



# Impact of Ponzi Schemes on Economy: A Study on West Bengal

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## ABSTRACT

*Following Commonwealth Games, 2G Spectrum, Coal Block allocation scams, India plunges into another Rs 1 lakh crore scam of money laundering in Eastern India - Ponzi Scam. The Bengal Ponzi business got a different dimension in the socio-economic environment due to the political patronage extended by few influential leaders of the running state government.*

*The overall impact of Ponzi business in economy is hardly comprehended in naked eyes. The effects can be classified as direct and indirect. To analyse the effect on financial systems, an investigation on relationship between state small savings and growth in state domestic product in agriculture sector made, which reveals a reasonably significant result. Discussions were made regarding how the Ponzi Business has shaken the lives of deceived people and created a financial crisis in the state economy.*

**KEYWORDS :** Capital Expenditure, Chit Funds, Financial Systems, Microfinance, Multi-level Marketing, Ponzi Schemes, Nominal GDP, Ponzi Schemes

### 1. Introduction

The state West Bengal has drawn attention of the world for its recent Rs 1 lakh crore Ponzi scam where nearly 33 lakhs people duped by more than 200 fraudulent companies. Following Commonwealth, 2G, Coal Block Scams, India plunges into another scam of money laundering in the form of Ponzi schemes. Only *Sharada Group*, one of the Ponzi companies operating in eastern India, cheated 17 lakhs people pocketing around 30000 Crore Rupees.

Unlike other scams, Ponzi schemes affect millions of lives and shake the socio-economic dynamics of a state. This paper investigates the nature and likely impact of Ponzi schemes on macro-economic variables of a state, and West Bengal in particular.

### 2. Objective

The objective of this paper is to find out overall impact of Ponzi Business on economy in a 360 degree angle hardly comprehended in naked eyes.

### 3. Ponzi Scheme not Chit Fund

Let's get one thing clear - *Sharada* and other fraudulent companies are not Chit Funds. A chit fund company is a company that manages, conducts, or supervises a chit scheme under Chit Funds Act, 1982. Sometimes, State government passes separate law and operations of chit fund come under state control. This is quite popular in south India, especially Kerala where 3000 chit fund companies – Govt. owned, registered and unregistered operate. A chit or kitty is collected together by a promoter, known as Foreman, and each month and one subscriber wins the pot (deducting the Foreman's commission, generally 5% of the corpus) either by lot or auction. Registered chit fund is safe and one of the microfinance instruments. Whereas, a Ponzi scheme is a fraudulent investment operation where the operator, an individual or organization, pays returns to its investors from new capital paid to the operators by new investors, rather than from profit earned by the operator. Therefore, a Ponzi company must collapse some day. Ponzi players registered themselves under Company Act, 1956. They employ a network of agents under multi-level marketing strategy and offer high rate of commission to the chain (sometimes 40% of deposit collected). They offer highly attractive company stocks, equity, debentures or other cash management options to the depositors making a false promise of 12% - 24% of return. Sometimes, they practice the Collective Investment Scheme and accumulate huge money from the market without complying government regulations.

In 2014, SEBI asked to refund ₹ 60,000 crore collected by 117 companies out of which Bengal's share is ₹ 52000 crore (which is nearly 15% of Real State GDP). This is the reason why Bengal is tagged as Ponzi Capital of India.

### 4. Why Bengal Scam is Different

Decline in market interest rate, rapid financialisation of household savings, lack of awareness and knowledge on capital market, awareness, absence of adequate deterrence and regularity arbitrage enhances the growth of Ponzi companies. In 1980's and 1990s, companies like *Sanchayita*, *Verona*, *Overland* spreaded their network but soon comes under regulatory rudder. But, the recent scams, *Sharada Group* in particular, have made a new dimension due to the political patronage endorsed by some influential leaders of the running state government. These companies take the advantages of 'managing' the regulatory bodies, in the spurge of a mutually beneficial tacit.

### 5. Effect on Macroeconomic Variables

The effects of such a big scam cannot be as simple as it seems. It has a long run as well as short run impact on our economy. Direct and indirect effects of the Ponzi Schemes of that extent have been listed in the Table 1.

