



Strategies to Tackle the Issue of Black Money in India

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ABSTRACT

Economists and social scientists have shown considerable interest in recent years to measure the gap between the observable economic activity and the actual economic activity. This has led to the conceptualization of 'hidden economy, although several synonyms such as black, shadow, underground, unobserved, unofficial, unrecorded and parallel were used for the 'hidden economy. Black money is a new threat for the Indian economy. In India parallel economy is expanding very rapidly. The Government of India has introduced many commissions for estimating black money. In India amount of black money are increasing continuously which is badly impacts the economic growth of the nation. Such money is a new challenge for Indian economy. Over six and half-decades the government has at various times announced several schemes offering opportunities to bring black money overboard but the results are not so effective. Hence, the need of the hour is a multi-pronged strategy including joining the global crusade against black money, creating an appropriate legislative frame work, setting up institutions for dealing with illicit money, developing systems to implementation, and imparting skills for effective action, is required to deal with issue of generation of black money and its illicit transfer outside the country and for bringing it back to India.

KEYWORDS: Parallel Economy, Black money, Hidden economy, Strategies

Introduction:

Economists and social scientists have shown considerable interest in recent years to measure the gap between the observable economic activity and the actual economic activity. This has led to the conceptualization of 'hidden economy, although several synonyms such as black, shadow, underground, unobserved, unofficial, unrecorded and parallel were used for the 'hidden economy. In general, it tries to capture the activities beyond measurement of official activity. The hidden economy consists of legal and illegal activities outside the reach of the government. A comparison of the two ways in which black money is generated is fundamental to understanding the problem and devising the appropriate policy mix with which can be controlled and prevented by the public authorities.

Empirical estimates demonstrate that underground activities have been on the rise since 1970s when presence of government activity became stronger in the economies around the world. With increase in tax rates to finance larger public spending programmes, the desire to escape taxes and regulatory restrictions also gained in prominence (Tanzi and Schuknecht 1997).

Given the importance of the phenomenon, the next question that naturally arises is regarding the definition of the hidden economy, Tanzi (1999) suggests that the shadow economy crops up because of presence of activities that are difficult to measure and tax, like household work and also criminal and illegal activities. Schneider (1986) sums this point by defining the underground economy as "all economic activities that contribute to the value added and should be included in national income in terms of national accounting conventions but are presently not registered by national measurement agencies".

Bhattacharayya (1999) describes the hidden economy as reflected by the unrecorded national income "Calculated as the difference between the potential national income for given currency in circulation and recorded national income". Bagachwa and Naho (1995) consider it as a combination of informal (small-scale production and distribution units), parallel (illegal production of legal activities) and black market activities (production and distribution of market and non-market goods forbidden by the government). Acharya (1995), in the Indian context, refers to the black money as "the aggregate of incomes which are taxable but are not reported to the tax authorities" and also "the extent which estimate of national income and output are biased downwards because of deliberate, false reporting of income and output and transactions for reasons of tax evasion flouting other economic controls and related motives". A commonly used working definition is: all currently unregistered economic activities, which contribute to the officially calculated (or observed) Gross National Product. Smith (1985, P.18) defines it as "market-based production of goods and services whether legal or illegal that escapes detection in the official estimates of GDP".

All recent available evidence suggests that the unrecorded economy is growing for most of the countries. This observation raises many questions both in terms of economic theory and economic policy. Parallel economy or black economy is existing in both developed and developing countries.

MAGNITUDE OF BLACK MONEY

The NIPFP has estimated black money in Indian economy during 1975-76 and 1983-84 which is given below:

Table-1

year	Range of Black money (Rs. crores)	Percent of GDP
1975-76	9958 to 11870	15-18
1980-81	20362 to 23678	18-21
1983-84	31584 to 36784	19-21

Table-1 implies that the black money as percentage of GDP has mounted during 1975-76 and 1983-84. In absolute terms to the amount of black money has increased approximately three fold. The studies about the black money made by different committees and individual economists with special reference to the studies made by Gupta and Gupta (1982) whose estimates are found to be on high side compared to the estimates made by NIPFP and estimates made by Rangnekar are found to be lower than that of NIPFP. (Refer table-2).

