
Bank Nationalization Case: Changes that the case brought

Debayan Samanta
KIIT School of Law, Bhubaneswar

Abstract

At present, there is a huge wave of privatization in India. The government is trying to privatize banks, airlines, and railways. The whole nation is going through a debate about the pros and cons of this decision. However, to fully understand the move and impact of the decision of the government one needs to study the past. We need to know what was the condition of the nation before our government started the nationalization process. One of the major incidents in understanding everything is the Bank Nationalization case. We need to understand what was the condition of the nation before the government started nationalization. What were the effects of the move? And how did the move change the future of the industries in India?

Introduction

India is a socialist country or at least tries to achieve it. It is one of the words that the preamble uses for India. Indian governments have been working on establishing welfare states. Most of the steps of the government are aimed at doing the same. We have had different governments who tried different ways of becoming a welfare state. The Indira government did this by nationalizing the banks. The move nationalized more than 20 banks in total. But in the recent past, we have been hearing about privatization. The current government is trying to privatize many industries and businesses to ensure quality and smooth functioning. But what has changed in the nation between the time when we nationalized the banks and the current scenario. Also, the RC Cooper judgment which is also known as the Bank nationalization case is one of the landmark judgments of the nation. The judgment missed some good chances but at the same time working on some other important tasks.

What does the word Nationalization mean?

Nationalization is the process of taking over a private organization by the government. Taking over means that the government will take ownership of the business, and now they control the business. The decision is unilateral in nature i.e., the process of taking over of the business is the decision of the government in which bank owners have no say. Nationalization may also be used as a method of saving a failing bank. Failing banks are considered to be a bad sign for any economics. The government to save the interest of the public at large may enter into any business by nationalizing it. But when we talk about the above scenario, we are talking about the situation where there is only one bank or enterprise. But there is a situation where the government may completely take over the business industry and restrict any other person from entering the business.

In India, the bank nationalization happened on the midnight of July 19, 1969. Bank nationalization was the brainchild of former Prime Minister, Indira Gandhi. It has been 52 years since the decision was taken by the government. Indira Gandhi had nationalized 14 major banks of the country. Banks that were nationalized, actually held over 85% of the bank deposits of the nation. By the end of the 1980s, 6 more banks were nationalized.

What was the condition before nationalization?

Before the banks were nationalized by the Indira government, there were some steps taken by the government to improve the condition of the banks. These steps were the brainchild of the then finance minister, Morarji Desai. It was Mr. Desai who gave the idea of '*social control of banks*'¹. The government bought Banking Laws Amendment Act (1968). In this amendment, the government ordered the banks to change their laws and prohibit them from sanctioning the loan to their directors. The amendment also introduced a 'National Credit Council'. If anyone reads the way the new nationalization happened, the major reason was to sync the banking sector with the goals of socialism. RBI's history shows that the idea of nationalization originated in the year 1948. The government nationalized the insurance sector way back in the year 1956. SBI was also nationalized in 1955. The nation's economical condition was in the best state. We have had fought a war with China in 1962. And 3 years later, in 1965 we were fighting a war against Pakistan. India had already encountered two droughts in the 1960s. GDP was falling and the inflation rates were skyrocketing. The foreign exchange had also declined during the financial year 1964-65. During the same financial year, the government of India devalued the Rupee. Export duties were also increased in the nation. One of the major reasons that people usually ignore the need for nationalization was the condition of the agricultural sector. There was a high part of the Indian public involved in agriculture, and yet they were not financially strong. Banks were not interested in giving them loans as returns were not guaranteed. All these reasons made the government decide to nationalize the banks.

