



The Indian Journal for Research in Law and Management

Open Access Law Journal – Copyright © 2026

Editor-in-Chief – Dr. Muktai Deb Chavan; Publisher – Alden Vas; ISSN: 2583-9896

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DEMONETISATION AND ITS UNINTENDED CONSEQUENCES: WHAT THE 2016 INDIAN CURRENCY REFORM TELLS US ABOUT THE LIMITS OF LEGAL FORESIGHT

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ABSTRACT

On November 8, 2016, the government of India announced that currency notes of Rs. 500 and Rs. 1000 would no longer be a legal financial tender with immediate effect. What followed was one of the most contested economic policy experiments in modern democratic history. This research paper looks at the socio-economic repercussions of that decision, particularly the ones that nobody planned for. It argues that the demonetization decision is a telling case study in the limits of legal foresight – that is, the docility of policymakers and law to fully predict what will happen when sweeping rules meet a messy, unequal, and largely cash-dependent society. The paper sums up its stance on judicial responses, academic research, and on-the-ground accounts to make this argument.

KEYWORDS: Demonetization, Legal Foresight, Cash-Dependent Economy, Socio-Economic Repercussions, Economic Policy Experiment

INTRODUCTION

Imagine being told, with only four hours' notice, that the money in your wallet is no longer money, does not hold any monetary value. That is largely what happened to 1.3 billion Indians on the night of November 8, 2016. Prime Minister Narendra Modi appeared on national television and declared that Rs. 500 and Rs. 1000 notes – which accounted for about 86 per cent of all currency in circulation – would stop having legal value in monetary terms.

The official reasons were lucid enough: eliminate black money, stop the funding of terrorism, curb counterfeit currency, and push India toward a digital economy. The legal instrument used

was the Specified Banknotes (Cessation of Liabilities) Act, 2017,¹ passes after the initial notification under the Reserve Bank of India Act, 1934.² On paper, the framework looked strong and coherent. In practice, the consequences spread far beyond what any piece of legislation could have expected.

This paper is not merely about whether demonetisation succeeded or failed as an economic policy. This debate is ongoing and debated. This paper is about something different from usual: what happens when law moves faster than society can respond, and what that tells us about the gap between a law's stated target and its lived reality.

THE LEGAL FRAMEWORK BEHIND DEMONETISATION

To perceive where the law falls short, we first need to understand which legal tools were used and what they were designed to do. The Reserve Bank of India Act, 1934, gives the central government the authority to demonetise currency in relation to the RBI's central board.³ Section 26(2) of this act was the key law relied upon in 2016. The government issued a notification on November 8, 2016, under this section. This was later given statutory backing through the Specified Bank Notes (Cessation of Liabilities) Act, 2017.⁴

The Supreme Court of India, in *Vivek Narayan Sharma v. Union of India*,⁵ upheld the constitutional value of the demonetisation decision by a 4:1 majority in January 2023. The majority held that the decision was accurate and that economic policy decisions must be given a large space for judicial deference. The lone dissenting judge, Justice B.V Nagarathna, took a dissimilar view. She held that a measure of such value could not have been legally initiated by the Central Government alone through Section 26(2) – it needed independent recommendation by the RBI Central Board, and the process followed in 2016 was constitutionally imperfect.⁶

This judicial division is instructive. Even the Supreme Court could not reach a unanimous decision about whether the legal process was right. If the law itself was divided, it is not surprising that its repercussions were arduous to manage.

¹ Specified Bank Notes (Cessation of Liabilities) Act, No. 2 of 2017, India Code (2017).

² Reserve Bank of India Act, No. 2 of 1934, § 26(2), India Code (1934).

³ *ibid*

⁴ Specified Bank Notes (Cessation of Liabilities) Act, No. 2 of 2017, India Code (2017), pmb1.

⁵ *Vivek Narayan Sharma v. Union of India*, (2023) 3 SCC 1 (India).

⁶ *Id.* at 220–245 (Nagarathna, J., dissenting).

