PROJECT REPORT

ON

IMPACT OF THE 2016 DEMONETIZATION ON THE INDIAN ECONOMY

Submitted By:

Mann Rathod (23108034)

Rohan Vashishth (23108025)

Samiksha Sharma (23108020)

Subhradip Sarkar (23108041)

Submitted To:

Dr. Rakesh Kumar

Assistant Professor

Centre Of Management

and Humanities

PUNJAB ENGINEERING COLLEGE

(DEEMED TO BE UNIVERSITY)

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Declaration

We the students of Punjab Engineering College, Chandigarh, hereby declare that the research project titled "Impact of Demonetization on the Indian Economy" is our original work. It has been completed in fulfilment of the requirements of the Economics Research under the guidance of Dr. Rakesh Saharan, and it has not been submitted to any other institution or university for any degree or diploma.

We confirm that the data and information presented in this project have been obtained and analyzed by me through careful research and proper referencing, and any sources or data from other works have been duly acknowledged.

We take full responsibility for the contents of this project.

Team Members:

Rohan Vashishth (23108025)

Mann Rathod (23108034)

Samiksha Sharma (23108020)

Subhradip Sarkar (23108041)

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Contents

Abstract

Demonetization is when a government declares certain currency notes invalid for transactions. This step is usually taken to tackle problems like black money, fake currency, and corruption. India has seen demonetization three times in history, with the most recent one happening on November 8, 2016. On that day, the Indian government announced that Rs. 500 and Rs. 1,000 notes would no longer be legal tender, bringing major changes to the economy.

The 2016 demonetization had a huge impact because these notes made up about 86% of the total cash in circulation. This sudden decision led to a cash shortage, which affected businesses, individuals, and financial institutions. The main goal was to reduce unaccounted money, tax evasion, and fake currency, but the move caused both short-term disruptions and long-term changes in the economy.

India had previously gone through demonetization in 1946 and 1978, but the 2016 demonetization was much larger in scale. The sudden ban on high-value notes created immediate challenges, especially for small businesses and daily wage earners who depend on cash transactions.

In the short term, demonetization caused a cash crunch, slowing down daily transactions and reducing consumer spending. Sectors like retail, real estate, and agriculture were badly hit as cash transactions stopped overnight. Many small businesses suffered losses or even shut down. However, digital payments and online banking became more popular as the government encouraged cashless transactions.

In the long run, demonetization had both positive and negative effects. On the positive side, digital payments increased, more people started paying taxes, and more businesses became part of the formal economy. Policies like the Goods and Services Tax (GST) and financial programs like Jan Dhan Yojana supported the goals of demonetization. Also, banks received more deposits as people rushed to exchange their old notes, increasing the money available for loans and investments.

This research aims to study the impact of the 2016 demonetization on different sectors of the economy. It will look at the reasons for the move, the problems caused by the cash shortage, and the long-term effects on financial stability, digital transactions, and economic growth. By exploring these factors, this study will provide a clear understanding of how demonetization shaped India's economy.

Introduction

Demonetization is a significant chapter in the history of our nation's economy. An attempt to curb Black money, eliminating counterfeit currency and promoting digital transactions turned into weeks or even months of long Queues outside of Banks. This decision didn't just have an immediate impact, it changed the course of how transactions took place in our country, via the introductions of digital payment platforms like UPI and is continuing to shape our economy even today, after almost 10 years since the decision.

1.1 History of Demonetization:

India experienced demonetization twice before 2016—first in 1946 and then in 1978. In 1946, the British government demonetized ₹1,000 and ₹10,000 notes to curb tax evasion, but its impact was minimal since high-denomination notes were rarely used. These notes were reintroduced in 1954. In 1978, the government under Prime Minister Morarji Desai demonetized ₹1,000, ₹5,000, and ₹10,000 notes to combat black money. However, since only a small fraction of the population used such high-value notes, the economic impact remained limited. Unlike these earlier instances, the 2016 demonetization targeted 86.9% of the total currency in circulation, affecting every sector of the economy, particularly the cash-dependent informal and service industries. While earlier demonetizations were focused on restricting wealth hoarding by the elite, the 2016 move had a much broader reach, leading to short-term economic disruption but also accelerating the transition toward a digital and formalized economy.

1.2 The Demonetization of 2016:

On the night of 8th November 2016, Prime Minister Narendra Modi announced that the Currency Notes of Rs.500 and Rs.1000, would no longer be legal tender, rendering them out of service. This Decision caused about 86.9% of the total currency to be out of circulation. This caused an immediate cash shortage, severely impacting the informal sector, small businesses, and cash-dependent industries like real estate and retail. GDP growth slowed to 7.0% in Q3 2016-17 from 7.3% in the previous quarter. On the positive side, digital payments surged, with UPI transactions increasing from 0.29 million in November 2016 to 6.2 million by March 2017. Banking deposits also rose significantly as people deposited old notes into formal financial channels. While demonetization disrupted the economy in the short term, it accelerated financial inclusion and pushed India towards a more digital and tax-compliant economy. The long-term impact remains debated, with mixed opinions on its success in curbing black money.

1.3 Impact on Agricultural and Primary Sector:

Agriculture, being the largest employment sector in India, was severely affected by demonetisation due to its heavy reliance on cash transactions. Many people in rural areas depend on it to earn a living, especially through agriculture, which provides jobs to over 40% of the country's workers. Since most work and payments in this sector happen through cash and not through banks, the sudden shortage of currency after demonetisation in November 2016 hit it particularly hard. The sudden liquidity crunch disrupted the purchasing of essential inputs like seeds and fertilisers, leading to delays in sowing and a decline in overall agricultural productivity.

After ₹500 and ₹1,000 notes were taken out of circulation, which made up almost 86% of all cash being used, rural areas faced a serious cash shortage. Farmers, especially those with small pieces of land, struggled to buy seeds, fertilizers, and pay workers, since all these usually require cash. On top of that, many could not sell their crops because middlemen and traders did not have enough cash to buy them. The shortage of cash reduced their ability to carry out these activities efficiently, leading to lower crop yields, reduced sales, increased wastage, and diminished income. Retail vegetable sellers also faced a sharp decline in demand. As fruits and vegetables are perishable, much of the produce went unsold and was wasted. The unavailability of Rs. 500 notes and difficulty in getting change for Rs. 2000 notes further worsened the situation. Consumers began shifting to larger retail outlets, impacting the small vendors and the informal sector's livelihood.

Additionally, demonetisation coincided with the peak Rabi sowing season, during which minimal bank lending occurred. Farmers without PAN cards couldn't carry out high-value transactions, hampering their ability to purchase farm equipment. Moreover, the lack of banking infrastructure and ATMs in rural regions led to cash shortages, allowing moneylenders and middlemen to exploit the crisis.

1.3.1 Agricultural Markets & Rabi Season:

Demonetization happened right around the time farmers were starting to plant Rabi crops. Since many villages did not have easy access to banks and there were not enough new notes available, sowing got delayed in some areas. The Ministry of Agriculture said that the total area covered under Rabi crops did not change much, but the quality and cost of things like seeds and fertilizers might have been affected in ways that were not fully recorded.

1.3.2 Long-term Ripple Effects:

Some experts believe that demonetization encouraged more people in villages to use digital payments and move towards formal banking. But this did not happen much in the farming sector. Many farmers went back to using cash once things settled down. Since most deals in markets and mandis still happen in cash, and because there's not enough digital infrastructure in rural areas, there was not a big shift toward online payments.

1.3.3 Real-World Evidence:

A survey by NABARD in 2017 showed that only about 8% of rural families used digital methods for money transactions after demonetization. Also, government data from later years showed that wages in rural areas, especially in farming states like Uttar Pradesh, Madhya Pradesh, and Bihar, either stayed the same or even dropped a bit. This shows that rural incomes did not really grow after demonetization, and many people continued to face money problems.

1.4 Impact on Digital Transactions:

During the demonetisation period, digital transactions witnessed a significant surge, rising from ₹97,554 crore to a peak of ₹1,54,059 crore. The government actively promoted digital payments by introducing Aadhaar-linked apps like BHIM and expanding platforms such as RuPay, aiming to reduce the economy's reliance on cash. However, following remonetisation, digital transactions declined to ₹1,13,827 crore. The adoption of digital payments also varied across states — with southern states like Karnataka, Tamil Nadu, and Andhra Pradesh recording over 24.5% penetration, while states like Jammu & Kashmir, Madhya Pradesh, Bihar, and West Bengal remained below 12%. On a national scale, digital transaction share rose from 9% to 18%, reflecting increased formalisation of the economy and a broader tax base.

