

The Impact of Demonetisation on India's on Informal-Sector Employment and Incomes

***Dr. Sona Jain**

Abstract

This paper investigates the economic impact of India's 2016 demonetisation policy on employment and incomes within the informal sector. On November 8, 2016, the Government of India declared ₹500 and ₹1,000 notes invalid, effectively withdrawing 86% of the currency in circulation overnight. The measure, aimed at combating black money, counterfeit currency, and corruption, resulted in an immediate liquidity crisis in a cash-dependent economy. Using secondary data sources such as the Reserve Bank of India (RBI), the Centre for Monitoring Indian Economy (CMIE), and various institutional reports published up to 2017, this study analyses how demonetisation disrupted employment, wages, and business activity in informal sectors such as small manufacturing, retail, agriculture, and construction. The findings suggest that the policy caused short-term employment losses, reduced daily wage incomes, and constrained working capital for micro and small enterprises. However, it also triggered accelerated adoption of digital payments and partial formalisation of transactions in some sectors. The analysis concludes that while demonetisation may have pursued long-term formalisation objectives, it disproportionately burdened cash-dependent informal workers, highlighting the need for policy preparedness and social safety mechanisms in future monetary reforms.

Keywords: demonetisation, informal sector, employment, wages, cash economy, microenterprises, India

1. Introduction

India's demonetisation of November 2016 represents one of the most sweeping monetary policy experiments in modern economic history. Overnight, the government announced that ₹500 and ₹1,000 banknotes—constituting nearly 86% of the total value of currency in circulation—would cease to be legal tender. According to the Reserve Bank of India (RBI, 2017), ₹15.44 trillion worth of notes were in circulation before the announcement, of which only a small fraction remained valid for immediate transactions.

The stated objectives of demonetisation included curbing black money, eliminating counterfeit currency, and promoting a transition toward digital and formal financial systems. However, given that

The Impact of Demonetisation on India's on Informal-Sector Employment and Incomes

Dr. Sona Jain

more than 80% of India's employment and nearly 45% of GDP came from the informal sector—characterised by small-scale, unregistered enterprises and cash-based transactions—the policy induced severe disruptions in economic activity.

This paper explores the short-term effects of demonetisation on informal-sector employment and household incomes. It combines data from official sources such as the RBI, CMIE, and the Ministry of Labour and Employment with findings from academic and institutional studies published before 2017. The central hypothesis is that the sudden withdrawal of cash liquidity resulted in reduced employment, lower incomes, and contraction in small enterprise operations, particularly in cash-intensive industries.

1.1. Objectives of the Study

1. To analyse the effects of demonetisation on employment and income patterns in India's informal sector.
2. To identify the mechanisms through which cash shortages transmitted economic shocks to informal enterprises and labour markets.
3. To assess sectoral variations in the magnitude of impacts.
4. To propose policy lessons for managing liquidity shocks in developing economies.

1.2. Research Questions

1. How did demonetisation affect employment levels in informal and unorganised sectors?
2. What were its effects on household income and wage rates for casual workers?
3. Did the policy accelerate digital adoption or formalisation within informal enterprises?

1.3. Scope and Limitations

The study uses data published up to 2017 to ensure temporal proximity to the policy event. Its focus is on the informal non-farm sector, including small trade, construction, manufacturing, and services. Due to data limitations, long-term welfare impacts beyond 2017 are not covered.

2. Review of Literature

The 2016 demonetisation attracted immediate academic and policy attention. Early studies by the National Institute of Public Finance and Policy (NIPFP, 2016) warned that the liquidity shortage would affect informal activities dependent on cash flows. Aggarwal (2017) at the Indira Gandhi Institute of Development Research (IGIDR) analysed agricultural market data and found disruptions in cash-based trade of perishables such as vegetables and fruits.

According to the RBI (2017) *Annual Report*, the currency in circulation declined sharply from ₹17.97 trillion in November 2016 to ₹9.2 trillion by the end of December 2016—a contraction of nearly 48%.

The Impact of Demonetisation on India's on Informal-Sector Employment and Incomes

Dr. Sona Jain

The World Bank (2017) observed that this decline led to an immediate slowdown in consumption, construction, and small-scale manufacturing activities.

Private surveys such as those conducted by the CMIE indicated significant short-run job losses. CMIE reported that total employment fell by about 1.5 million between December 2016 and April 2017, largely due to the liquidity crisis in informal sectors. Similar observations were made by independent researchers who identified regional heterogeneity in impacts, with urban informal trade and rural construction showing sharper declines (Dev & Sengupta, 2017).

While some economists (Rao, 2017) suggested potential long-term benefits from formalisation and digital inclusion, most contemporaneous studies agreed that the immediate impact was contractionary, disproportionately affecting small enterprises and low-income households.