INTENDED AIMS: WHAT THE POLICY WAS SUPPOSED TO BE.

The government set four main goals: First, to eliminate black money, which is the untaxed cash held by corrupt individuals and businesses. Second, to get rid of fake currency notes, especially those smuggled in from across the border. Third, to cut off the financial support for terrorist and criminal groups. Fourth, to speed up the move towards a digital, cashless, and properly documented economy.⁷ Each of these goals is valid. The issue was not with the aims themselves. The issue lay in the law's assumption about how the country would respond, and that assumption turned out to be incorrect.

UNINTENDED SOCIO-ECONOMIC CONSEQUENCES

A.

The Cash Dependency Problem

In 2016, India was, by any measure, a cash-heavy economy. The World Bank had estimated that nearly 53 per cent of the adult population had no bank account.⁸ In rural areas, the figure was even higher. Agricultural workers, street vendors, daily-wage labourers, domestic workers, and small traders dealt mostly in cash. For these groups, demonetisation was not a small problem – it was a break. The policy assumed that people would easily go to banks, exchange or deposit their old notes, and continue their lives. But this idea did not hold. People in remote areas without nearby bank branches had no way to exchange notes quickly. Migrant workers who had saved in cash found their savings temporarily unusable. Some lost their salaries because employers could not pay them.⁹

The Reserve Bank of India's own data showed that 99.3 per cent of the demonetised currency was deposited into the banking system – meaning very meagre black money was actually destroyed.¹⁰ This outcome was wholly unforeseen by those who crafted the policy.

B. Impact on Informal Labour and Agriculture

⁷ Press Information Bureau, Govt. of India, Prime Minister's Address to the Nation on 8th November 2016 (Nov. 8, 2016), <https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1491623>.

⁸ World Bank, The Global Findex Database 2014: Measuring Financial Inclusion Around the World 4 (2015), <https://openknowledge.worldbank.org/handle/10986/21865>.

⁹ Dipa Sinha & Reetika Khera, Cash Transfers, Digital Payments and the Rural Poor: Evidence from India 14–18 (Indian J. of Labour Econ., 2019).

¹⁰ Reserve Bank of India, Annual Report 2017–18, at 138 (2018), <https://www.rbi.org.in/Scripts/AnnualReportPublications.aspx?Id=1151>.

India's informal sector employs most of its workforce. The Centre for Monitoring Indian Economy (CMIE) reported a rise in unemployment in the months right after demonetisation. Millions of jobs were lost in small-scale industries and agriculture.¹¹

The agricultural sector faced severe challenges. November marks the start of the Rabi sowing season in many regions of India. Farmers need cash to buy seeds, fertilisers, and to pay their workers. With cash suddenly unavailable, many farmers could not plant on time. Agricultural markets, or mandis, slowed down. Prices for perishable goods dropped sharply because sellers couldn't make transactions.¹²

Professor Prabhat Patnaik from Jawaharlal Nehru University noted that the damage to the informal economy was systematic and not just temporary. This disruption occurred at a crucial moment in the agricultural cycle.¹³

C. Healthcare and Social Emergencies

Perhaps the impactful unintended consequence was in healthcare. Hospitals, chemists, and emergency services often work on cash payments in India, particularly in smaller towns and villages. Patients who came to hospitals with only old currency were turned away or stayed. Several news reports and academic studies recorded deaths that occurred due to delayed medical treatment.¹⁴

The law, as prepared, did not make any special exception for medical emergencies in the initial days. While some exemptions were largely issued – allowing old notes at government hospitals for a short period – these appeared after the damage had already started.¹⁵

D. Gender and Marginalised Communities

Women, especially those in rural areas, faced an unfair burden. Many women in India keep small amounts of cash at home, which is often the only money they can access on their own. This cash became useless overnight. Studies by the Self-Employed Women's Association

¹¹ Centre for Monitoring Indian Economy, Unemployment Rate in India Post-Demonetisation, CMIE Econ. Outlook (Jan. 2017).