In terms of overall electronic transactions, the total value stood at ₹94 lakh crore in November 2016 and peaked at ₹149.6 lakh crore by March 2017. However, this momentum did not sustain, with values dropping to ₹109.6 lakh crore in April, ₹107.3 lakh crore in July, and ₹99.2 lakh crore in October 2017—almost reverting to pre-demonetisation levels, thus challenging the assumption that demonetisation led to a lasting boost in digital payments.

Different digital payment modes showed varied trends. Mobile banking volumes increased from 72.3 million to 86.3 million, but transaction values fell from ₹1.24 lakh crore to ₹1.12 lakh crore. RTGS and NEFT peaked in March 2017 but dropped significantly by September. Consistent growth was observed only in UPI apps, credit cards, and mobile wallets, although they operated from a low base. For instance, IMPS usage grew significantly, but its value remained minor compared to NEFT.

The decline in digital usage post-demonetisation can be attributed to limited awareness, high transaction costs, and security concerns. Addressing these challenges is essential for the success of the Digital India initiative.

1.5 Impact on Secondary sector:

The secondary sector, comprising manufacturing, construction, and small-scale industries, is a vital pillar of the Indian economy. It contributes significantly to GDP and provides employment to a substantial workforce. Since a large segment of this sector relies on cash transactions for raw material procurement, wages, and retail sales, the demonetization of ₹500 and ₹1,000 notes in November 2016 caused significant disruptions.

1.5.1 Immediate Impact

With nearly 86% of India's cash removed from circulation, small and medium enterprises (SMEs) faced severe liquidity shortages. Many businesses struggled to pay wages to daily laborers, leading to temporary shutdowns and job losses. The manufacturing sector, particularly those dependent on unorganized labor, witnessed a drop in production as workers migrated back to their hometowns due to delayed payments.

1.5.2 Manufacturing & Industrial Output:

Demonetization coincided with a slowdown in industrial activity. The Index of Industrial Production (IIP) reported a decline in growth in the months following the cash ban, as demand for consumer goods fell and supply chains were disrupted. Small manufacturers, who primarily deal in cash transactions, found it difficult to procure raw materials, resulting in production delays and increased costs.

1.5.3 Labor Market Disruptions:

The secondary sector, particularly construction and small-scale manufacturing, relies heavily on informal labor, which is often paid in cash. Due to demonetization, many daily wage earners lost their jobs as companies struggled to arrange payments. Construction projects slowed down due to cash shortages, and many workers were forced to return to rural areas in search of alternative employment. This sudden labor migration led to further inefficiencies in urban industries.

1.5.4 Long-Term Effects:

While the immediate impact was largely negative, demonetization also accelerated formalization efforts in the industrial sector. Many businesses were pushed towards digital payments and banking systems, leading to increased tax compliance and financial transparency. However, the transition was not uniform across industries. Larger corporations adapted more quickly, while smaller businesses continued to struggle due to limited digital infrastructure and financial literacy.

1.5.5 Policy Implications and Recommendations:

A study by the Reserve Bank of India (2018) emphasized that although demonetization aimed to curb black money, its execution negatively impacted cash-dependent sectors. The report suggested that greater financial literacy and improved access to digital banking solutions were necessary for smoother transitions in similar policy interventions.

1.5.6 Real-World Evidence:

Reports indicate that the manufacturing and construction sectors took several months to recover from the impact of demonetization. The SME sector, which employs a significant portion of India's workforce, experienced a dip in profitability due to reduced cash flow and consumer demand. Surveys also suggest that while digital transactions increased post-demonetization, the overall adoption rate in smaller industries remained low.

1.6 Impact on tertiary sector

The tertiary sector of the Indian economy consists of services like retail,banking,finance,healthcare and education for the citizens of the country to use. This sector has a huge grip over the GDP, owing to advancements in technology, globalization, and increased consumer demand. Being a sector such heavily dependent on Cash transactions, Businesses were severely Impacted by the aftermath of demonetization, suffering from crises like liquidity crunch, reduced consumer spending and reduced cash flow among others.

1.6.1 Impact on liquidity:

The government was slow to produce and distribute the replacement bills, which caused a temporary but sharp cash squeeze. Using data on the geographic distribution of the new notes, the researchers find that in December 2016 the value of the new notes in circulation in the median geographic district amounted to only 31 percent of the value of the old notes in circulation before November 8.

1.6.2 Impact on GDP:

In Q1 2017 (April-June), quarterly GDP growth was at 5.7 percent, while 2017 January-March GDP growth was only 6.1 percent. The Q1 GDP growth a year ago was 7.9 percent. While different sectors contributed differently to this slowdown of 2.2 percent, the largest hit was taken by the manufacturing

sector which in the 2016 quarter had expanded by 10.7 percent as compared to only 1.2 percent in the 2017 quarter. The financial, insurance, real estate and professional services sector slowed down by about 3 percent from 9.4 percent growth in Q1 2017 to only 6.4 percent growth in Q1 2017.
According to statisticstimes.com – citing the Planning Commission, Government of India, the Ministry of Statistics and Programme Implementation, and the IMF as its sources – the Economy of India was about 152.51 lakh crore rupees. Suppose we were to approximate that there was about 2 percent lower GDP growth after demonetization. Then this two percent loss would equate to Rupees 305,020 crores loss in GDP – due to demonetization.

1.6.3 Impact on E-commerce:

83 % of consumers in India settle for COD option. As a result of demonetization, it had a detrimental effect on the number of orders placed online as most consumers did not wish to settle for online transaction. Credit and debit cards are the existing options for online payments; but the additional option to patch this void would be the online wallet service: for example: the amazon pay balance usage for purchase. This option made the consumers feel much more comfortable during online transactions. One good impact of demonetization was the increase in the usage of cashless transactions via credit and debit cards rather than being tied up in unending queues at the ATM. Even something as simple as purchase of vegetables from a vendor began to be done via mobile wallets such as PayTm- with cashless money transfer. Vendors as well as public transport workers settled for online payments due to the ban on notes.

1.7 Impact on FDI

Demonetization in 2016 had a mixed impact on Foreign Direct Investment (FDI) in India, causing short-term disruptions but also leading to long-term structural improvements. In the immediate aftermath, the sudden currency withdrawal created economic uncertainty, making foreign investors cautious. Cash-intensive sectors like real estate, construction, and retail, which traditionally attract FDI, faced a significant slowdown due to liquidity shortages. Additionally, consumer demand declined as people struggled with cash availability, discouraging investment in consumer-driven industries like FMCG and automobiles. The stock market experienced volatility as foreign investors withdrew funds, fearing an economic slowdown and declining corporate earnings.

However, in the long run, demonetization improved financial transparency and regulatory oversight, making India a more attractive investment destination. The move accelerated tax compliance, digitization, and financial inclusion, which reassured foreign investors about the country's economic stability. Increased adoption of digital payments led to a surge in FDI in the banking, financial services, and fintech sectors. The real estate sector, initially hit hard, gradually regained investor confidence due to regulatory reforms like the Real Estate (Regulation and Development) Act (RERA), which enhanced transparency. Furthermore, the government's push for initiatives like **"Make in India" and "Startup India"** post-demonetization encouraged FDI in manufacturing, technology, and entrepreneurship, fostering long-term growth.

While the short-term effects of demonetization on FDI were largely negative, the structural reforms it triggered contributed to a more formalized and transparent economy. The overall impact on FDI depended on sector-specific adaptability and investor confidence in India's long-term economic stability. By addressing financial irregularities and promoting digital transactions, demonetization ultimately positioned India as a more attractive destination for foreign investors in sectors aligned with financial technology, e-commerce, and regulated industries.

Literature Review

Ashita Chadha (2017) examines the economic impact of India's 2016 demonetization, when Rs 500 and Rs 1000 notes were invalidated to combat black money, corruption, and counterfeit currency. This sudden move disrupted cash-dependent sectors and daily life, particularly for the rural and middle class. The GDP growth rate declined from 7.9% (2015–16) to 7.1% (2016–17), with a sharper impact seen in the financial, real estate, construction, tourism, and hospitality sectors. Agriculture, automobile, and healthcare sectors also faced challenges due to cash shortages. However, the banking sector experienced a surge in deposits, supporting future lending and digital transactions. Despite short-term economic disruption, the report concludes that demonetization could yield long-term benefits such as improved tax compliance, digitization, transparency, and reduced corruption. Overall, while initial hardships were significant, especially for informal sectors, the initiative is projected to support sustainable economic growth in the long run.

