

**An e- Lecture
on
Demonetisation**

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Demonetization and its effects.

Demonetization is the act of stripping a currency unit of its status as legal tender. Demonetization is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit. A recent example of demonetization occurred when the nations of the European Monetary Union adopted the euro. In order to switch to the euro, authorities first fixed exchange rates for the varied national currencies into euros. When the euro was introduced, the old national currencies were demonetized. However, the old currencies remained convertible into euros for a while so that a smooth transition through demonetization would be assured

India recently undertook demonetisation of 500 and 1000 banknotes on 8 November 2016, ceasing the usage of all 500 and 1000 banknotes of the Mahatma Gandhi Series as a form of legal tender in India from 9 November 2016.

The banknote denominations of Rs.100,50,20,10 and 5 of the Mahatma Gandhi Series continued to remain as legal tender and were unaffected by the policy. The demonetisation was done in an effort to stop counterfeiting of the current banknotes allegedly used for funding terrorism, as well as a crack down on black money in the country. The move is also aimed at reducing corruption, drug menace and smuggling

Reasons for Demonetization

Demonetization according to Prime Minister Narendra Modi was undertaken to tackle blackmoney in the economy. To eliminate fake currency which terror groups are using to sponsor terrorism in the country. The move is aimed to reduce corruption and black money which are the major obstacles in our country in weakening the efforts to eradicate poverty.

Impacts of Demonetisation

Inflation : It will cause deflation in the market as people who have earned money through illegal ways would be afraid to declare the money as they may be prosecuted by the Income tax department on the legitimacy of their income.

Reduction in Monetary Circulation: This will lead to reduction of money circulation in the economy leading to deflation. Value of money will be increasing which we have because the total money supply will be going down but the commodities and things available in the market have not gone down. It will lead to inflation slowly but not overnight.

Cash Deposits in Banks: A lot of cash which are legally earned will be deposited in the banks and now the banks with more deposits will be able to do more lending.

Easy Loans: Loans will become easier and interest rates may come down. As banks will have more money so more loans will be given out which will increase the money supply in the market and it will create inflation.

Advantages of Demonetization

1. The biggest advantage of demonetization is that it helps the government to track people who are having large sums of unaccounted cash or cash on which no income tax has been paid because many people who earn black money keep that money as cash in their houses or in some secret place which is very difficult to find and when demonetization happens all that cash is of no value and such people have two options one is to deposit the money in bank accounts and pay taxes on such amount and second option is to let the value of that cash reduced to zero.
2. Since black money is used for illegal activities like terrorism funding, gambling, money laundering and also inflating the price of major assets classes like real estate, gold and due to demonetization all such activities will get reduced for some time and also it will take years for people to generate that amount of black money again and hence in a way it helps in putting an end this circle of people doing illegal activities to earn black money and using that black money to do more illegal activities.

3. Another benefit is that due to people disclosing their income by depositing money in their bank accounts government gets a good amount of tax revenue which can be used by the government towards the betterment of society by providing good infrastructure, hospitals, educational institutions, roads and many facilities for poor and needy sections of society.

Disadvantages of Demonetization

1. The biggest disadvantage of demonetization is that once people in the country gets to know about it than initially for few days there is chaos and frenzy among public as everybody wants to get rid of demonetized notes which in turn sometimes can lead to law and order problem and chaotic situation especially in banks and ATMs which are the only medium to change the old currency units to new currency units.
2. Another disadvantage is that destruction of old currency units and printing of new currency new units involve costs which has to be borne by the government and if the costs are higher than benefits then there is no use of demonetization.
3. Another problem is that majority of times this move is targeted towards black money but if people have not kept cash as their black money and rotated or used that money in other asset classes like real estate, gold and so on then there is no guarantee that demonetization will help in catching corrupt people.