question of a special dividend right now?

**Dr. Urjit R. Patel:** Not just by the withdrawal of legal tender character, no.

**David Keohane:** Can I ask when it would have a balance sheet effect? When will notes, for example, stop being exchangeable at RBI branches?

**Dr. Urjit R. Patel:** Even then they still carry the liability of the RBI as long as only the legal tender characteristic status is withdrawn.”

Thus, the liability of the RBI will not stand “extinguished” even if a certain amount of proscribed currency does not return to the system. Therefore, the estimates of “recovery” of black money through the demonetisation exercise stand invalidated. This is not surprising for any sane person within the economics profession, because the entire idea of revenue mobilisation through demonetisation was, to begin with, conceptually bizarre.

The 2012 Report of the Committee headed by Chairman, CBDT on “Measures to Tackle Black Money in India and Abroad”, which has formed the basis of most policy action against unaccounted wealth since then, had clearly spelt out its stand on demonetisation:

9.1 One common demand from the public is that high denomination currency notes, particularly Rs. 1,000 and Rs. 500, should be demonetized. In this connection, it is observed that demonetisation may not be a solution for tackling black money or economy, which is largely held in the form benami properties, bullion and jewellery, etc. Further, demonetisation will only increase the cost, as more currency notes may have to be printed for disbursing the same amount. It may also have an adverse impact on the banking system, mainly logistic issues, i.e. handling and cash transportation may become difficult and may also cause inconvenience to the general public as the disbursal or payments of wages/salaries to the workers will become difficult. Besides, it may also adversely impact the environment as more natural resources would be depleted for printing more currency notes. Demonetisation undertaken twice in the past (1946 and 1978) miserably failed, with less than 15% of high currency notes being exchanged while more than 85% of the currency notes never surfaced as the owners suspected penal action by the government agencies.

This shows that the proposal for demonetisation was made from certain quarters during the tenure of the previous Government, but it was not considered to be a sound policy option. The present Government has chosen to implement demonetisation, going against the observation of the above-mentioned Committee Report, without conducting any fresh study. How can this be considered as a rational policy?

### **Why another Tax Amnesty?**

Realization on the part of the Government that demonetisation per se will not yield any fiscal gain has prompted the passage of the Taxation Laws (Second Amendment) Bill, 2016 in the Loksabha on November 29, without any debate or amendments. Another tax amnesty scheme - the second one during this financial year - has been launched through this law, whereby tax evaders can get away with paying 50% tax on their undisclosed income. There are valid questions on whether the Pradhan Mantri Garib Kalyan Yojana launched through the new law is in keeping with the Constitutional mandate of sharing all tax revenues with the states. A more pertinent question is whether announcing one tax amnesty scheme at the back of another, constitutes rational economic policy. If taxpayers start expecting the Government to announce tax amnesty schemes so frequently, why should anybody pay their taxes in due time?

The first tax amnesty scheme of this year yielded a paltry Rs. 30000 crore in tax revenues, which is only around 3.5% of the direct tax mobilisation target of Rs. 8.47 lakh crore set for FY 2016-17 in the Union Budget. The second one announced post-demonetisation is likely to yield even less. Most importantly, if the Government's fiscal strategy is to mobilise revenue and unearth black money through tax amnesty schemes, what was the need to demonetise 86% of the currency in circulation and that too in such a sudden and secretive manner?

### “Cashless” and “Less-Cash” Economics

The notification issued on November 8 made no mention of the objective to promote cashless transactions. This has clearly been an afterthought that has subsequently been posited by the Prime Minister and other senior functionaries.

The Central Government made a contention through its affidavit submitted in the Supreme Court that the cash-GDP ratio of India is abnormally high. This is based on a very selective citation of data. India's currency-GDP ratio has been deviously compared only with countries like Sweden, South Africa, UK, Canada, Brazil, Australia etc., which have much lower ratios compared to India, conveniently excluding countries that have higher or comparable ratios. As per the data provided by the Bank for International Settlements (BIS), countries like Japan (20.6%) or Hong Kong (15.51%) had much higher cash-GDP ratios than that of India (12.25%) in 2015 (Table 3). Other countries like Russia (10.56%), China (9.34%), Switzerland (11.76%) or Singapore (9.55%) had comparable cash-GDP ratios.

**Table 3: Cash-GDP Ratios: Selected Economies**

Country	Currency-GDP Ratio (%) 2014 (BIS)	Currency-GDP Ratio (%) 2015 (BIS)	Currency-GDP Ratio (%) 2015 (Rogoff)*
Australia	4.41	4.64	4.15
Brazil	3.89	3.82	3.44
Canada	3.80	4.08	3.74
China	-	-	9.34
Eurozone	10.31	10.63	10.09
Hong Kong	15.65	15.51	14.65
<b>India</b>	<b>11.60</b>	<b>12.25</b>	<b>12.51</b>
Japan	20.07	20.66	18.61
Korea	5.03	5.56	5.41
Mexico	6.19	6.83	5.76
Russia	11.35	10.56	9.00
Saudi Arabia	6.40	8.20	-
Singapore	8.87	9.55	8.46
South Africa	3.54	2.39	3.42

Sweden	2.11	1.73	1.80
Switzerland	10.97	11.76	11.14
Turkey	4.95	5.37	4.70
UK	3.61	3.72	4.07
US	7.72	7.90	7.38
*Kenneth S. Rogoff, <i>The Curse of Cash</i> , Princeton University Press, 2016			

High cash-GDP ratios can be attributed to a host of complicated factors and no conclusive evidence exists linking it to the accumulation of unaccounted wealth in cash. Else we have to conclude that Japan and Hong Kong have the largest concentration of illicit cash in the world.