¹² Ashok Gulati et al., Demonetisation and Its Impact on the Rural Economy 7–10, Indian Council for Research on International Economic Relations Working Paper No. 340 (2017).

¹³ Prabhat Patnaik, Demonetisation: An Assessment, Frontline (Dec. 9, 2016), <https://frontline.thehindu.com/economy/article8983456.ece>

¹⁴ Rukmini S., Deaths After Demonetisation: What the Data Shows, The Hindu (Dec. 1, 2016), <https://www.thehindu.com/data/deaths-after-demonetisation/article16906027.ece>.

¹⁵ Ministry of Finance, Notification S.O. 3568(E), Gazette of India (Nov. 13, 2016).

(SEWA) and similar groups showed how demonetisation weakened the financial independence of women in low-income households.¹⁶

Scheduled Caste and Scheduled Tribe communities, which are heavily involved in daily-wage and casual work, also experienced significant disruptions. These groups had limited access to digital services and few formal banking connections. The policy wrongly assumed that the population was ready for a digital shift, ignoring these realities.¹⁷

E. The Rise of Financial Jugaad: Unintended Legal Creativity.

One repercussion that policy crafters almost certainly did not foresee beforehand was the large creativity with which people found ways around the system. Some individuals paid years of utility bills in advance using old currency. Others purchased gold and silver. Jan Dhan accounts – started under a government financial inclusion scheme – saw sudden and unusual surges in deposits, suggesting that some people used these accounts to launder or legitimise old currency.¹⁸

This is what legally savvy people sometimes call ‘regulatory arbitrage’ – finding gaps in the rules and using them. It points to a structural clash in law: the tougher the rule and the higher the values, the more creative people become in working around it.

WHAT THIS REVEALS ABOUT THE LIMITS OF LEGAL FORESIGHT

A. The Gap Between Rational Law and Irrational Reality

Legal systems are, by their nature, built on generalisations. A law says ‘when X happens, Y will follow’. It cannot account for every individual circumstance. Demonetisation is the best example of the gap between this logic and large inequality.

Professor Lon Fuller, in his seminal work on the inner morality of law, identified eight principles that a well-legislated legal rule must meet – including that laws must be possible to follow and that they must be administered justly.¹⁹ Demonetisation stumbled on both things. It was not possible to follow up with it fully (millions had no chance to exchange old currency), and it was administered patchily, with rules and exemptions changing largely daily.

¹⁶ SEWA, Impact of Demonetisation on Self-Employed Women: A Field Report 8–12 (2017), <https://www.sewa.org/publications>.

¹⁷ Santosh Mehrotra & Jajati Keshari Parida, India's Demonetisation: Impact on the Informal Sector 19–23 (ILO Asia Pacific Working Paper, 2017).

¹⁸ Reserve Bank of India, Report on Trends and Progress of Banking in India 2016–17, at 97 (2017); see also Amartya Lahiri, The Great Indian Demonetisation, 32 J. Econ. Perspectives 185, 195 (2020).

¹⁹ Lon L. Fuller, The Morality of Law 33–94 (Rev. ed. 1969).

B. The Problem of Compressed Timelines

One reason why legal foresight failed here was the intentional secrecy and speed of the policy. The rationale for keeping it secret was acceptable – advance notice would have defeated the anti-corruption purpose. But this very secrecy meant that no mind-matching²⁰ could happen with the affected people, that regulatory bodies had no time to prepare, and that implementation machinery was easy but not ready.

Good law, in general circumstances, goes through public scrutiny, stakeholders' engagement, and parliamentary scrutiny. Each of these processes is partly a mechanism for identifying unintentional consequences before a law comes into play. Demonetisation bypassed all of them.