Facts of the Bank Nationalization case:

The acting president of India during 1969, promulgated the Banking Companies (Acquisition and Transfer of Undertakings) ordinance. The power to do so has been given in article 123(1) of the Indian Constitution. As an effect of the ordinance, 14 private banks were nationalized. The Central Bank of India was one of the banks which were nationalized. The parliament passed the Banking Companies Act as soon as they sat for the monsoon session. The ordinance which was passed and the new act were exactly copied in the new act. Director of the Central Bank of India,

¹ Amol Agrawal, "Why Indira Gandhi Nationalised India's Banks", Bloomberg (July 12,2019), <https://www.bloombergquint.com/opinion/why-indira-gandhi-nationalised-indias-banks>

Mr. R.C. Cooper² challenged the ordinance based on which nationalization was happening. The issues in the case were:

1. Whether the act in question violated Article 19(1)(g), and Article 31(2) of the Indian constitution?
2. Whether the ordinance was properly made or not?
3. Whether the act formulated was within the powers of the parliament?
4. Whether a shareholder could file a Writ petition for the violation of his Fundamental Rights when the company in which he is a shareholder is acquired by the Government?

Arguments by the Petitioner: The petitioner was represented by Mr. Nani Palkhiwala. He argued that the petitioner was filing the writ petition as a citizen of India and not as a representative of his company.

The next argument of Mr. Nani was regarding the fact that the president is given the power to pass an ordinance when the parliament is not in session and there is an absolute necessity of making a law. The ordinance was passed when the parliament was just 2 days away from starting its session. This seemed like an abuse of Article 123(1).

The next issue in dispute was whether the parliament was competent to make the impugned law? There are 3 lists in the Indian constitution that prescribe the topics that state or central government will face. The first one is the Union list, the second is the state list and the last one is the concurrent list. Mr. Palkiwala argued that the central government was only allowed to make the laws on 'banking' as defined by the Banking Regulations Act, 1949. The said act was beyond that limit.

Also, the petitioner argued that the government's takeover of the banks was against the fundamental right to property. (The right to property was a fundamental right at the time of this case and had not been removed till then).

Arguments by Defendant: The defendant contested that the writ petition was not maintainable in the court as it was filed to claim the rights of the company. As per the Indian Citizenship Act, 1955 a company was not a citizen of the country. The government's representative said that regarding article 123, the powers of the president were subjective. The words 'if he felt' were used in the article. This meant that the necessity of the law was to be decided by the president.

Defendant also argued that nationalization was a necessary step for achieving the socialist aims. It was an obligation on the state to do this. Hence, they asked the court to interpret the word 'banking' as not limited to just what the Banking Act defined it as. Defendant wanted the court to interpret the word in the widest interpretation possible. They also argued about the mutual

² R.C. Cooper V. Union of India, AIR 1970 SC 564

exclusivity of fundamental rights. The point of mutual exclusivity was backed by the case of *A.K. Gopalan V. State of Madras*³. The defendant contested that the said act was not in violation of Article 19(1)(g) because it fell within the ambit of Article 31.

Judgment

The judgment was delivered by the Supreme Court on 2nd February 1970. Justice A.N. Ray was the only dissenting judge. All the other judges held that there was no right of the shareholder to move to the court for implementation of fundamental rights in the name of the company they represent.

One of the main highlights of this case was the overruling of the ‘Mutual Exclusivity’ theory. The court held that the violation of fundamental rights cannot be overlooked just because of some technicality.

Regarding the question of the validity of the ordinance, the court held that the ordinance had been converted into an act. hence, now it was unnecessary to talk about the validity of the ordinance.

The court said that the act was not in violation of the rights guaranteed under Article 19(1)(g). But the court found the act to be violating article 14. The act barred 14 banks from carrying any banking activities, but strangely there was no reason given to explain this act. Various banks were not stopped from practicing the same business. It was hence arbitrary to not allow a certain bank to work without doing a reasonable classification.

Justice Ray gave a dissenting opinion in the judgment. He said that the only way that one could challenge the president’s ordinance was based on malafide intentions. Hence, the passing of any ordinance just 2 days before the session began was not the basis on which an ordinance can be challenged. He upheld the ‘mutual exclusivity theory’.