Table 2 Various estimates of black money (as percent of GDP)

Year	Chopra's estimates		Gupta and Mehta's estimates	Ghosh et al' estimates	Ragnekar's estimates
	Wanchoo method	Own method			
1970-71	4.8	5.2	22.3	-	7.6
1971-72	5.1	3.2	28.7	-	7.8
1972-73	4.0	3.8	31.9	-	7.8
1973-74	4.9	8.1	27.1	-	7.4

1974-75	5.9	12.4	20.9	13.8	8.1	9.3
1975-76	5.6	9.9	25.0	-	8.4	10.0
1976-77	5.7	10.2	37.6	-	8.7	11.3
1977-78	-	-	38.4	-	8.7	12.1
1978-79	-	-	48.1	19.8	-	13.5
1979-80	-	-	-	-	-	14.4

Source: White paper (May 2012), Ministry of Finance, Department of Revenue CBTD, New Delhi

Table-3 Growth in size of hidden economy for states of India

State	Pre liberalization period(1975-76 to 1991-92)		Post liberalization period(1992-93 to 1995-96)	
	Mean	Standard deviation	Mean	Standard deviation
AP	0.049	0.099	-0.067	0.059
Bihar	0.046	0.199	-0.014	0.070
Gujarat	0.047	0.202	-0.068	0.139
Haryana	0.079	0.313	0.122	0.123
Karnataka	0.056	0.156	-0.040	0.075
Kerala	0.025	0.094	0.036	0.027
MP	0.047	0.185	0.007	0.186
Maharashtra	0.026	0.054	0.018	0.101
Orissa	0.163	0.508	0.019	0.059
Punjab	0.045	0.097	0.013	0.014
Rajasthan	0.049	0.202	0.117	0.105
Tamil Nadu	0.041	0.078	-0.051	0.077
U P	0.058	0.076	0.056	0.067
West Bengal	0.056	0.259	0.090	0.085
All	0.056	0.211	0.017	0.103
India	0.024	0.010	0.016	0.027
CV	41.67		168.75	

Source: Kaushik Chaudhuri et al: The size and development of Shadow economy: An empirical investigation from states of India, Journal of development Economics, vol.80, No.2, (August, 2006)

Table-3 reveals that the growth in the size of the hidden economy for the major states in India has declined in post liberalization period in relation to that of pre liberalization period but the slow growth of hidden economy in post liberalization period is subject to high degree of volatility which evident from the values of coefficient of variation in pre and post liberalization periods. It is further observed that the growth of the hidden economy is negative (a positive sign of good economic governance) in some states in India which include Andhra Pradesh, Bihar, Gujarat, Karnataka, and Tamil Nadu.

Causes of Generation of Black economy:

1. Controls and licensing system black money in India for the reasons of controls, permits, quotas, licenses.
2. High rates of tax resulting tax evasion is resulted a growing tendency of tax evasion among the tax payers.
3. Ineffective enforcement of tax laws.
4. Funding of political parties: There us an upward tendency of sup-

5. porting of political parties with the help of black money... Making money out of shortage and not out of extension of the business activities.
6. Inflation: the addition of prices of commodities like petrol, etc. in international market, boost in prices of commodities due to high increase in duties and taxes imposed by the government, the conspicuous utilization created buy people with unaccounted money.
7. Agricultural income: The reluctance to bring the agricultural income in the realm of income tax has also contributed to creation of black money.
8. Privatization: Privatization has opened up a new area to the private sector as well as to ministers and bureaucrats for making black money.
9. Other factors : Generation of black money in a country like India also results from different activities like smuggling, property deals, Bribery, kickbacks, concealment of income by professionals, artists etc this way an enormous amount of black income increasingly results in enhancement of black money.

Impact of Black money on the Indian Economy: Generation of black income and thereby establishment of parallel economy has been creating the following serious impacts on the social and economic system of the country.

- a. Underestimation of GDP in India as an enormous volume of income is diverted to this unaccounted sector resulting in growing continuation of parallel economy.
 - b. Strengthening of the parallel economy.
 - c. Loss of revenue to the state exchequer as a result of tax evasion.
 - d. Diversion of resources to purchase real estate & luxury housing.
 - e. Transfer of funds from India to foreign countries through clandestine channels.
 - f. Inequalities in income and wealth.
 - g. Increase in real savings.
 - h. Virtues like hard work and honesty one underestimated.
 - i. The existence of parallel economy has totally distorted and disrupted the planning of the economy.
5. Shadow or hidden economy deals with the portion of the income earned from legal and illegal activities that cannot be accounted for by the standard measurement procedures used in compilation of national income account.
 6. Guntmann who attributes the subterranean economy to the following additional causes:
 - a. Inflation.
 - b. Immensely complex tax system requiring inordinate taxpayer time, paper work and expenses.
 - c. The increase in size of the government which leaves smaller share of national output for direct consumption by wage earners.
 - d. Perception of government as wasteful and inefficient by the public making up inadequate use of their hard money.