Dr. Virender Atwal (2021) highlights the consequences of the Indian government's 2016 decision to invalidate ₹500 and ₹1000 notes. The move aimed to combat black money, corruption, counterfeit currency, and terrorism financing. While the banking sector benefited from increased deposits and financial inclusion, the overall economy experienced short-term disruption. The agriculture sector, already strained, suffered from cash shortages; manufacturing faced reduced demand; and the service sector, especially small traders and informal businesses, saw significant downturns. Real estate and FMCG sectors also faced sharp declines. However, the long-term goals included promoting a less-cash economy, increasing tax compliance, and strengthening the banking system. Though not a complete solution to black money, demonetization was seen as a major step toward financial transparency and economic reform, with the potential for long-term benefits despite immediate economic slowdowns.

Anandajit Goswami (2023) explores the wide-ranging effects of India's 2016 demonetization policy. It uses both primary and secondary data to evaluate the impact on informal and formal workers, rural and urban populations, and the Indian stock market. The study found that informal workers faced a significant drop in income and increased financial vulnerability, while formal workers were largely unaffected. In rural areas, low digital awareness and limited banking infrastructure hindered the adoption of digital transactions, contrasting with better adoption in urban regions. Although the stock market initially showed a decline, it rebounded and demonstrated stable long-term trends. The study concludes that while demonetization accelerated digitalization and financial inclusion efforts, it also highlighted deep structural disparities, especially affecting the informal sector. It calls for inclusive digital infrastructure, better awareness, and stronger protection for vulnerable groups.

Anita Prasad, Anandajit Goswami, and Amulya Gurtu (2023) examines the impact of India's 2016 demonetization on informal workers, rural and urban populations, and the stock market. It finds that informal workers faced significant income losses, while formal workers were largely unaffected. Rural areas struggled with digital payment adoption due to limited infrastructure, whereas urban areas adapted more easily. The stock market experienced short-term fluctuations but no lasting negative impact. The study highlights policy gaps and the need for better financial inclusion, digital infrastructure, and financial literacy, concluding that demonetization disproportionately harmed economically vulnerable groups.

Dr. V.G. Sumathy and T. Savitha's (2017) study explores the impact of India's 2016 demonetization on the agricultural sector, which heavily depends on cash transactions. Farmers struggled to buy essential inputs like seeds, fertilizers, and labor due to the cash crunch, leading to delays in agricultural activities and loss of employment. Small farmers, lacking bank accounts and access to formal credit, were forced to rely on illegal moneylenders, worsening their financial burden. The unavailability of cash also disrupted the sale and transport of perishable goods, causing wastage and income loss. Cooperative banks, a primary funding source for farmers, faced restrictions, further limiting access to loans. While the government introduced measures like withdrawal limits for farmers, rural areas without banking facilities suffered the most. The authors emphasize the urgent need for better financial inclusion and banking infrastructure to prevent such crises and ensure long-term stability in the agricultural sector.

Ayash Yousuf Shah's (2017) study explores the impact of India's 2016 demonetization on rural India, particularly in agriculture and daily transactions. The sudden withdrawal of high-value currency caused severe cash shortages, making it difficult for farmers to buy seeds, fertilizers, and pay laborers. With limited banking infrastructure, rural communities struggled more than urban areas. Daily wage workers and small traders also faced financial distress due to reduced cash flow. While demonetization aimed to eliminate black money and encourage digital payments, its execution led to economic hardship. The study emphasizes the need for better financial inclusion and banking access to support rural populations.

Shukla et al. (2018) critically evaluated India's demonetization policy, analyzing its intended benefits and implementation challenges. The study highlighted the primary objectives, such as curbing black money, eliminating counterfeit currency, and promoting digital transactions. However, it also revealed significant drawbacks, including cash shortages, economic disruptions, and public inconvenience. The research emphasized that poor execution led to hardships, particularly for small businesses and daily wage earners. The authors concluded that while demonetization had long-term benefits, large-scale economic reforms require careful planning, robust infrastructure, and phased execution to minimize negative short-term consequences and ensure smoother transitions for all stakeholders.

Muthulakshmi (2017) conducted a cross-sectional study assessing the impact of demonetization on the socio-economic and health status of people residing in an urban area of Kanchipuram district. The findings indicated that while a majority of participants were satisfied with the demonetization move, there were significant challenges related to cash shortages, affecting daily transactions and access to healthcare services

Veerakumar (2017) examined the impact of demonetization on the Indian banking sector, highlighting a substantial increase in bank deposits and a surge in digital transactions. He noted that the sudden influx of cash strained banking operations but also accelerated the adoption of digital payment methods. He also found that while education level does not have a significant impact on perceptions of demonetization, factors such as gender, age, income, and occupation do play a significant role in shaping people's views on its effects.

Manju and Kalamani (2017) analyze the economic impact of India’s 2016 demonetization, which withdrew ₹500 and ₹1,000 notes to curb black money, counterfeit currency, and corruption. The sudden move led to a liquidity crisis, disrupting cash-dependent sectors like real estate, retail, and agriculture, while daily wage earners and small businesses suffered. GDP growth slowed, and consumption declined due to cash shortages. However, banking deposits surged, facilitating future lending and digital transactions. The paper highlights both short-term distress and potential long-term benefits, including increased tax compliance, digitization, and financial transparency. Despite hardships, demonetization aimed to create a formalized economy.

Shah & Upadhyay (2017) looks at how demonetization disrupted the Indian agriculture sector, especially for small and marginal farmers. It highlights how the cash crunch made it hard for farmers to buy seeds, fertilizers, and pay laborers. Essentially, the rural economy, heavily dependent on cash transactions, took a direct hit. The authors also touch on how market prices dropped for many crops due to weak demand and fewer buyers in mandis.

Singh & Singh (2018) Focused specifically on rural Punjab, this study found that demonetization triggered panic and confusion among farmers. Many could not access new currency easily, affecting their ability to hire labor, transport produce, or make daily purchases. The paper emphasizes that while the intention of curbing black money was clear, the implementation caught the agricultural community off-guard and unprepared.

Ashwini et al. (2017) brings a broader lens to the discussion. It shows how demonetisation affected the overall agricultural supply chain—from production to distribution. It points out delays in payments to farmers, reduced consumer demand, and a dip in overall productivity. However, the paper also suggests that long-term effects might be positive if digital transactions are adopted widely—but acknowledges that this transition is not easy for everyone, especially in rural areas.

Tripathi (2017) is more statistical in nature but provides useful insights. It identifies the heavy reliance of Indian agriculture on informal credit systems—mostly cash-based. Post-demonetization, this informal system collapsed temporarily, leaving many farmers stranded. The paper underlines that the lack of financial inclusion played a major role in worsening the impact.

2.1 Need of Research

Demonetization has been one of the most significant economic decisions in India’s history, with far-reaching effects on various sectors, particularly the tertiary sector. The government’s sudden withdrawal of ₹500 and ₹1,000 currency notes on November 8, 2016, led to an immediate cash crunch, disrupting economic activities, especially in cash-dependent industries. While the move was intended to curb black money, eliminate counterfeit currency, and encourage digital transactions, its real impact on the Indian economy remains a topic of debate. The tertiary sector, which contributes significantly to India's GDP and employment, was among the hardest hit. However, there is a lack of detailed research focusing specifically on how demonetization affected various service industries, making this study essential.

Another key reason for this research is to evaluate whether demonetization achieved its intended objectives. The government aimed to reduce black money, push for greater financial inclusion, and accelerate digital payments. While digital transactions saw an initial surge, there is a need to examine whether this shift was sustained in the long term or whether cash usage rebounded once liquidity was restored. Furthermore, studies by the Reserve Bank of India (RBI) and World Bank suggest that a significant portion of demonetized currency returned to the banking system, raising questions about the effectiveness of the policy in eliminating black money. This research will analyze the impact of demonetization on financial services, banking, and payment systems to determine whether it led to lasting structural changes in India’s economy.

By analyzing data from credible sources such as the RBI, World Bank, and government reports, this study will provide an in-depth understanding of how demonetization shaped India's service economy. It will offer insights into the immediate economic shock, sectoral recovery, and the long-term implications of this policy. This research is crucial in assessing the successes and failures of demonetization and its role in transforming India's financial and service sectors.