The rise in India's cash-GDP ratio in the recent past could be caused by several factors. High inflation, especially food inflation, must have been a proximate cause. Moreover, a significantly high proportion of India's GDP is contributed by the unorganised sector - almost 55% in 2012-13 as per the CSO estimates. Around 92% of India's 47 crore strong workforce are in informal employment. Is it surprising that such an economy would have a high usage of cash? To ignore these stark realities and deduce that high cash-GDP ratio implies growing hoards of slush money is to miss the woods for the trees.

In its attempt to advocate the virtues of cashless transactions, the Government's affidavit to the Supreme Court also conflates – deliberately or otherwise – the “shadow” or “parallel” economy with “black” economy. To suggest that millions of Indians, somehow making a living in the vast informal economy, are all dealers and hoarders of illicit cash, is not only outrageous but also unconstitutional, since the Indian Constitution guarantees the fundamental right of a citizen to carry on any legitimate occupation, trade or business. To illegalise or stigmatise a profession only because of its use of cash is an assault on the livelihoods and dignity of millions of honest and hardworking people, whom the economic system and the state have failed to provide a decent employment opportunity in the organised sector.

Moreover, India's record in financial inclusion has been dismal, with only 53% of its adult population having bank accounts (World Bank Global Findex, 2014). For the poorest 40% of the population, only 44% had bank accounts. Over 86% of India's wage-earners receive wages in cash. Out of the 25 crore bank accounts opened under the PM's Jan Dhan Yojana so far, 23% are still zero-balance accounts.

India lags way behind most developing countries in terms of penetration of bank branches and ATMs. Even in the BRICS group, others have a much higher penetration of cards with payment functions and PoS terminals compared to India. Despite high growth in recent years, internet access in India is yet to cross 35% of the population in 2016. As per the 2011 Census, 33% of Indian households do not have access to electricity and 28% do not even have a mobile phone.

Most importantly, with 25% of its population still illiterate, India is nowhere near attaining the level of financial and digital literacy required to make a smooth transition into cashless transactions for the bulk of its population and thereby a less-

cash using economy. Therefore, the attempt by the Government to leapfrog into a cashless or less-cash economy, piggybacking on demonetisation, is not only a chimera but also a cruel imposition on millions of unsuspecting public. No democratic country in the world has promoted cashless transactions in this draconian manner, riding on people's misery.

The way in which the Government has been promoting the products of online payment service providers from the private corporate sector after creating an enormous shortage of cash in the economy through demonetisation – while the public sector banks and other public service providers have been conspicuously lying low in promoting their own online payment services – raises serious questions vis-a-vis conflict of interest. Issues related to data and financial security in online transactions are also being ignored in the melee.

### **Exorbitant Costs, Elusive Benefits**

The 2001 Supreme Court judgement on the BALCO case makes judicial review of economic policy contingent upon transgressions of the Constitution and statutory provisions. It is time that the criterion of “rationality” behind any economic policy decision is also brought under the purview of judicial review. In the cases involving 2G spectrum auction or allocation of coal blocks during the previous regime, the Supreme Court did not hesitate to intervene and redress the wrongdoings, although they were economic policy decisions. Those faulty allocations were annulled, and justly so, because they involved losses to the public exchequer and affected public interest. Why should the demonetisation decision not be put to the same test?

It is clear by now that the economic benefits of demonetisation are practically zilch, or at best elusive. The costs, on the other hand, should not only be measured in terms of the eighty odd innocent lives that have already been lost or the inconvenience to a billion plus people standing in never-ending queues. There are other tangible costs in terms of the contraction of economic activity owing to the liquidity shock that has already impacted almost all the sectors. The results are being felt not only through the downsizing of GDP forecasts, but also through actual job losses for workers and declining markets for farmers and small businesses.

Economists across the ideological divide – from Nobel laureates to former RBI Governors, from Neoclassical welfare economists to the Marxists – are all agreed that a recession has been precipitated by a deliberate and thoughtless decision of the Government, inflicting enormous socio-economic pain. The heavy financial cost being borne by the RBI in printing and transporting the new currency notes (over Rs. 15000 crore by some estimates) should also be added to the cost of lost income and employment owing to the recession caused by demonetisation.

**Such warped pay-offs should make it clear that demonetisation is not a rational policy decision.** Rather, such a capricious and arbitrary decision does not qualify as economic policy.

\* This article first appeared in [www.dailyo.in](http://www.dailyo.in)