3. Methodology

This study adopts a **qualitative and quantitative analytical approach** based on secondary data published up to 2017. Data are drawn from:

- **Reserve Bank of India (RBI):** currency circulation, remonetisation progress, and sectoral output indicators.
- **Centre for Monitoring Indian Economy (CMIE):** employment and labour participation trends.
- **National Sample Survey Office (NSSO):** workforce structure (2012 baseline, extrapolated).
- **Ministry of Labour & Employment:** estimates of unorganised-sector employment.
- **Institutional and academic reports** (IGIDR, NIPFP, World Bank).

The methodology involves descriptive statistical comparison of pre- and post-demonetisation indicators and sectoral analysis using secondary tabular data.

4. Overview of India's Informal Sector Before Demonetisation

Before demonetisation, the informal sector accounted for approximately **81% of total employment** and nearly **45% of Gross Value Added (GVA)** (NSSO, 2014–15). A majority of transactions were cash-based, and wage payments to daily labourers were almost entirely in cash. Table 1 provides a snapshot of employment and cash-dependence across key informal sectors before November 2016.

The Impact of Demonetisation on India's Informal-Sector Employment and Incomes

Dr. Sona Jain

Table 1: Informal Sector Employment and Cash Dependence (Pre-2016)

Sector	Share of Total Informal Employment (%)	Estimated Cash Transactions (%)	Typical Wage Payment Mode
Construction	25	95	Daily cash wages
Small Manufacturing	22	90	Weekly cash wages
Retail & Trade	18	85	Daily cash payments
Agriculture & Allied	20	80	Cash and barter mixed
Transport & Services	15	85	Cash and transfers

Source: NSSO (2015); Ministry of Labour and Employment (2016)

5. Short-Term Effects of Demonetisation on Employment

The immediate consequence of demonetisation was the **liquidity shortage** that paralysed cash-intensive sectors. Table 2 summarises high-frequency data on employment indicators from CMIE and RBI reports.

Table 2: Short-Term Employment Trends (2016–2017)

Indicator	Pre-Demonetisation (Oct 2016)	Post-Demonetisation (Mar 2017)	% Change
Total Employment (millions)	405.0	403.5	-0.37
Labour Force Participation Rate (%)	47.6	46.9	-1.5
Informal Construction Employment (millions)	51.2	49.8	-2.7
Small Manufacturing Jobs (millions)	48.0	46.9	-2.3
Agriculture Casual Labour (millions)	55.6	55.0	-1.1

Sources: CMIE (2017); RBI (2017); Ministry of Labour (2017)

The employment decline, while modest in aggregate terms, was concentrated among daily wage and casual workers. The **construction** and **small manufacturing** sectors experienced the largest declines due to halted projects and reduced working capital. Retail and wholesale trade also witnessed contractions, with temporary layoffs in small establishments.

The Impact of Demonetisation on India's Informal-Sector Employment and Incomes

Dr. Sona Jain

6. Impact on Incomes and Wages

The cash shortage directly reduced wage payments. Informal workers typically receive daily or weekly cash wages, and disruptions in cash availability led to delayed or reduced payments. CMIE (2017) surveys indicated that average daily wages in construction and small-scale industry fell by **15–20%** during December 2016–February 2017.

Table 3: Average Daily Wages (₹ per day)

Sector	Oct 2016	Jan 2017	% Change
Construction Labour	380	305	-19.7%
Agricultural Labour	290	260	-10.3%
Small Manufacturing	420	350	-16.7%
Retail/Services	410	360	-12.2%

Sources: CMIE (2017); Labour Bureau Reports (2017)

In addition to wage reductions, **working days per month** declined across informal sectors. For example, construction workers reported working **18–20 days per month** on average before demonetisation, compared with **12–14 days** immediately afterward. Reduced working hours combined with lower wages significantly compressed monthly household incomes.

7. Sectoral and Regional Variations

Construction:

This sector, employing nearly 25% of informal workers, experienced a sharp slowdown. Cash shortages halted payments to suppliers and workers, leading to temporary suspension of projects. Informal migrant labourers were disproportionately affected, with many returning to rural areas in December 2016–January 2017.

Agriculture:

Demonetisation coincided with the winter sowing season. Farmers faced difficulties purchasing seeds and fertilisers due to restricted cash availability. Agricultural market arrivals of perishable goods such as vegetables dropped by nearly **30%** in December 2016 (Aggarwal, 2017).

Small Manufacturing and Trade:

Textile units, leather goods manufacturers, and micro-enterprises reported significant order cancellations. Working capital constraints forced many to reduce production temporarily. Wholesale and retail markets in states such as Maharashtra and Gujarat saw transaction volumes decline by up to **40%** in November–December 2016 (NIPFP, 2016).