2.2 Research Gaps:

Despite extensive research on the 2016 demonetization and its effects on the Indian economy, several key research gaps remain:

1. **Outdated Data** – Many studies analyzing the impact of demonetization rely on data from the immediate aftermath (2016–2018), while its long-term effects remain underexplored. This study aims to incorporate more recent data to assess lasting economic changes.
2. **Limited Sector-Specific Analysis** – While broad economic impacts have been studied, there is limited in-depth research on specific service industries like tourism, IT, banking, and retail. This study will analyze the differential impact on various segments of the tertiary sector.
3. **Lack of Focus on Informal Sector Recovery** – The informal sector, which was hit hardest by demonetization, has not been adequately studied in terms of its long-term recovery, adaptability, and digital integration.
4. **Inadequate Assessment of Digital Transition** – While demonetization accelerated digital payments, research lacks insights into whether this shift was sustained in rural and semi-urban areas, and how businesses adapted to digital transactions post-demonetization.
5. **Insufficient Policy Evaluation** – Government initiatives like GST implementation, financial inclusion programs, and digital banking reforms have shaped the post-demonetization economy, yet their effectiveness in mitigating its negative effects needs further study.
6. **Limited Understanding of Employment and Income Effects** – Most studies focus on GDP impact, but there is insufficient analysis of how demonetization affected employment trends, wage structures, and job losses, particularly in the unorganized sector.
7. **Regional Disparities** – The impact of demonetization varied across different states and regions, with rural and urban economies facing different challenges. More research is needed to analyze these disparities and their long-term consequences.

8. **Entrepreneurial and Small Business Challenges** – Small businesses were among the worst affected, yet research lacks a detailed exploration of how MSMEs and startups adapted or struggled in a cashless economy.

By addressing these research gaps, this study aims to provide a comprehensive, updated analysis of demonetization's effects on India's tertiary sector, offering insights into economic transformation, challenges, and policy recommendations for future financial reforms

Research Methodology

3.1 Introduction

Research is a systematic and scientific approach to investigating a particular subject, problem, or phenomenon to obtain relevant insights. It involves formulating research questions, collecting data, analysing findings, and drawing conclusions. In simple terms, research refers to a structured exploration to gain knowledge and provide solutions.

3.2 Objectives

The present study is undertaken with the following objectives:

• To analyse the overall impact of demonetization on the Indian economy, considering both short-term and long-term effects.

• To examine the effects of demonetization on various economic sectors such as banking, MSMEs, real estate, and digital payments.

• To investigate the changes in cash circulation, financial transactions, and the transition to a digital economy post-demonetization.

• To assess the public perception of demonetization and its effectiveness in addressing black money, counterfeit currency, and tax compliance.

3.3 Research Design

A research design is a structured framework that outlines the methodology for data collection and analysis to ensure the study's relevance and efficiency. The present study employs a descriptive research design to analyse the economic impact of demonetization by utilizing both qualitative and quantitative data.

3.4 Sources of Data & Data Collection

Data collection is a crucial aspect of research that ensures the accuracy and reliability of the study.

3.4.1 Secondary Data

Secondary data includes information collected from existing sources such as government reports, research papers, and financial statistics. The study refers to:

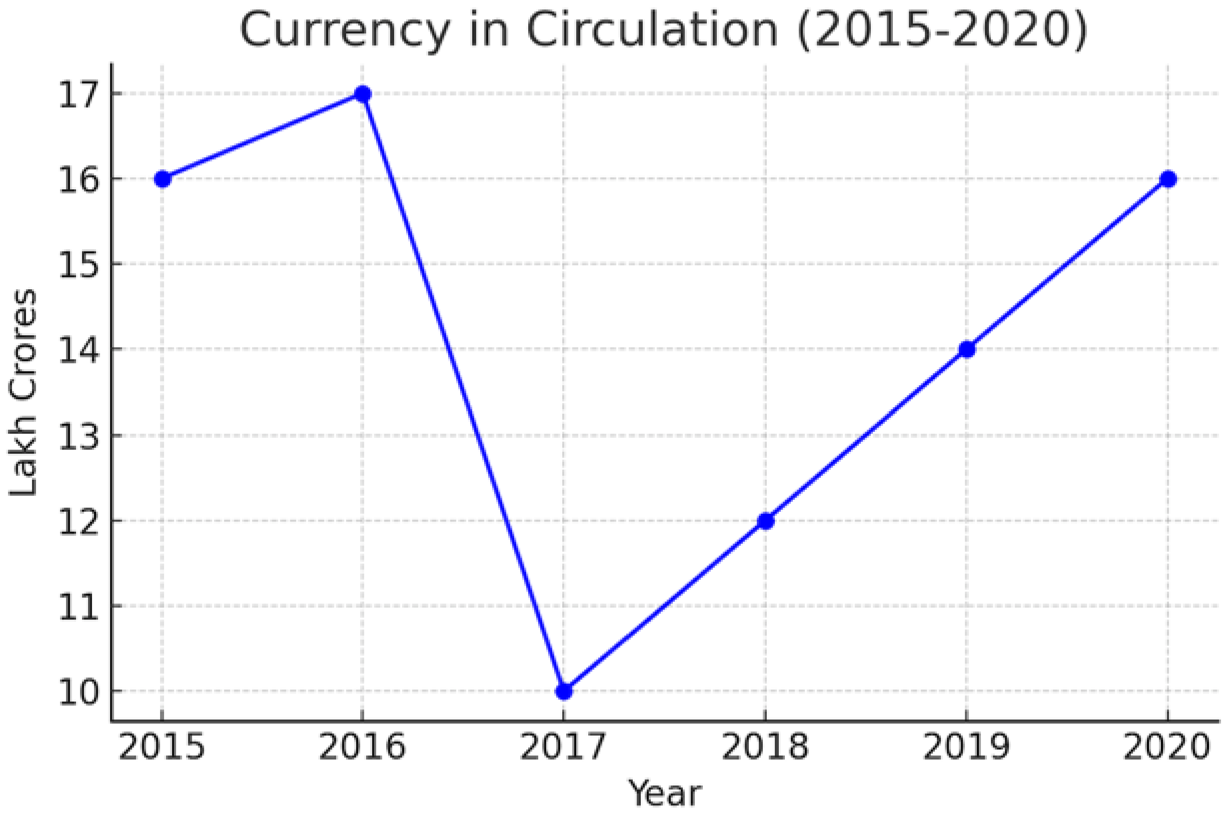
• Government Reports: Reserve Bank of India (RBI) reports, Ministry of Finance publications, and Economic Survey reports on demonetization.

• Research Papers & Articles: Published studies analyzing the macroeconomic impact of demonetization.

• Newspaper & Media Reports: Articles from reputable sources like The Economic Times, Business Standard, and The Hindu for real-time economic analysis.

Data Analysis and interpretation

Figure 1: Impact of demonetization on the currency in circulation.

