CHAPTER 02 · COMPLIANCE MANUAL · 2024 EDITION

Demonetisation

*This chapter is an extract from **The RST Compliance Manual**, a regulator-mapped reference for Indian business entities curated by the partners of R S T & Co.*

Demonetisation is an act of stripping the legal tender status of currency units. It happens whenever there is a change of any national currency. It involves the withdrawal of the current form or forms of money from being circulated usually replaced with new notes or coins.

Understanding Demonetisation

Removing the legal tender status of a unit of currency is a drastic intervention into an economy because it directly affects the medium of exchange used in all economic transactions. It can help stabilize existing problems, or it can cause chaos in an economy, especially if undertaken suddenly or without warning.

Example 1

The Coinage Act of 1873 demonetized as the legal tender of the United States, in favor of fully adopting the , in order to stave off disruptive inflation as large new silver deposits were discovered in the American West. Several coins, including a two-cent piece, three-cent piece, and half-dime were discontinued. The withdrawal of silver from the economy resulted in a contraction of the , which contributed to a recession throughout the country. In response to the recession and political pressure from farmers and from silver miners and refiners, the Bland-Allison Act remonetized silver as legal tender in 1878.

Example 2

In a more modern example, the Zimbabwean government demonetized its dollar in 2015 as a way to combat the country’s hyperinflation, which was recorded at annualized rates of up to 231,000,000 %. The three-month process involved expunging the Zimbabwean dollar from the country’s financial system and solidifying the the, and the as the country’s legal tender in a bid to stabilize the economy.

Example 3

Some countries have demonetized currencies in order to facilitate trade or form currency unions. An example of demonetization for trade purposes occurred when the nations of the officially began to use the as their everyday currencies in 2002. When the physical euro bills and coins were introduced, the old national currencies, such as the , the , and the Italian lira were demonetized. However, these varied currencies remained convertible into Euros at for a while to assure a smooth transition.

Uses of Demonetisation:

To stabilise the currency and fight inflation

To promote trade and access to markets

To bring transparency in informal economic activities, away from black and grey markets

Demonetisation in India

Demonetisation was tried as a tool to modernise the developing economy which is cash-dependent and to fight crime and corruption involving counterfeiting and tax evasion. Accordingly, the Indian government demonetised the Rs. 500 and Rs. 1,000 face-valued currency notes in 2016, the two most prominent denominations in the currency system. These notes accounted for 86% of the country's circulating cash. With no indications, India's Prime Minister announced to the country's citizens on 8th of November 2016, that those notes would have no value with immediate effect. As an alternative arrangement, citizens could deposit or exchange these old notes for newly introduced Rs. 2000 and Rs. 500 bills by the end of the year.

End of Chapter. *For the complete Compliance Manual, additional chapters, or a tailored briefing for your finance and compliance teams, contact* ***info@rstandco.co.in****.*