Table 1. Impact of Ponzi Scam on Economy

Direct Effect	Indirect Effect
<ul style="list-style-type: none"> <li>• Money Loss</li> <li>• Credibility Loss</li> <li>• Leakage to Financial Systems</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in Consumption Expenditure</li> <li>• Wrong Signal to industry</li> <li>• Failure of Governance</li> <li>• Loss of Morale</li> </ul>

**5.1 Money Loss:** Millions of duped depositors primarily belonging to poorest strata of our society have lost their hard-sweat money. Monetary loss to the underprivileged section reduces their capability which turns into social exclusion in terms of health, education and basic needs of livelihood. Financial exclusion also (most of the districts of WB have 0.1 Index of Financial Inclusion against highest value 1) sets down social mobility for the wage earners and migratory labour force. Only hope is that government machinery can recover the cheated money and return at least the principal amount.

**5.2 Credibility Loss:** A sound network of Multi-Level Marketing mechanism was adopted to suck money from each nook and corner of almost every village in West Bengal. High rate of educated unemployment encouraged many youths to get engaged into the Ponzi schemes and capitalise their personal relationship with relatives, friends and acquaintances. With collapse of the Ponzi Business, lower tier agents instantly come under the rage of defrauded depositors. Since 2011, more than 100 agents committed suicides in Bengal to avoid social pressure and loss of face. Thousands of agents involved

in Ponzi chains, now, are selling their personal property to pay back the deposits

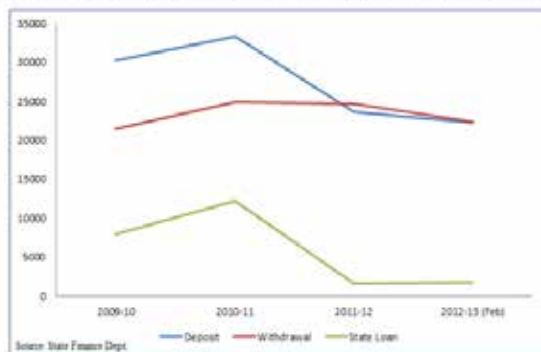
**5.3 Leakage to Financial Systems:** Financial system of a country enables borrowers and lenders to exchange funds. The surplus money in the forms of savings gets transformed into investable funds through this system. The operations of such Ponzi business create a loophole to the system.

Money which could have been utilised for capital expenditure spent for personal luxury or non-productive activities, which ultimately slows down the entire process of capital formation and growth of an economy.

Small savings in Post office deposits are one of the prime sources of low cost state finance. Under Left front government Finance Minister Dr. A. Dasgupta could utilise 80% of Rs 75,000 crore postal savings in 2010-2011 fiscal. When this savings go down, state government is forced to resort funds for public expenditure from alternative sources paying higher interest rate or conditioned public debt. Had Mamata Banerjee, Chief Minister of West Bengal comfortable small-savings deposits in 2012-13 FY, she could have bargained more for hike in interest rates in small-savings schemes in post offices, as recommended by 13th Finance Commission of India.

Traditionally, poor people of West Bengal save their money in post office savings bank and Bengal ranks highest in India. In 2009-10, net savings in post office reach a Rs 8,984 crore but, ironically, that was gone down to Rs (-) 987.22 crore in 2011-12. It means whole amount plus Rs 987.22 crore of earlier savings was withdrawn and invested to other scrupulous investment schemes. Companies illegally moving deposits diverted an estimated sum of Rs. 24000 crore from small savings funds promoted by state government since 2010 (Diagram1).

Diagram 1. Deposit, Withdrawal and State Loan in WB During 2009-10 to 2012-13



Agriculture and allied sector is the most affected area of the state economy since most of the Ponzi depositors depends on the primary sector. To find out any significant relationship between growth of agriculture sector with small savings deposits during the period of Ponzi business, the following data tables are used: i) Growth Rate (%) of Gross State Domestic Product in Agriculture Sector (SGDP-Agri) at Constant 2004-05 Prices (West Bengal). ii) Net collection in Post Office small savings in West Bengal. Calculations are made in Table 2.