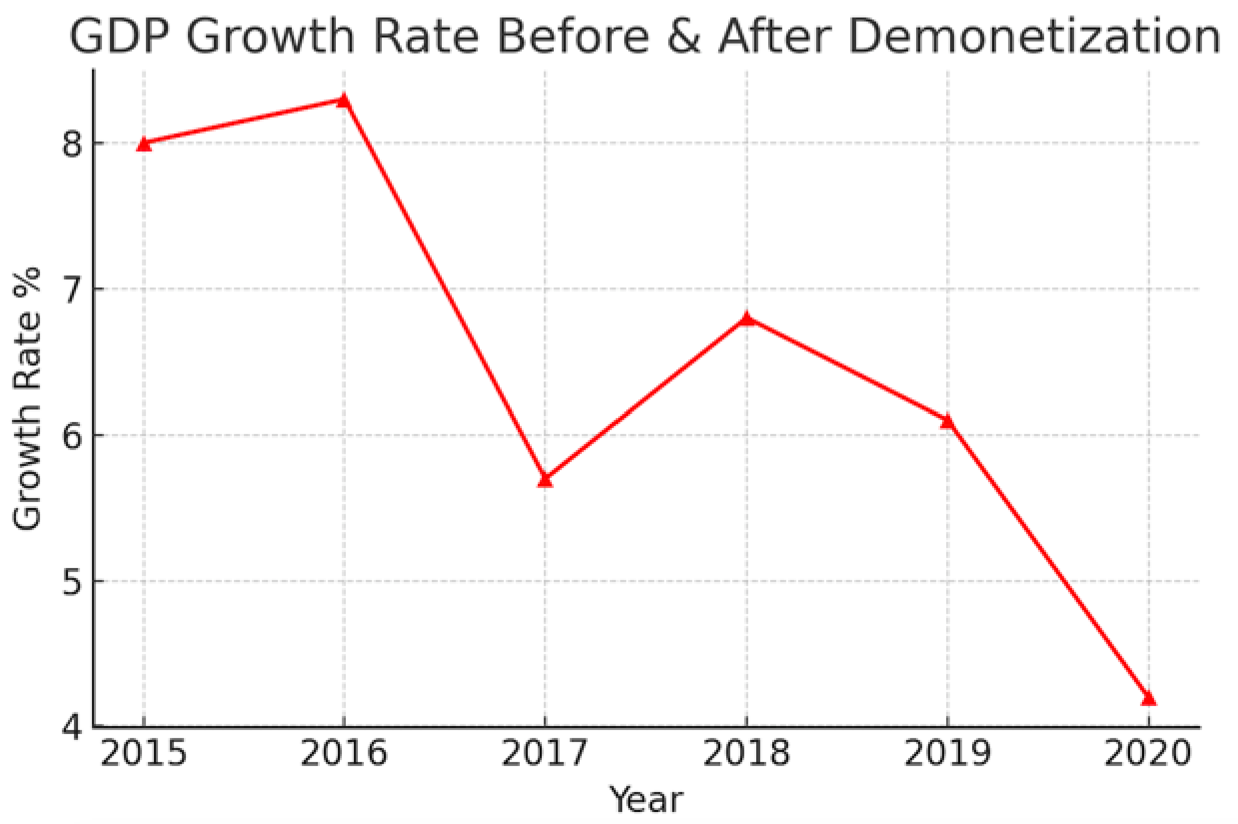


Source: Reserve Bank of India (RBI). (2017). *Annual Report 2016-17*

Analysis: The graph illustrates the impact of India's 2016 demonetization on currency circulation. The Steady rise of the Currency in circulation was suddenly disrupted by the announcement of Demonetization as it withdrew close to 86% of the total currency in circulation. This severe cash crunch is reflected in the graph, which shows a steep decline in the currency in circulation between the years 2016-17. It also reflects the gradual return to pre-demonetization levels, depicting a gradual adjustment of the new currency notes withing the economy.

The recovery period also accounts for the new currency notes of Rs. 500 and 2000 being introduced to circulation.

Figure 2: Change in GDP growth post 2016.



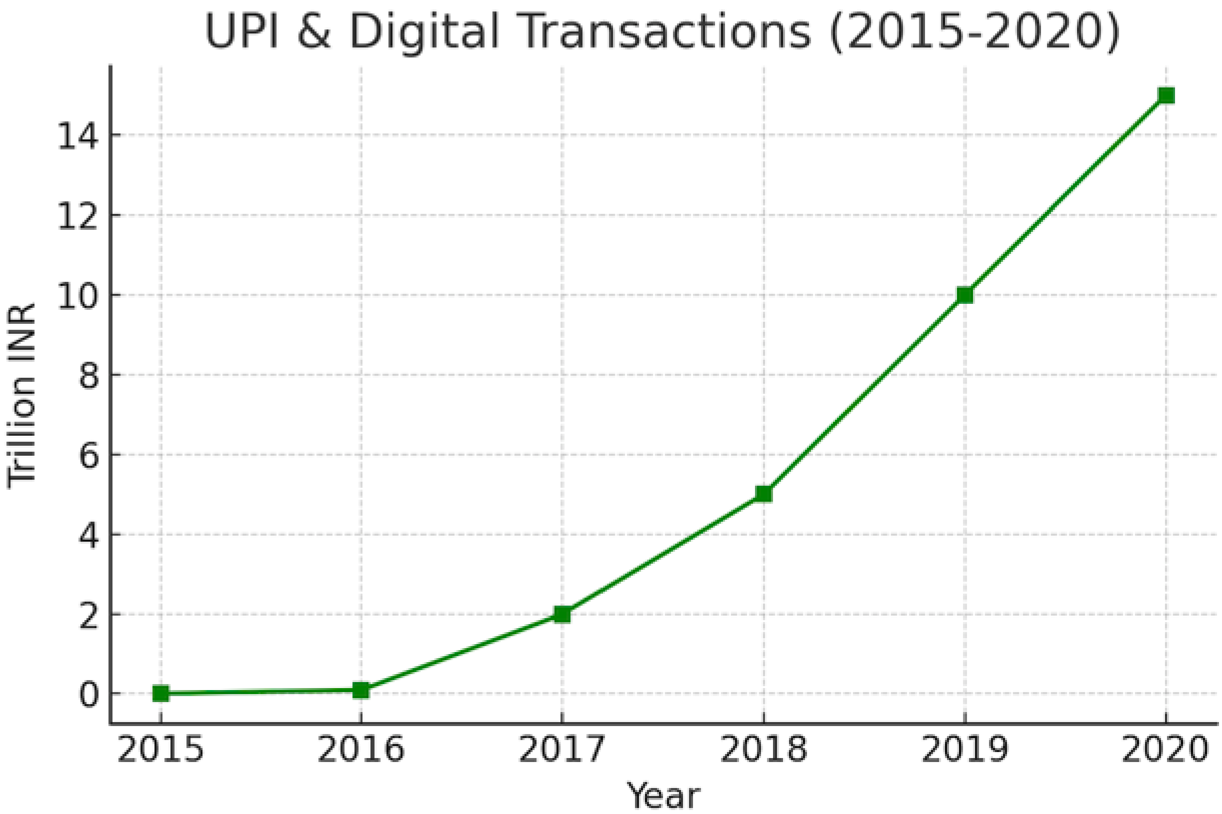
Source: **Reserve Bank of India (RBI).** (2017). *Annual Report 2016-17*

Analysis: The graph illustrates the GDP growth rate of India from 2015 to 2020, highlighting the impact of demonetization. In 2015 and 2016, the economy exhibited strong growth, with the GDP growth rate peaking above 8% in 2016. However, following the demonetization announcement in November 2016, a sharp decline is evident, as the GDP growth rate fell to around 6% in 2017. This drop can be attributed to the sudden removal of ₹500 and ₹1000 currency notes, which disrupted cash-dependent sectors such as small businesses, agriculture, and informal markets.

In 2018, the economy showed some signs of recovery, with the GDP growth rate rising to approximately 7%, possibly due to the stabilization of the financial system and the introduction of new currency notes. However, this recovery was short-lived as the growth rate declined again in 2019 to around 6%, indicating underlying structural weaknesses. By 2020, the economy suffered a steep drop to nearly 4%, which could be attributed to a combination of factors, including the lingering effects of demonetization and the onset of the COVID-19 pandemic.

Overall, the graph suggests that while demonetization had an immediate negative impact on GDP growth, the economy attempted to recover but struggled with fluctuations in subsequent years. The declining trend towards 2020 reflects broader economic challenges beyond demonetization, including global economic conditions and domestic policy factors.

Figure 3: Rising Adoption of alternative modes of payment.



Souce: **NITI Aayog.** (2019). *Digital Transactions and Financial Inclusion in India Post-Demonetization*

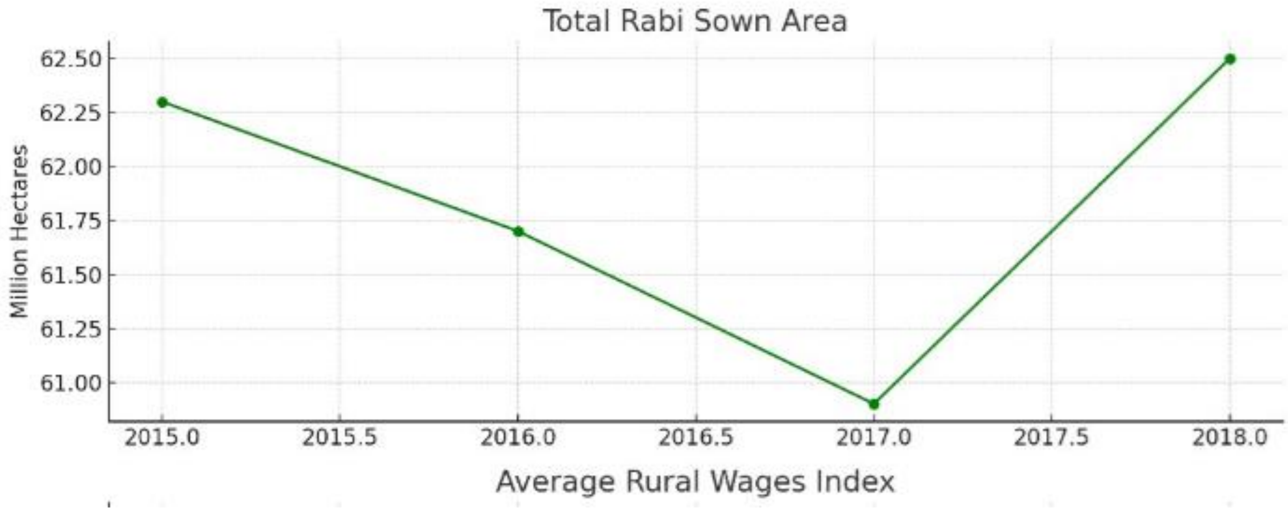
Analysis: The graph shows how UPI and digital payments grew in India from 2015 to 2020. Before 2016, most people relied on cash, and digital payments were uncommon.