C. The Assumed Subject of the Law

Every law imagines a particular entity it is talking to. The assumed manner of demonetisation appears to have been an urban, banked, digitally literate individual with easy access to formal financial services. The actual population of India is largely different. This mismatch between the 'ideal citizen' imagined by the law and the actual, diverse population it governed is one of the most prominent structural issues of legal foresight.²¹

Critical legal professors have written about how law tends to be structured from the vantage point of those who craft it – typically educated, urban, formally employed people – while being applied to populations whose lives look very mismatched.²²

D. Second-Order Effects and System Complexity

Complex systems — economic, social, institutional — do not respond to shocks the way a textbook equation might suggest. They do not absorb a blow and return neatly to equilibrium. They fracture, adapt, improvise, and sometimes collapse in ways nobody predicted, and then the rubble of those responses creates entirely new crises of their own. This is not a theoretical observation. It is something that plays out repeatedly whenever sweeping policy decisions are made without adequate understanding of the living systems they are entering.

²⁰ Raghuram Rajan, *I Do What I Do* 183–189 (2017) (noting that the RBI governor was given only a few hours' notice before the announcement).

²¹ Martha Nussbaum, *Creating Capabilities: The Human Development Approach* 58–62 (2011) (discussing the gap between formal legal capacity and actual capability to comply).

²² Kimberlé Crenshaw, *Mapping the Margins: Intersectionality, Identity Politics, and Violence Against Women of Color*, 43 *Stan. L. Rev.* 1241 (1991) (on the blind spots of law to intersecting vulnerabilities).

Consider what it actually means to remove 86 per cent of a country's currency supply overnight. On paper, it might appear to be a blunt but manageable intervention — a financial reset, a tool against hoarding or corruption. But paper does not buy vegetables. Paper does not pay the auto-rickshaw driver or settle the tab at the neighbourhood pharmacy. The moment that currency disappears from circulation, you are not simply inconveniencing people who happen to be holding it. You are severing the connective tissue of everyday economic life.

Think about what that actually looks like. A vegetable seller at a morning market cannot accept only the notes her customers have. A truck driver carrying medicines across a district cannot pay the toll booth or refuel at the pump. A small contractor who owes wages to six daily labourers cannot make payroll because his own client cannot liquidate funds in time. Each of these is a single thread, but they are woven into the same cloth. Pull hard enough on one, and others begin to unravel, too.

Economists use the term *second-order effects* to describe consequences that flow not directly from a policy, but from the responses to it — the adaptations, the workarounds, the breakdowns, and the human decisions made under pressure. A farmer who cannot sell his crop does not simply wait. He takes a loss, or he borrows at painful rates, or he stops planting next season. A family that cannot access cash does not simply pause its spending. It draws on community lending networks, or delays a hospital visit, or pulls a child out of school for a term. These are not dramatic moments. They are quiet, dispersed, nearly invisible adjustments — and yet they compound. They accumulate across millions of households and thousands of supply chains until their aggregate weight becomes something no single official ever intended to impose²³.

Legal drafters are rarely trained to model these cascading effects. This is not a criticism aimed at any particular lawyer or civil servant — most of them are intelligent, diligent people working under significant constraints of time, information, and institutional inertia. It is, rather, an observation about the structural limitations of a particular kind of imagination: one trained to think in terms of provisions and clauses, in definitions and prohibitions, in the clean mechanics of what the law says rather than the turbulent social physics of what the law *does*.

Law, at its finest, is a form of careful social engineering. But engineering requires not just the ability to design, but the willingness to model failure — to ask not just "what does this instrument intend?" but "what happens when it meets reality?" Reality is not a blank slate. It is

²³ Dani Rodrik, *The Globalisation Paradox* 178–182 (2011) (on second-order economic effects of rapid policy changes).

already populated: with habits and workarounds, with informal economies and trust networks built over generations, with fragile systems that function precisely because they have never been subjected to sudden, total disruption.

The gap between legal intention and social consequence is not new, and it is not unique to any one country or political system. But it becomes especially dangerous when the stakes are high and the timeline is short. The faster a policy moves, the less time there is for feedback to travel back up the chain. The more sweeping the intervention, the more threads you are pulling at once. And the more certain the designers are of their own reasoning, the less likely they are to build in the mechanisms that might catch what they have missed.