Table 2. Test of Significance of Correlation between Growth of Net Postal Small Savings and Growth Rate of Gross State Domestic Product in Agriculture Sector (SGDP-Agri) in West Bengal

Financial Year	Growth Rate (%) of SGDP - Agri <sup>1</sup> (X)	Net Collection in Postal Small Savings <sup>2</sup> (Rs. Crore)	Growth (%) of Net Postal Small Savings <sup>3</sup> (Y)	Correlation coefficient(r) of X and Y	t-Test on r [with d.f. = 6]	Test of Significance (one-tailed) T <sub>0.10,6</sub> = 1.440
2005-06	1.84	9895.53	2.59	r = 0.542	t = 1.58 [P value = 0.082]	Significant (at 10% level)
2006-07	1.01	6238.93	-36.95			
2007-08	6.14	490.64	-92.14			
2008-09	-3.52	1133.1	130.94			
2009-10	8.31	8985.38	692.99			
2010-11	-2.1	8409.45	-6.41			
2011-12	0.2	-987.22	-111.74			
2012-13	3.86	1789 <sup>3</sup>	281.22			

**Source:**

1. Planning Commission of India, Data-book for PC, 22nd December, 2014
2. Statistical Appendix, Economic Review, 2012-13, Government of West Bengal and
3. The Economic Times, July 17, 2013

We found that the correlation coefficient between growth of net Postal small savings and growth rate of state agriculture allied sector is significant at 10% level. Therefore, it can be concluded that *the Ponzi business which has created a reverse consequence on net small savings of the state is likely to influence negatively on the growth of primary sector of an economy.*

**5.4 Reduction in Consumption Expenditure:** Poorest people are prime victims. Rational Expectations force them to reduce their consumption expenditures and regain the monetary losses. Fall in consumption propensity reduces the effective demands, especially, in rural market which ultimately hinders the development process. Primary survey on local rural market depicts that there is a substantial fall of consumer demand, viz, clothes, medicines, private education etc.

Many greedy investors borrowed money from banks and other non-bank financial resources to invest in the Ponzi schemes to reap a speculative interest income generated from the interest rate differences. The situation becomes more vulnerable since other lenders keep on asking their interest and principal amount which were eventually lost in Ponzi investment.

**5.5 Negative Signal to Industry:** Bengal witnesses the crunch of investment during last couple of years due to changed industrial policy framework and government attitude towards business. In addition to that, the social and political unrest shaped by such a big scam blinks a negative signal to the investors.

Secondly, the other NBFCs and regular private players operating legally in the financial market get the hurdle of mistrust or misconception. Today, India is a member of trillion dollar club in the world. Avoidance of such big scams, happening recurrently, could have put India earlier to this prestigious club of global economic powers.

**5.6 Failure of Governance:** Millions of people have been cheated by more than 200 companies through more than thousands schemes under the nose of state government, RBI, SEBI. Who are the culprits? None can deny responsibilities. According to Indian acts, even depositors to Ponzi schemes are guilty. Moreover, this is not merely the question of warning to the company (as done by SEBI for *Sharada*

Group) or common man. It needs a strong and rapid action since each day is paying. State government (both running and earlier) cannot refuse their accountability by justifying their ignorance. Paying no attention to crime is an offence.

A serious allegation came that about Rs 850 crore had been sent abroad using the *hawala* channel to fund terror activities, of which major chunk was generated by the *Sharada* scam. Though, as reported recently, no evidence was found till date but it evokes a politically potential danger.

If we argue that social network of political parties fail to track the fraudulent business activities, we have sufficient reasons to concern for anti-social, anti-national activities subdued across our society.

**5.7 Loss of Morale:** The scam occurred when Bengal was experiencing a political change of Left front regime to Trinamool Congress with expectation of betterment of socio-economic life. But, unfortunately, the inertia depicted by new state government regarding the investigations and bringing out the truth deteriorated morale of the millions of people. The intention of the government to combat a financial crime also raised a question to ponder over their investment decisions by the entrepreneurs.

## 6. Conclusion

Long run and short run effects of Ponzi schemes to our economic environment is inevitable. It is utmost important to curb the activities of dubious companies operating in financial market to avoid obnoxious economic impact and undesirable tantrum. In country like India, with poor financial literacy, high rate of unemployment, high inflation rate coupled with low interest income call for a strict monitoring and control system to get rid of any scrupulous money market business. A separate empowered administrative cell may be formed by the govt. to control such activities. All registered political parties can be brought under the ambit of RTI Act and mandatory disclosure of party fund collections. A consensus is required in all party forum to enact strong regulatory actions against the party which raises funds from business houses as 'Protection Money' or any other kind promising them undue favour. Transparency and accountability may be considered as two strong macroeconomic parameters for strong governance.

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