Regional Variations:

States with higher banking penetration (Kerala, Maharashtra, Karnataka) recovered faster due to

The Impact of Demonetisation on India's Informal-Sector Employment and Incomes

Dr. Sona Jain

access to banking facilities and digital payment systems. In contrast, cash-dependent northern states (Uttar Pradesh, Bihar, Madhya Pradesh) faced prolonged disruptions.

8. Adjustment and Policy Response

The government and RBI implemented **remonetisation** and **cash replacement** measures in late 2016 and early 2017. According to RBI (2017), by March 2017, **74% of withdrawn currency** had been replaced, reducing transaction frictions. Digital payments—through Unified Payments Interface (UPI), mobile wallets, and debit cards—increased sharply, rising from **₹104 billion transactions in October 2016 to ₹312 billion in March 2017**.

To mitigate liquidity stress, several short-term measures were introduced:

- Temporary withdrawal limits were progressively relaxed by January 2017.
- Banks and post offices facilitated cash exchange services for rural households.
- The government launched digital literacy campaigns to promote electronic payments.

Despite these efforts, adoption of digital payments remained limited in rural areas due to low connectivity, technological illiteracy, and cultural preferences for cash.

9. Discussion: Formalisation versus Welfare Costs

While demonetisation may have accelerated the move toward **formalisation**, the welfare cost to informal workers was substantial. The shift toward digital transactions and bank deposits expanded formal financial inclusion. However, immediate income losses, job uncertainty, and liquidity stress disproportionately affected vulnerable groups.

Key trade-offs identified:

- **Formalisation benefit:** increase in bank account usage and small savings deposits.
- **Short-run cost:** loss of employment and wage income in cash-based sectors.
- **Policy gap:** lack of direct cash-transfer mechanisms to cushion low-income workers during liquidity crises.

10. Policy Implications

1. **Gradual Transition:** Future monetary reforms should be implemented gradually with adequate advance notice to minimize transactional disruptions.
2. **Cash-flow Protection for Workers:** Temporary wage-support schemes or direct benefit transfers (DBT) could protect daily wage earners.
3. **Digital Infrastructure Expansion:** Broader access to digital and banking services, especially in rural areas, would mitigate the risks of cash shortages.
4. **Data Systems:** Strengthening real-time labour market and payment data could improve policy response during economic shocks.
5. **Institutional Coordination:** Close coordination between the central bank, financial institutions, and state agencies is vital for liquidity management.

The Impact of Demonetisation on India's Informal-Sector Employment and Incomes

Dr. Sona Jain

11. Conclusion

Demonetisation in India in 2016 was a historically unprecedented policy designed to curb illicit cash holdings and promote formalisation. Its immediate impact, however, was regressive for the informal sector—the backbone of India's employment base. Evidence from 2016–2017 suggests that cash shortages led to declines in informal employment by 1–3%, reduced daily wages by up to 20%, and temporarily suppressed consumption.

While some positive effects emerged—such as the expansion of digital payments and bank deposits—the short-run welfare costs outweighed these benefits for low-income households. The episode underscores the vulnerability of cash-dependent informal economies to monetary shocks and the need for stronger social safety mechanisms during large-scale policy transitions.

In retrospect, demonetisation's experience offers valuable lessons in balancing macroeconomic objectives with inclusive, humane policy design. Sustainable development in a diverse economy like India requires that reforms protect livelihoods while promoting long-term transparency and efficiency.

***Lecturer**
Department of Economics
LBS Govt. College
Kotputli (Raj.)

References

1. Aggarwal, N. (2017). *Impact of India's demonetisation on domestic agricultural markets*. Indira Gandhi Institute of Development Research (IGIDR) Working Paper.
2. Anand, N. (2017). *India lost 1.5 million jobs in the aftermath of demonetisation*. Quartz India.
3. Bandyopadhyay, S. (2004). *From Plassey to Partition: A History of Modern India*. Orient Blackswan.
4. Centre for Monitoring Indian Economy (CMIE). (2017). *Employment and Unemployment Survey 2016–2017*. Mumbai: CMIE.
5. Chandra, B. (1989). *India's Struggle for Independence*. Penguin Books.
6. Ministry of Labour and Employment. (2017). *Annual Report on Employment Trends*. Government of India.
7. National Institute of Public Finance and Policy (NIPFP). (2016). *Analysis of the Effect of Demonetisation*. Working Paper.
8. Reserve Bank of India (RBI). (2017). *Annual Report 2016–17*. Mumbai: RBI.
9. World Bank. (2017). *India Development Update: Unlocking Women's Potential*. Washington, DC: World Bank.

The Impact of Demonetisation on India's on Informal-Sector Employment and Incomes

Dr. Sona Jain