



EFFICACY OF DEMONETISATION TO CURB BLACK MONEY IN INDIAN ECONOMY: A STUDY

Ritu Kang Walia

Assistant Professor of Economics, Guru Nanak Girls College, Yamuna Nagar (Haryana)

Suraj Walia

Assistant Professor of Economics, R.K.S.D. (PG) College, Kaithal (Haryana)

ABSTRACT

On November 8, 2016 the Government of India has implemented a major change in the economic environment by demonetising the high value currency notes of Rs 500 and Rs 1000 denomination with objective to unearth the black money in general and to curb the corruption, counterfeit currency as well as terror financing in particular. This move stops legal tender from the midnight of November 08, 2016. People holding notes of Rs 500 and Rs 1000 can deposit the same in their bank and post office accounts from November 10 till December 30, 2016. Keeping in the above back drop, the present paper is a humble attempt to highlight the extent of black money in India and to analyse the efficacy of demonetisation to curb black money.

KEYWORDS : Demonetisation, Black Money and Indian Economy.

I. INTRODUCTION

Black economy (parallel economy, shadow economy, unplanned economy and underground economy) is based on the black money or unaccounted money. According to NIPFP, "Black money is aggregate of income which is taxable, but is not reported to tax authorities". It can also be said that it is illegal money generated from illegal activities. Almost every sector (viz. real estates, financial market, bullion & jewellery market, non-profit organisations, external trade and so on) in our country generates and uses black money. A parallel economy destroys and eats into the vitals of the planned economy in any country including India. It generates inflation which adversely affects the poor and the middle classes more than others. To tackle the problem of parallel economy, the Government of India has taken many steps time to time like tax reforms and demonetisation. Earlier, the high tax was considered as a major source of black money in India. Over the period, India has moved to a low tax regime. Yet, tax reforms are not adequate to eliminate the black money from the economy. It means that low tax regime will not address the problem of black money in India. In this context, demonetisation is a relief to a certain extent. Demonetisation is a process by which a series of currency will not be legal tender or the old unit of currency is retired and replaced with a new currency unit. Keeping in above backdrop, the present study is an attempt to highlight the extent of black money in India and to analyse the efficacy of demonetisation to curb black money at present scenario. To achieve this, the present paper is divided into five sections. Section II will deal with the literature review, section III will explore the extent of black money in India. Impact analysis of demonetisation will be depicted in section IV and section V will conclude the study with policy implications.

II. LITERATURE REVIEW

There is no dearth of literature on the present issue. To justify the present study following literature have been reviewed. Sarkar Sukanta (2010) analyzed the estimates of black money and its impact on Indian economy. He concluded that the amount of black money is increasing continuously that has badly affected the economic growth of the nation. Because of this, GDP is underestimated, inequality of income increases and illegal activities expands. Although government has taken many steps but the results are not so effective. Arora Rajni (2012) in her study investigated the diverse aspects of black money and its association with policy and administrative measures in our country. Study also reflected the policy and strategies that the Government has been pursuing in the context of recent initiatives and need to adopt in the near future to address the problem of black money as well as corruption in public life. Kapur Shalini (2015) analysed the reasons and impact of black money in India. The study also presents the government measures to check the problem of black money and highlights that parallel economy is a new threat for the Indian

economy which is expanding rapidly. Kaur Manpreet and Aakriti (2015) concluded that black money has a significant impact on economic, social and political levels of our lives. It has a significant effect on the institutions of governance and conduct of public policy in the country. The study argued that India is amongst the richest nations if stashed black money is brought back & converted to white money.

It is clear from the above studies that black money has negative impact on society as well as on economy therefore, serious efforts are necessary to control the black money in India.

III. ESTIMATES OF BLACK MONEY IN INDIA

Two central issues with black money are, 'Who has it?', 'How much do they have?' and what are the major sources of black money? There is no clear data on the quantum of black money in Indian economy. Estimates vary from 10 to 40 per cent of GDP, i.e. anywhere between \$100 billion to over \$400 billion. Over the period of time, Government of India constituted various committees to estimate the black money in India which are as follows:

- **Kaldor's Estimates:** The first estimate of black money in India was made by Kaldor for the year 1953-54 in his report published in 1956. Kaldor estimated the black incomes generated in each of the thirteen sectors of NAS. Kaldor estimated the amount of black money at Rs 600 crores in 1953-54 which was 6.0 per cent of GNP at market prices in that year (Rs 9993 crores)
- **Wanchoo Committee's Estimates:** The Wanchoo Committee (Direct Taxes Enquiry Committee) followed Kaldor's methodology of estimation of black incomes with some modification. It estimated assessable non-salary income for the year 1961-62 as Rs 2686 crores. As against this, the non-salary income actually assessed to tax was Rs 1875 crores. Thus, the income which escaped tax was Rs 811 crores. After making some adjustment in this figure, Wanchoo Committee scaled down the estimates of black money to Rs 700 crores which was 4.4 per cent of the GNP at market prices in the year 1961-62 (Rs 15879 crores). For the year 1965-66, Wanchoo Committee estimated the black money as Rs 1000 crores which was 4.2 per cent of the GNP in that year.
- **Rangnekar's Estimates:** D. K. Rangnekar's, a member of the Wanchoo Committee, dissented from the estimates of the Wanchoo Committee. According to him, tax evaded income for 1961-62 was Rs 1150 crores against the Committee's estimate of Rs 811 crores. For 1965-66, it was Rs 2350 crores against the Committee's estimate of Rs 1000 crores.
- **O.P. Chopra's Estimates:** In his study published in 1982, O.P. Chopra presented estimates of black money in India for a period of 17 years 1960-61 to 1976-77 by using the methodology which was already used by Wanchoo Committee with some

modifications. According to Chopra's estimates, black money in 1960-61 was Rs 916 crores which was 6.5 per cent of GNP at factor cost in that year. This rose to Rs 8098 crores in 1976-77 (11.4 per cent of GNP). Three important conclusions of Chopra committees are as: (a) Tax evasion is more likely the higher the rate of tax (b) Increase in prices leads to an increase in unaccounted income and (c) The funds are diverted to agriculture to convert unaccounted income into legal money.

- **Poonam Gupta and Sanjay Gupta Estimate:** In their study published in 1982, Poonam Gupta and Sanjay Gupta presented estimates of black money in India over the period 1967-68 to 1978-79. According to their estimates, the size of the black economy in 1967-68 was Rs 3034 crores and these rose to as high as Rs 46867 crores in 1978-79, that is more than 15 times. In percentage terms, in 1967-68, the underground economy formed nearly 9.5 per cent of measured GNP. By 1978-79, it had jumped to 48.8 per cent. Thus, in 1978-79 almost half of the official income was being produced outside the 'legal' sector.
- **National Institute of Public Finance and Policy (NIPFP's):** A study on black income conducted by NIPFP's under the guidance of Shankar Acharya was published in 1985. While preparing the estimate of black income, the study excluded incomes generated through illegal activities like smuggling, black market transactions, and acceptance of bribes and kickbacks. After aggregating the different components of black income, the study quantified the extent of black money for different years as shown in table 1.

TABLE 1: NIPFP ESTIMATES OF BLACK MONEY IN INDIA (1975-1983)

Year	Estimates of Black Money (Rs. Crores)	Per cent of GDP
1975-76	9958 to 11870	15 to 18
1980-81	20362 to 23678	18 to 21
1983-84	31584 to 36786	18 to 21

Source: NIPFP, Aspects of the Black Economy in India (New Delhi, 1985)

The study suggested with some degree of confidence that black incomes generated in the Indian economy in 1983-84 was not less than 18 per cent of GDP at factor cost or 16 per cent of GDP at market prices.

- **Suraj B. Gupta Estimates:** Study pointed out some erroneous assumptions in NIPFP study and estimated black income at 42 per cent of GDP for the year 1980-81 and 51 per cent for the year 1987-88. Arun Kumar pointed out certain defects in Gupta's method as well as in the NIPFP study. He estimated black income to be about 35 per cent of GDP for the year 1990-91 and 40 per cent for the year 1995-96.
- **Illicit Money Transferred outside India:** Reports of Global Financial Integrity (GFI) Illicit flows are all unrecorded private financial outflows involving capital that is illegally earned, transferred or utilised, generally used by residents to accumulate foreign assets in contravention of applicable capital controls and regulatory frameworks.
- **GFI Report 2010:** The international watchdog Global Financial Integrity (GFI) released its report of the Drivers and Dynamics of Illicit Financial Flows from India 1948-2008 in November 2010. The report estimates that over the 61 years period 1948- 2008, illicit capital flight from India amounted to a total of US \$ 213.2 billion or about 16.6 per cent of India's GDP. For the entire 61 year period 1948-2008, the growth rate of real illicit flows was 6.38 per cent per annum. The report also presents estimates of the size of the black economy in India. According to it, the size of the black economy has grown considerably in the Indian Economy over the Years.