Demonetisation in 2016 created a cash shortage, forcing people to switch to digital transactions. This led to a sharp rise in UPI and other cashless payments.

From 2017, digital payments surged, crossing 6 trillion INR by 2018 and 14 trillion INR by 2020. Government initiatives, smartphone growth, and better internet access fuelled this trend.

Overall, demonetisation acted as a turning point for digital payments, making them a dominant mode of transactions in India today.

Figure 4: Impact on Agriculture, depicted in terms of Rabi Crops



Source: The Hindu, The Economic Times, Business Standard, Livemint. (2016-2019). *Real-Time Analysis of Demonetization's Effects on Different Economic Sectors.*

Analysis: The graph shows how demonetisation (2016) affected Indian agriculture, particularly the total area of Rabi crops sown from 2015 to 2018 (in million hectares).

Rabi sowing dropped sharply between 2015 and 2017, hitting its lowest point in 2017. This decline aligns with the cash crunch caused by demonetisation, which disrupted payments for seeds, fertilizers, and farm labor—most of which relied on cash transactions.

The steep fall in 2017 suggests that farmers struggled to finance their crops, and labor shortages may have worsened due to delayed payments. However, by 2018, the sector bounced back, likely due to government support, improved banking access, and growing adoption of digital payments.

Overall, demonetisation had a short-term negative impact on agriculture, but the sector gradually adjusted, leading to a recovery in Rabi sowing by 2018

Figure 5: Average wages provided to Rural workers.

Source: **The Hindu, The Economic Times, Business Standard, Livemint.** (2016-2019). *Real-Time Analysis of Demonetization's Effects on Different Economic Sectors.*

Analysis: The graph shows the Average Rural Wages Index from 2015 to 2018, reflecting changes in rural earnings.

From 2015 to 2016, wages steadily increased, likely due to strong agricultural output and rising labor demand. However, after demonetisation in 2016, rural wages dropped in 2017. This was because the cash shortage affected workers and employers who relied on cash for payments.

By 2018, rural wages started to rise again, indicating that the rural economy had started recovering. This recovery was likely helped by the circulation of new currency, the rise of digital payments, and government support programs like rural employment schemes and farm subsidies.

In summary, the graph shows that demonetisation temporarily hurt rural wages, but the economy bounced back as cash flow returned to normal and rural activities picked up again.

	GVA AT BASIC PRICES [`Cr.]			PERCENTAGE CHANGE OVER PREVIOUS YEAR/ PREVIOUS QUARTER					
Industry	**2016-17**			**2015-16**			**2016-17**		
	Q1	**Q2**	**Q3**	**Q1**	**Q2**	**Q3**	**Q1**	**Q2**	**Q3**
Agriculture, forestry & fishing	378847	317976	541851	2.6	2.3	**-2.2**	1.9	3.8	**6.0**
Mining & quarrying	92810	69877	89684	11.2	13.9	**13.3**	-0.3	-1.3	**7.5**
Manufacturing	501002	494773	475618	8.5	10.3	**12.8**	9.0	6.9	**8.3**
Electricity, gas, water supply & other utility services	60647	59323	59435	2.5	5.9	**4.1**	9.6	3.8	**6.8**
Construction	220195	209434	218466	4.8	0.0	**3.2**	1.7	3.4	**2.7**
Trade, hotels, transport, communication and services related to broadcasting	515079	501864	515009	10.6	8.9	**9.6**	8.2	6.9	**7.2**
Financial, real estate & professional services	646730	720369	523081	10.2	13.1	**10.4**	8.7	7.6	**3.1**
Public administration, defence and Other Services	323063	371712	378944	6.3	7.2	**7.5**	9.9	11.0	**11.9**
GVA at Basic Price	2738372	2745328	2802089	7.8	8.4	7.0	6.9	**6.7**	**6.6**

Source-**Ministry of Statistics & Programme Implementation, Second Advance Estimates of National Income -2016-17|as on 28 February 2017.**

Table 1: Impact on various sectors in terms of GVA

Analysis: The table presents Gross Value Added (GVA) at Basic Prices for various industries in India for 2016-17, along with the percentage change over previous years and quarters. The period covered includes the third quarter (Q3) of 2016-17, which was directly impacted by the demonetization policy of November 2016.

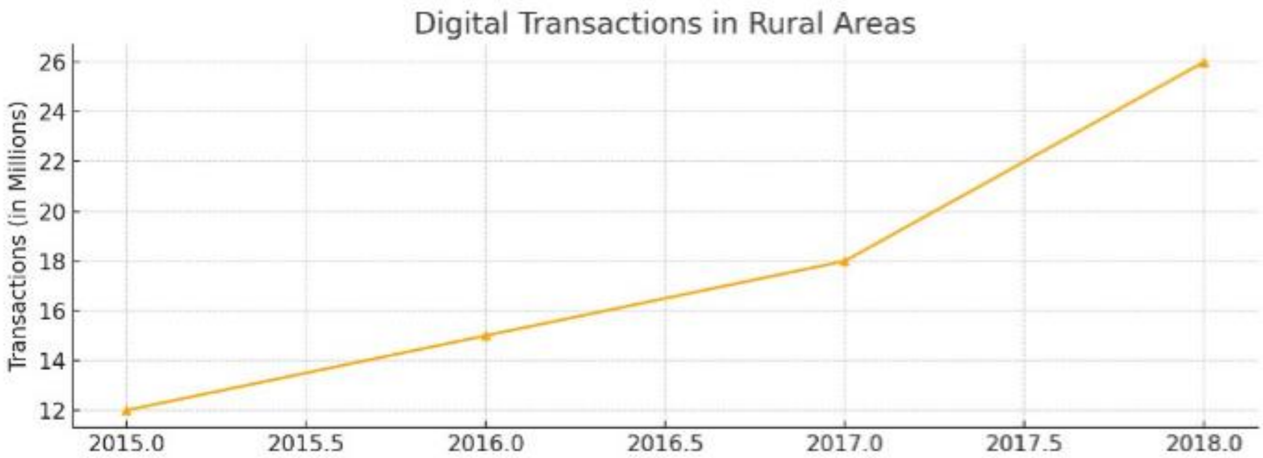
A key observation is the sharp decline in growth rates across multiple sectors in Q3 of 2016-17, which aligns with the immediate economic disruption caused by demonetization. For instance, the manufacturing sector, which showed a robust 12.8% growth in Q3 of 2015-16, dropped significantly to 8.9% in Q3 of 2016-17. Similarly, mining & quarrying, which had a strong 13.3% growth in Q3 of

2015-16, saw a major contraction to -7.5% in Q3 of 2016-17, likely due to cash shortages affecting operations and demand.

The construction sector, which is heavily reliant on cash transactions, showed a major slowdown as well. Its growth rate fell from 3.2% in Q2 of 2016-17 to 2.7% in Q3, indicating a decline in labor availability and stalled projects. However, public administration, defence, and other services exhibited strong growth, rising from 9.9% in Q2 to 11.9% in Q3, suggesting that government spending played a key role in supporting overall GVA during this period.

Overall, the table highlights how demonetization created a significant short-term economic shock, particularly in cash-intensive industries like construction, mining, and manufacturing. Meanwhile, government-driven sectors such as public administration and financial services managed to cushion the overall impact on India's economic growth.

Figure 6: Increased use of Digital transactions in Rural Areas.