This is the deeper challenge — not just that laws sometimes have unintended consequences, but that the systems used to design and evaluate them are often poorly equipped to anticipate complexity. Until that structural gap is taken seriously — until economists, social scientists, and on-the-ground practitioners are genuinely embedded in the policy drafting process rather than consulted as an afterthought — we will keep writing laws that are coherent on paper and chaotic in practice. The real world is not a margin note. It is where the law actually lives.

E. The Role of the Judiciary: Too Late, Too Deferential?

The Supreme Court received around 50 petitions challenging demonetisation. Still, the final judgment came only in January 2023 – more than six years after the effects had been integrated into the system. The court’s majority held the decision on grounds of economic policy deference, importantly saying: the government had the power, the means were rational, and courts should not second-guess economic choices.²⁴

This raises a lot of questions about whether judicial review, as currently formed in India, is capable of providing a meaningful shield against poorly foreseen consequences of economic legislation. The dissent by Justice Nagarathna is notable –she argued that the procedural illegality of the decision was itself a constitutional mistake, irrespective of the results.²⁵

²⁴ Vivek Narayan Sharma v. Union of India, (2023) 3 SCC 1, ¶¶ 89–110 (India).

²⁵ Id. at 231–238 (Nagarathna, J., dissenting).

BROADER LEGAL LESSONS

Demonetisation is kind of an extreme case, but I think the lessons from it still apply in a broader way. Any law that throws in a sudden, sweeping change to the basic conditions of everyday life— be it land, labour, currency, or even health— ends up running into the same snag. The quicker it moves, and the less it checks with people, the more likely it is to create side effects nobody actually wanted. A few principles show up pretty clearly from this whole analysis. First, what matters is not only legal authority, but also the capacity to implement. Having the power to do a thing is not the same thing as having the necessary infrastructure to do it safely. The government had the first part, yet it didn't have adequate groundwork for the second part. Second, emergency provisions really need sunset clauses and some review mechanisms too. When extraordinary powers are used, the legal system should build in checkpoints, like moments where the consequences are actually evaluated, and if something goes wrong, corrections can be made. Third, you have to do a differential impact assessment. Any big economic piece of legislation should require an assessment of how it will affect the most vulnerable groups — those who have the least access to formal systems, and the least ability to absorb disruption.²⁶ Fourth, legal legitimacy leans on process rather than only the final outcomes. As the dissent in *Vivek Narayan Sharma* argued, the validity of an emergency economic measure cannot be judged just because the goals were legitimate; it also depends on whether the process used to reach those goals respected constitutional norms.²⁷

CONCLUSION

Demonetisation of 2016 was, at its core, a legal act – verified and authorised by statute and legal standing, executed by a democratically elected government, and eventually upheld by the Supreme Court. And yet, the human repercussions of that legal act fall hardest on those who were never really in the room when it was crafted.

The paper has argued that this is not just hideous policymaking. It is a structural feature of legal foresight itself. Law deals in abstractions; life does not. Law imagines an average person; poverty, gender, caste, geography, and language mean there is no such person. Law plans for the following rules; people find workarounds.

²⁶ United Nations Development Programme, *Social Impact Assessment: Integrating Social Issues in Development Projects 22–30* (2009).

²⁷ *Vivek Narayan Sharma v. Union of India*, (2023) 3 SCC 1, ¶ 238 (Nagarathna, J., dissenting).

None of this really means that the law should be given up as a way of driving economic change. It just means the law has to be a bit more humble about what it can actually do, you know. It has to add more consultation, more phasing, more focus on whether implementation can work on the ground, and also more readiness to adjust course when things go sideways. It also needs a deeper grasp of judicial review, so it can respond in a meaningful manner to actual harm, not only looking at it years later, six years after the fact. The 86 per cent lesson from 2016 is plain. When you adjust the rules for a country of 1.3 billion people overnight, you have to be ready for that country to surprise you. And the law was not.