Influence of the case on India

The nationalization of banks was one of the biggest steps that the Indira government took. In one of her famous speeches to the nation, she said that “*Control over the commanding heights of the economy is necessary, particularly in a poor country where it is extremely difficult to mobilize adequate resources for development.*”⁴. Banks that were before nationalization catering to the rich and economically stronger were now working for helping the poor and needy. There were many benefits that India got from nationalization. The 20 nationalized banks formed a strong team of Public Sector Banks. The banks moved from ‘class banking’ to ‘mass banking’. These PSBs were not only acting as the distributor of the banking services. These banks played a real

³ A. K. Gopalan Vs. State of Madras, AIR 1950 SC 27

⁴ Shruti Rajagopalan, “Robbing a Nation”, Thinkpragati (15th August 2017), <https://www.thinkpragati.com/opinion/2034/robbing-a-nation/>

and important role in implementing government policies. This is visible from the statistics regarding our nation. the branches of nationalized banks increased from 8k in the 1970s to 1 million in March 2020.⁵ The share of rural and semi-urban branches also increased. The biggest benefit of this move was the farmers who wanted money to increase their business but were denied earlier.

Significance of the judgment:

The R.C. Cooper case judgment is considered to be one of the landmarks of the nation. The first thing which this judgment dealt with was the balance between individual rights and socialism. The judgment also dealt with the problems regarding compensation in India. The court had to deal with the question of public purpose. The Supreme court had been deferring the topic in many previous cases, and they did the same in this case. The court here failed to create a doctrine of public purpose. Most of the projects of every government are said to be furthering public purpose. But there is a line that needs to be drawn when we talk about the same projects depriving the rights of individuals. Whether the public purpose or the rights of the individuals, what has to be given prominence will differ from case to case.

The act was held void, and the major cause behind it was compensation. The owners and shareholders of the banks were not given enough compensation after nationalization. Compensation was a fundamental right under article 31 but was ignored by the government. The honorable Supreme court recognized the right to compensation here. Here, we could see the importance being given to the right to property by the court. But in the future, everyone will witness a different approach to the supreme court. The property right will be removed from the fundamental rights.

Privatization; The future

The shift in the policy of the Indian government can be seen by the economic reforms of 1991. Since then, the government has been constantly involved in disinvestment. Slowly and steadily a lot of departments have been privatized. The government has sold its shares in various PSU by the use of IPOs. Privatization in India has been a rare thing and we have no prior example of completely privatizing banks by the government. The current condition of the finances of some banks in India might give one the idea of privatizing. Banks have been making losses for a long time now. Some banks in India are still under restrictive frameworks. This means that their lending, business expansions have been restricted by the government. One has to keep in mind that the government has not been able to earn money in the past few quarters. Hence, they will have to check that also before privatizing banks as they are the source of earning for the government.

⁵ K Srinivasa Rao, “*How bank nationalisation contributed towards banking outreach?*”, Financial Express)Jusly 19th, 2019), <https://www.financialexpress.com/opinion/how-a-move-to-nationalise-banks-contributed-towards-robust-banking-outreach/1649081/>

Conclusion

The nationalization of banks was a step that was meant to ensure that the government is creating a welfare state. India was just a new nation where most of the country was poor. We were in a very bad situation and were economically weak. Our nation was facing food shortages and droughts. Hence, there was an urgent need for investing in the agricultural and manufacturing sectors. Both the sector needed external support to grow. This was however not possible in a situation where most of the banks were not supporting these industries. And they were not to be blamed. Any business needs security that the person to whom they are lending money will be able to return the money. Any private bank would not lend money without promising output from the borrower. Hence, the government had to take over the banking industry to lend support to these industries. By nationalizing banks, it was a clear sign that the government wanted a higher degree of control in the market. But the method of the government was filled with complete haste and wrong methods. There was no sense in passing an ordinance just 2 days before the start of the monsoon session. It appeared as a move that the government might have done to avoid debate in the parliament. Also, the act was not upholding the right to compensation and was violating article 14. This judgment acts as a good example that even though the act of legislation aims to do good, but by wrong methods, then also it is wrong. They wanted to control and influence the market as per their wish. But all these measures are not business-friendly. Businesses would not enter such a market. Hence, these steps were not of much use after the adoption of the liberalization policy. The government now wants the market to be a free market and hence privatizing of industries is happening.