Source:**NITI Aayog.**(2019).*Digital Transactions and Financial Inclusion in India Post-Demonetization*

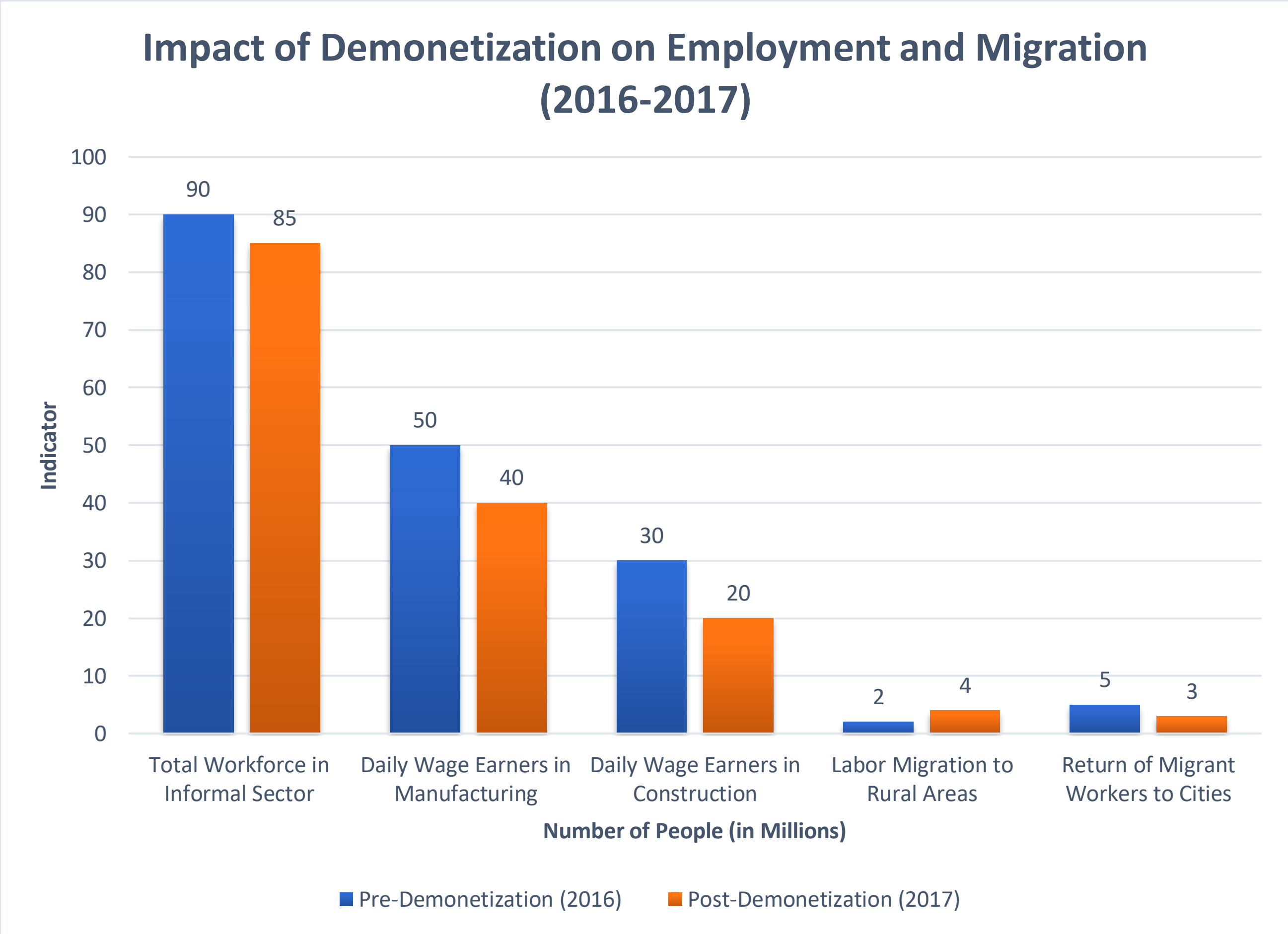
Analysis: The graph shows the growth of digital transactions in rural areas from 2015 to 2018, with a steady increase over the years.

Before demonetisation in 2016, digital transactions in rural areas grew at a moderate pace. But after demonetisation, the rate of digital transactions increased sharply, especially from 2017 onward.

The removal of ₹500 and ₹1000 notes caused a severe cash shortage, pushing people to use alternatives like UPI, mobile wallets, and online banking. Rural areas, which were once largely cash-dependent, had to adapt to digital payments out of necessity. This shift is clearly seen in the sharp rise in digital transactions after 2016.

By 2018, digital transactions in rural areas reached their peak, showing that people had fully embraced digital payments. Government initiatives like BHIM UPI, Aadhaar-linked payments, and better internet access in rural areas all helped this digital transition. The graph shows how demonetisation became a catalyst for the growth of digital payments in rural India, despite the initial disruptions.

Figure 7: Impact of Demonetization of Employment and Migration.



Source: *Impact of Demonetization on India's Economy: Disruptions and Long-Term Prospects*

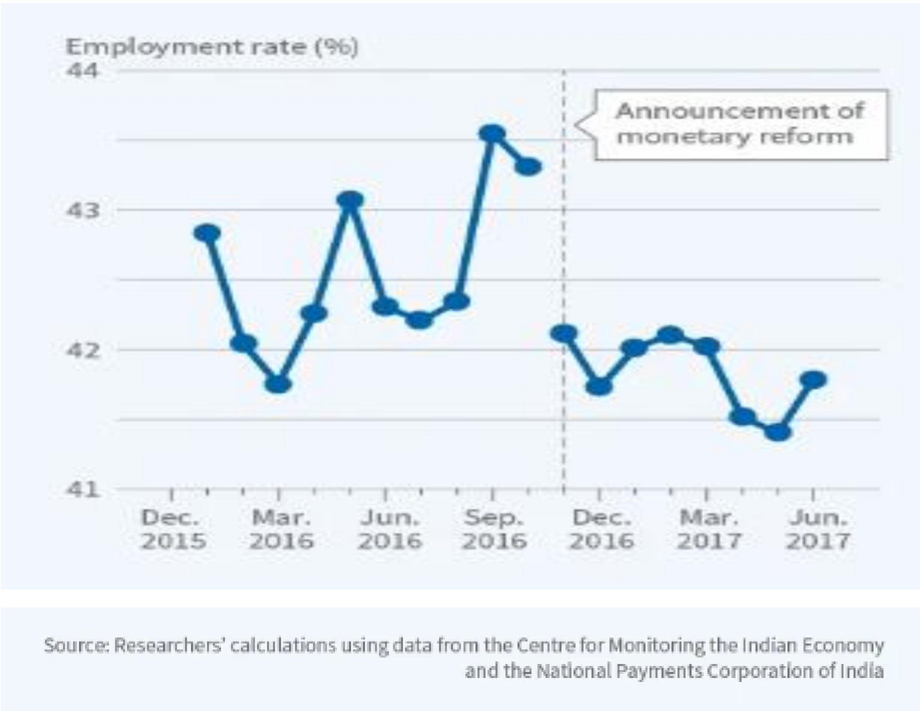
Analysis: The graph shows how demonetization affected jobs in the informal sector and changed migration patterns. The total number of informal workers dropped slightly from 90 million in 2016 to 85 million in 2017, showing that some people lost their jobs due to the cash shortage.

Daily wage workers in manufacturing fell from 50 million to 40 million, while those in construction dropped from 30 million to 20 million. Since these jobs mostly relied on cash payments, many businesses struggled to pay workers, leading to job losses.

The lack of cash also forced more workers to move back to rural areas, with migration doubling from 2 million in 2016 to 4 million in 2017. At the same time, fewer migrant workers returned to cities, dropping from 5 million to 3 million, suggesting that urban jobs had not fully recovered.

Overall, the graph highlights how demonetization disrupted employment, especially for daily wage earners, and pushed many workers to return home. While the economy may have adjusted later, the initial impact on jobs and migration was clear

Figure 8: Fluctuations in the Employment rate post 2016.



Analysis: The graph illustrates the employment rate (%) from December 2015 to June 2017, with a key event marked as the announcement of monetary reform (demonetization) in November 2016. Before demonetization, the employment rate fluctuated between 42% and 43%, showing periodic rises and falls but maintaining relative stability. However, immediately after November 2016, there is a noticeable decline in employment, indicating that demonetization had an adverse impact on the job market.