TABLE 2: SIZE OF BLACK MONEY IN INDIA

Year	Amount in \$ Billion	% of GDP	Year	Amount in \$ Billion	% of GDP
1961	3.3	9.1	2001	198.4	41.1
1971	17.6	28.6	2008	640.7	50
1991	128.1	44.6			

Source: GFI Report

- GFI Report 2013: GFI released its report Illicit Financial Flows from Developing Countries: 2002-2011. Authored by Dev Kar and Brian le Blanc in December 2013, the report estimates that in 2011, US \$ 84.93 billion (over Rs. 4 lakh crores) was taken out of India illegally. This illegal outflow is nearly one third of India's total budgeted expenditure in 2011 of Rs 13 lakh crores.

The extent of black money from above estimates can be depicted in table 3.

TABLE 3: EXTENT OF BLACK MONEY IN INDIA

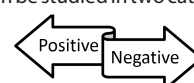
Estimates	Year	Amount of Black Money	% of GDP
Kaldor's Estimates	1953-54	600 Crores	6 %
Wanchoo Committee's Estimates	1961-62	700 Crores	4.4 %
Wanchoo Committee's Estimates	1965-66	1000 Crores	4.2 %
Rangnekar's Estimates	1965-66	2350 Crores	-----
O.P. Chopra's Estimates	1976-77	8098 Crores	11.4 %
Poonam Gupta and Sanjay Gupta's Estimates	1978-79	46867 Crores	48.8 %
National Institute of Public Finance and Policy	1980-81 1983-84	20362 to 23678 Crores 31584 to 36786 Crores	18 to 21 % 18 to 21 %
Arun Kumar's Estimates	1995-96	-----	35%
Global Financial Integrity (GFI) Report 2010	2008	\$ 640.7 billion	50%

Source: Compiled from Various Reports

IV. IMPACT ANALYSIS OF DEMONETISATION

Recently on November 8, 2016 evening, Prime Minister Modi has demonetized the high value currencies i.e. currency notes of 500 and 1000 with objective to unearth the black money and to curb the corruption, counterfeit currency as well as terror financing. People holding notes of Rs 500 and Rs 1000 can deposit the same in their bank and post office accounts from November 10 till December 30, 2016. All notes in lower denomination of Rs 100, Rs 50, Rs 20, Rs 10, Rs 5, Rs 2 and Re 1 and all coins continued to be valid, and new notes of Rs 2000 and Rs 500 were introduced. This decision was considered as biggest cleanliness drive against the black money in the history of Indian economy.

Demonetisation was first done in January 1946 in which currency notes of Rs 1000, Rs 5000, and Rs 10000 were taken out of circulation. But all three notes were reintroduced in 1954. In the early 70's, the Wanchoo committee suggested demonetization as a measure to unearth the spread of black money. Then in January 16, 1978 Janta Party deemed the Rs 1000, Rs 5000 and Rs 10000 notes illegal for the second time. But it was not so effective because due to recommendation the public nature sparked black money hoarders to act fast and rid themselves of high denominations before the government was able to clamp down on them. There are always two sides of a coin and there are some merits and demerits of Demonization in Indian economy. In the same way impact analysis of demonetisation can be studied in two categories:



Positive Impact Analysis of Demonetisation

This move by the government is likely to have long term benefits for the economy. The extinguishing of the major proportion of unaccounted currency would reduce from the liabilities of the government and would add to its finances. This can have very strong implication as the government would get money to spend without borrowing from the market. One of the biggest benefits of this move is that it is going to drastically affect the malpractices of the economy. Now people are alert and they have fear that their corrupt practices are not going to survive any long. The smuggling of arms and dealing with the terrorist will not sustain further as all of the money will be on record now. It has wiped out black money accumulated over many years within India. There is possibility that inflation will be contained through this, especially land and housing prices. Counterfeit currency and black money are largely used in the real estate sector (particularly in unorganised sector and for secondary sales), where prices continuously remained high, due to the presence of black money. This has curbed the problem of counterfeit currency in circulation. The denominations of fake currency are comparatively very large. In this connection, it may be noted that while the total number of bank notes in circulation rose by 40 per cent between 2011 and 2016, the increase in number of notes of Rs 500 denomination was 76 per cent and for Rs 1000 denomination was 109 per cent during this period. This demonetization brought money back from outside system into main financial system. It has increased the liquidity with banks, leading to fall in rate of interest. This can be used for further lending of funds. Government tax revenue will increase, as black money holders will convert this into white. This would be helpful in public spending. Now government is moving towards cashless society. It will increase credit access and financial inclusion. It will also stop generation of new black money in future.