7. Guntmann provides with some example of biased economic data leading to biased conclusions increasing the likelihood of erroneous policy perceptions which include.

- a. The overall rate of the economy is understated
- b. The official employment rate is overstated.
- c. Savings ratio, consumption ratios, saving function and consumption function generally biased.
- d. The calculation of average effective tax rates and marginal effective tax rates are over stated.
- e. Affects the revenue and expenditure sides of the government budget.
- f. Financial deficit.
- g. One of the more serious consequences of parallel economy is difficult to quantify namely the erosion of public confidence in the system of taxation and general administration and the ability of the government to operate efficiently and fairly.

The redeeming features of the hidden economy:

1. It provides purchases with goods and services which they may be Unable to obtain through formal channels.
2. It also lubricates the working of the formal economy.
3. Parallel economic activity is thought to have helped the transition towards market economics and to have mobilized entrepreneurial

endeavors in transmission economies.

4. Informal activity also confers many benefits in its participants including greater freedom, flexibility of working hours and condition, self satisfaction and independence.

According to Acharya, S.N. and Associates (1985) aspects of black money economy in India. Report of study by the NIPFP, New Delhi GOI, and Ministry of Finance) black money is converted into white money in the forms given below:

1. Show black income as income earned from agricultural activity.
2. Arrange to receive a large number of marketing gifts from friends and relatives.
3. Covert black money in to foreign exchange through the black market in the foreign exchanges and have it remitted as gifts from abroad.
4. Buy the lottery tickets from real winners.
5. Arrange for hawala loans (from a factious person or a friend or a relative) the most popular Indian method.
6. Arrange to distribute many to friends and relatives with little or no income have then pay income tax as these incomes, and have then return the remaining in the form of white loans.
7. Arrange with business or professions income sellers a fiction bill without delivery of goods and services. The buyer obtains a receipt for deductible expenses. The sellers show (Fictitious) sales, bring the revenue on its books and whiten the black income.
8. Buy bearer bonds.
9. Spend the black money on the consumption (such as a holidays or tourism).

SUGGESTIONS TO CONTROL HIDDEN ECONOMY

1. The Indian tax system is not administratively efficient. Both direct and indirect taxes are highly complex and thus, provide enough opportunities to unscrupulous elements to avoid as well as evade taxes which further resulted in enormous growth of hidden economy. Thus, the tax system must be made simple to comprehend and adhere to it.
2. According to Adam Smith, man is selfish. He is not ready to share his property with others so easily. Hence, black money to a small extent can be tolerated.
3. Black money is present where the state is very strong and hard. In a liberalized capitalist market economy, the portion of hidden economy is insignificant. Hence, liberalization of the economy is some what a sure means of controlling hidden economy.
4. Good economic governance practices may also reduce the role of black money in the economy.
5. Well integration of fiscal management with production and welfare economics will result in reduction of the levels of black money.
6. The right to private property must be acknowledged.
7. Lower the effective tax rates and marginal tax rates.
8. Widening the frontiers of investment opportunities to all the individuals by recognizing their legitimacy to invest.

In order to curb the size of the black money attributable to illegal sources can be controlled with the help of the following measures. They include

1. Thorough economic information systems must be developed covering the visible and invisible aspects of the entire economy.
2. Hawala deals can be curbed with well integrated global financial systems.
3. Narcotic cases can firmly be handled with the help of Interpol.
4. A close scrutiny of international fund transfers may also help to effectively check the flows of the black money.

Conclusion:

Black money is a new threat for the Indian economy. In India parallel economy is expanding very rapidly. The Government of India has introduced many commissions for estimating black money. In India amount of black money are increasing continuously which is badly impacts the economic growth of the nation. Such money is a new challenge for Indian economy. Over six and half-decades the government has at various times announced several schemes offering opportunities to bring black money overboard but the results are not so effective. Hence, the need of the hour is a multi-pronged strategy including joining the global crusade against black money, creating an appropriate legislative frame work, setting up institutions for dealing with illicit money, developing systems to implementation, and imparting skills for effective action, is required to deal with issue of generation of black money and its illicit transfer outside the country and for bringing it back to India.

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