The employment rate dropped sharply between December 2016 and March 2017, reaching its lowest point in early 2017. This decline can be attributed to the severe cash shortage caused by demonetization, which hit the informal sector, small businesses, and daily-wage laborers the hardest. Since a significant portion of India's workforce depends on cash transactions, the sudden removal of ₹500 and ₹1000 notes likely led to job losses, business closures, and a slowdown in hiring.

Post-March 2017, the employment rate showed slight fluctuations but did not return to pre-demonetization levels, indicating a longer-term economic adjustment period. This suggests that while demonetization was intended to curb black money and push for a digital economy, it had lasting negative effects on employment, particularly for sectors that relied heavily on cash transactions. The graph highlights how monetary reform can create economic disruptions, especially for the workforce in informal and cash-dependent industries.

Conclusion

Demonetisation was a bold and unexpected move by the Indian government that affected nearly every corner of the economy and touched the lives of millions overnight. With the goal of tackling black money, curbing corruption, eliminating counterfeit currency, and encouraging digital transactions, ₹500 and ₹1,000 notes—making up 86% of the currency in circulation—were suddenly declared invalid in November 2016.

Through our research, we found that the impact varied widely across sectors. The primary sector, especially agriculture, was hit hard due to its dependence on cash transactions. Small and marginal farmers struggled to buy seeds, pay labourers, or sell their produce. The lack of access to banking in rural areas worsened the situation, particularly during the critical sowing season. In the secondary sector, particularly in small-scale manufacturing and informal enterprises, cash shortages led to slowed production, job losses, and reduced demand. The tertiary sector (services) experienced mixed effects—while retail and transportation suffered in the short run, the financial and digital services industries saw growth as people shifted toward online and cashless transactions.

On the positive side, demonetisation pushed India toward a more formal and digitised economy. There was a surge in digital payments, higher bank deposits, and an expanded taxpayer base. These are long-term structural benefits that could support stronger economic governance in the future.

However, the suddenness of the policy and lack of preparation brought serious hardships—especially for people in informal jobs, rural households, and small businesses. Many daily wage workers lost income, and some sectors took months to recover from the liquidity crunch.

Demonetisation did bring about some of the intended outcomes, but not without significant short-term costs. It did not entirely wipe out black money or eliminate corruption, as those are deeper issues tied to governance and enforcement. Yet, it managed to change the way people transact, nudging India closer to a digital economy and greater financial transparency.

In conclusion, demonetisation was a policy that reshaped India's economic landscape in profound ways. It served as a wake-up call about the vulnerabilities of a cash-heavy system and highlighted the need for a more inclusive and resilient financial infrastructure. Whether seen as a necessary disruption or a costly experiment, its legacy continues to influence economic reforms and debates even today.

Recommendations and Implications

Based on our research and analysis, it is clear that demonetisation brought both opportunities and challenges. While the intention was to build a more transparent and formal economy, the sudden execution caused disruptions, especially in cash-dependent sectors. Going forward, here are a few key recommendations and takeaways that could help shape better policy decisions:

1. Strengthen Rural Banking Infrastructure

One of the biggest issues during demonetisation was the lack of banking access in rural areas. Many farmers and small vendors struggled simply because they could not reach a bank or ATM. Expanding banking services—through mobile banks, better ATM coverage, and more rural branches—can help ensure smoother transitions in any future reforms.

2. Promote Digital Literacy and Accessibility

While digital payments have grown, many people—especially in rural or low-income communities—still find them confusing or unsafe. The government and private sector should invest in digital literacy programs, vernacular payment apps, and secure, user-friendly platforms to build confidence and inclusivity in the digital economy.

3. Better Planning and Communication

A major takeaway from demonetisation is the importance of preparation. Policy changes that impact day-to-day life should be introduced with more planning, phased rollouts, and clear communication. This would help people and businesses prepare, adapt, and avoid unnecessary panic.

4. Special Focus on the Informal and Agricultural Sectors

The informal sector employs a huge portion of India's population, yet it's the most vulnerable during shocks like demonetisation. Future economic policies must account for their needs—by ensuring easy access to working capital, improving market linkages, and protecting incomes through supportive schemes.

5. Use Data to Monitor Impact

Any major policy should be followed by transparent data collection and regular reviews. Monitoring its impact in real-time allows for quicker adjustments and helps maintain public trust.

Scope of Future Research

While this report offers insights into how demonetization impacted various sectors of the Indian economy, there is still much to explore, especially in terms of its long-term consequences. The effects of such a massive policy move are wide-ranging, and some may only fully emerge over time. Future research can provide a more detailed understanding of how different sectors, regions, and population groups adapted in the years that followed, and what lessons can be applied to future economic reforms.

1. Long-Term Impact on Agricultural Practices

Future studies can explore whether farmers, especially small and marginal ones, shifted their methods or financial habits after demonetisation. Did they adopt digital payment systems or change the way they manage cash flow? Understanding these changes could show whether the disruption led to lasting improvements.

2. Region-Specific Experiences

Different states and regions faced demonetisation in unique ways, depending on infrastructure and economic conditions. Future research can focus on regional case studies to identify which areas struggled the most and why—and what can be learned from areas that adapted better.

3. Behavioral and Social Changes

How did demonetisation change people's habits—like spending, saving, and trusting formal banking systems? Did it build long-term financial discipline or increase reliance on informal systems? Exploring these human-level shifts can offer meaningful insights into economic behavior during crises.

4. Digitalisation of the Informal Sector

A key goal of demonetisation was to push the economy toward digital transactions. Future research can study how far informal workers and rural markets have embraced digital tools and what barriers still remain in adopting technology for daily transactions.

5. Evaluating Policy Effectiveness

There's also scope to evaluate how well government support schemes (like direct transfers or rural employment programs) helped people recover from the cash crunch. This can help refine policy responses in future economic disruptions.

Key Findings

The demonetisation policy announced in November 2016 had a far-reaching impact across the Indian economy. Through this report, we have examined how the sudden withdrawal of high-value currency notes affected different sectors, economic behaviour, and the pace of structural change. Below are the major findings of our study:

1. A Sudden Liquidity Crunch Disrupted Economic Flow

With 86% of the currency in circulation declared invalid overnight, the economy experienced an immediate and severe cash shortage. This disrupted routine transactions, led to long queues at banks and ATMs, and slowed down both consumption and production, particularly in areas heavily reliant on cash.

2. Informal Sector Faced Major Setbacks

India's informal sector, which employs a large portion of the population and operates largely on cash, was one of the hardest hit. Daily wage earners, small traders, and unregistered businesses suffered losses due to lack of working capital and reduced customer demand. Many workers faced temporary unemployment or wage cuts during this period.

3. Decline in Consumer Spending and Economic Activity

Household spending dropped as people prioritized essential goods and delayed non-urgent purchases. Sectors like retail, real estate, transportation, and small-scale manufacturing witnessed a slowdown in demand, causing ripple effects on employment and income levels.

4. Short-Term Boost in Financial Inclusion

A notable outcome was the surge in bank deposits as people rushed to exchange old currency. This temporarily expanded the formal financial system and brought many first-time users into the banking net. However, this trend saw a partial reversal as people reverted to cash usage over time.

5. Digital Payments Rose Sharply—But Unevenly

Demonetisation gave a big push to digital transactions, including mobile wallets, UPI, and card payments. Urban areas and large businesses adapted more quickly, while rural regions struggled due to poor infrastructure, digital illiteracy, and lack of trust in non-cash systems. The shift was real but not evenly sustained across the population.

6. GDP Growth Slowed Temporarily

India's GDP growth rate dipped in the quarters following demonetisation. The slowdown reflected reduced private consumption, disrupted supply chains, and uncertainty among investors and businesses. While the economy gradually recovered, the short-term shock had lasting implications for small businesses and employment.

7. Limited Evidence of Long-Term Gains in Tax Compliance

One of the key goals of demonetisation was to curb black money and increase tax compliance. While there was a modest increase in tax filings, the overall impact on unaccounted wealth remains unclear. Much of the demonetised currency eventually returned to the banking system, raising questions about the effectiveness of the move in addressing illicit wealth.

8. Implementation and Communication Gaps Were Critical

The sudden nature of the announcement and the initial unavailability of new currency led to widespread confusion and distress. The policy lacked a phased rollout or a comprehensive contingency plan, which could have mitigated some of the economic disruptions faced by vulnerable groups.

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