Negative Impact Analysis of Demonetisation

According to RBI Handbook on Statistics of Indian Economy 2015-16, a total of Rs 16.42 lakh crores worth of currency was in circulation as at the end March 2016. Of this, Rs 14.18 lakh crores was in form of Rs 500 and Rs 1000 denomination notes, representing around 86 per cent of the value of total currency and coins in circulation. So initially there was inconvenience to the general public due to cash crunch and they have to stand in long queue to banks for exchanging and depositing their Rs 500 and Rs 1000 notes. Daily wage earners have affected the most due to standing in queue to banks and ATMs. There is creation of short-term unemployment and small business affected due to liquidity crunch. It has also affected the Micro finance institutions and its clients. Short term fall in demand is also observed as people have low liquidity leading to low demand. There were many predictions about GDP growth

Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓

rate. India's growth rate which was forecasted to be 7.1 per cent falls to 6.75 per cent in financial year 2016-17. It will lead to low tax revenue to government.

Expected Outcomes of Demonetization

There were different prediction regarding, how much black money will be unearthed by this move of demonetization. According to one estimate, around Rs 12 lakh crores of the Rs 15.44 lakh crores demonetized currency is with banks now. It is believed that an estimated Rs 1.5 to 2 lakh crores may be identified as black money income. Out of this, around 1.2 lakh crores may be collected as taxes at 50 per cent to 85 per cent tax rate. If Rs 2 lakh crores is revealed as black money out of demonetization, it will amount to around 1.75 per cent of India's GDP. While according to NIPFP, black income is nearly 40 per cent of country's GDP. According to India Rating and Research, this demonetization is likely to destroy Rs 4 lakh crores worth of cash held as black money, it constitute 12 per cent of the black money in India, leading to 88 per cent of the black money to remain in the system. It is also argued that black money assets created and parked in real estate, gold, diamonds, foreign currency, art objects overtimes. As demonetisation can only affect the liquid asset. So there is no such enormous blow of this move.

V. CONCLUSION WITH POLICY IMPLICATIONS

In nut-shell, we can conclude that various committees tried to estimate black money in India. It has deep roots in the economy. It is mostly fled to foreign and is in the form of non-liquid asset. Though there is short term negative impact of demonetisation but it is one of the necessary steps to curb black money or parallel economy but not sufficient as it has wiped out a little portion of black money. There is rationale to impose a check on black money in real estate, gold etc. i.e. non liquid asset, for this mandatory digitisation of land and property records linked to PAN or Aadhaar numbers should be encouraged. Economic infrastructure must be strengthen and consolidated. Government must ensure the tax inclusion with in the country and counterfeit the black money which parked overseas. India would be the richest nation of the world, if this money is brought back. Now government is taking very serious move to convert Indian economy in to cashless economy, despite it is a great challenge because Cash-GDP ratio is 12.5 per cent, which is very high and people are not literate so it is very difficult to convert rural economy in cashless economy. Still it will be very helpful to stop generating new black money. Corruption is one source of generation of black money and to get rid from corruption, transparency is required through e-governance. There should be accountability of every employee. General public should also not indulge in corrupt practices. Election funding should be banned and it should come under the purview of RTI and income-tax authorities. There is urgent need to strengthen the control mechanism on financial transactions to stop continuous growth in black money. Last but not least, the country has witnessed many political Satyagrahas, but this is the first economic Satyagrahas. Although this has created social and political disturbance, but people of India are now ready to accept this change and ready to bear hardships.

REFERENCES

1. Business Today, Squeezing the cash Economy, Dec 2016,
2. Lalit Mohan Aggarwal (2012), 'White Paper on Black Money', Journal of Securities Academy & Faculty for E-Education, vol.72.
3. Kapur Shalini (2015), 'Impact of Black Money on Indian Economy', International Journal of Engineering Technology Science and Research, www.ijetsr.com, ISSN: 2394 - 3386, volume 2, Issue 9, September 2015.
4. Kaur Manpreet and Aakriti (2015), 'Black Money in India: Current Status and Impact on Economy', Abhinav National Monthly Refereed Journal of Research in Commerce & Management, Vol 4, issue 4, April, 2015 ISSN-2277-1166.
5. Ministry of Finance, Department of Revenue (May 2012), 'Black Money' Central Board Of Direct Taxes, New Delhi
6. Rajni Arora (2012), 'Black Money in India: Present Status and Future Challenges', International Journal of Science, Engineering and Technology Research (IJSETR) Vol 1, issue 5, ISSN: 2278 - 7798, November 2012.
7. Sarkar Sukanta (2010), 'The Parallel Economy in India: Causes, Impacts and Government Initiatives', Economic Journal of Development, Issues, Vol. 11-12, No. 1-2, pp.124-134.
8. www.gfintegrity.org/
9. <http://niti.gov.in/content/demonetization-%E2%80%93-opportunity-curtail-black-money-and-promote-digital-payments>
10. <https://www.rbi.org.in>
11. <http://timesofindia.indiatimes.com/business/india-business/Demonetisation-will-destroy-12-of-black-money-India-Ratings-says/articleshow/55756798.cms>