



## SHADOW ECONOMY MENANCE: A GREAT THREAT TO INDIA

### KEYWORDS

Shadow Economy , GDP, Demonetisation

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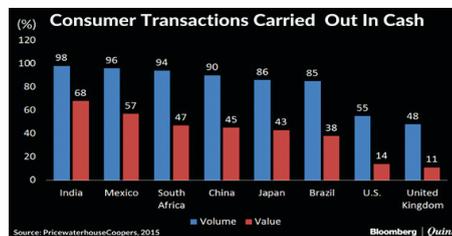
**ABSTRACT** *With the growth of the economy in the post-independence period the extent of the parallel or shadow economy has been magnified and now playing a dominant role to mould the national policies. Presently, most economists feel that the size of unreported economy would be close to 40 per cent of GDP. India's GDP currently being in the neighbourhood of 62 lakh crore, the country's underground economy would be worth at least Rs 25 lakh crore. This simply means that the government is losing a tax revenue of more than Rs 7 lakh crore every year which is more than a year's total tax collection. This size of shadow economy can be reduced or eliminated through the recently introduced demonetisation drive. This paper is an attempt to analyze the current situation of shadow economy, its size, causes, impact and govt. steps to tackle the problem of shadow economy in India.*

### Introduction:

The Shadow economy is a phenomenon that can be observed all over the globe, no matter how developed or underdeveloped a particular country is. The term shadow economy refers to an economy wherein all the transactions taking place are illegal in nature. In other words, the goods and services, which are traded in this economy do not come from legal channels. Owing to its illegality, the black market economy runs in parallel to the established economy of the state which is supported by the respective government. The term 'black market' encompasses illegal and many times, unethical trade of several different goods and services. These range from drugs, weapons, people, and counterfeit products to human organs, animals, currency, and fuel. Shadow economy is a critical issue which India is facing in these days. Certain measures are necessary to narrow down the impact of shadow economy on the growth of a nation.

### How Large Is the Shadow Economy in India?

India has among the highest usage of cash across global economies. According to a 2015 report from PWC, 98 percent of all transactions by volume happen in cash. 68 percent of the total value of transactions are conducted in cash.

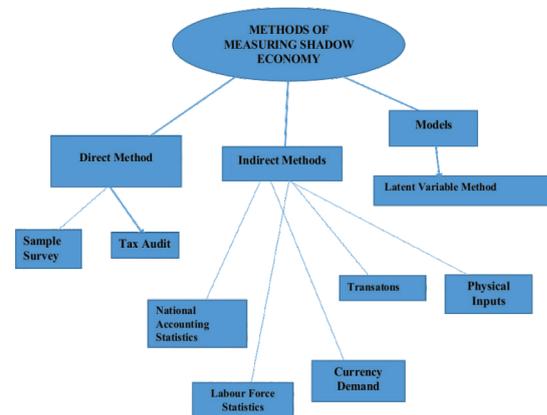


According to the most recent estimate, India's shadow economy is as large as 26 percent of the country's gross domestic product. This implies that almost one fourth of the Indian economy goes untaxed and unaccounted. Estimating the size of the shadow economy is difficult. After all, people engaged in underground activities do their best to avoid detection. But policymakers and government administrators need information about the people who are active in the shadow economy so that they can make appropriate decisions on resource allocation. Thus, economists and government statisticians have made a variety of calculations to gauge the large size of shadow economy in India.

### Methods for Measuring the Shadow Economy:

Analysts and policymakers have used different methods for measuring the shadow economy. Shadow economy is measured with various methods. In direct method, Sample survey estimates size of shadow economy from survey data. Tax audit estimates size of shadow economy from audit measurements of

undeclared taxable income. In indirect method, National accounting statistics estimates size of shadow economy on basis of the discrepancy between income and expenditure statistics in national accounting or in individual data. Labour force statistics estimates growth in shadow economy on basis of decline in labour participation in the official economy, assuming the labour force has a constant participation rate overall. Transactions uses data on the overall volume of monetary transactions in the economy to calculate total nominal GDP, then estimates size of shadow economy by subtracting official GDP from total nominal GDP.



Currency demand Estimates size of shadow economy from the demand for cash, assuming shadow transactions are undertaken in cash and that an increase in the shadow economy will raise demand for cash. Physical inputs Estimates growth of shadow economy from electricity consumption, assuming that electricity consumption is the single best physical indicator of overall economic activity. Latent variable approach estimates the size of the shadow economy as a function of observed variables that are assumed to influence the shadow economy i.e the burden of taxation, the burden of government regulation—and of variables where shadow economic activities leave traces, like cash, official working time, unemployment, etc. Different methods may give very different impressions of size and growth. They imply that decision makers should be careful if using estimates based only on a single method.

### Why Are Shadow Economies Growing???

Shadow economies are growing in India due to following reasons:

**1. Money laundering:** Money laundering is a term to describe the process whereby cash from illegal activities is converted to

an alternate form in a manner that conceals its origin, ownership or other potentially embarrassing factors. By increasing number of steps involved in laundering illegal funds, criminals try to obscure the origin of funds used to acquire assets.

**2. High tax rates:** Very high rates of taxation on income above a certain limit are expropriator in nature. In India marginal rate of income tax is very high and this provides a strong incentive to tax evasion which, in turn generates considerable black money.

**3. Sale of land and property in Urban Areas:** One of the important sources of black money in India is the sale and purchase of land and property in urban areas. In most cases as much as 60 per cent payment is in terms of black money while the white component is only 40 percent of the actual value.

**4. Poor implementation of tax laws:** The Indian tax structure is complex. There is a multiplicity of taxes and variety of tax rates. This makes the task of administration difficult. Widespread corruption in tax departments has led to poor implementation of tax laws and helped tax evasion.

**5. Generation of black money in the public sector:** The nexus between contractors, bureaucrats and politicians results in the generation of a large amount of black money as the costs are often artificially escalated for common dealings.

**6. Misuse of Public Money:** There is widespread corruption in awarding public works. There is massive escalation of costs in most of the works undertaken and large sums of public money were pocketed by some influential men.

**7. Bribes for undue favours:** In India sometimes people have to offer bribes to get any work done in the govt. departments. The public officials even demand bribes for performing their assigned duties.

**8. Donations to political parties:** Big businessmen provide large amount of money in form of donations to political parties to fight elections. This money is not accounted for under any head. The main motive behind this donation is to influence the economic policies in its favour.

**Impact of Shadow Economy on Country:** Owing to its illegal nature, any kind of products can be sold as there is nobody to ask how and why. Following are some of the effects that black market may have on the economy:

**1. Loss of revenue to the Government:** The share of black market is huge in the Indian economy and it has numerous direct and indirect effects on the same. The direct effect of black money is the loss of revenue to the State Exchequer.

**2. Loss of control over policy:** As the size of black economy increases, the control of the state on economic policies declines. This reduces the effectiveness of State's intervention in all other sectors as well.

**3. Unproductive investments:** A large amount of black money finds its way into unproductive channels like gold, jewellery and precious stones. Thus, resources that could have been utilised for productive purposes are wasted. As a result economic growth suffers.

**4. Losses to Domestic Industries:** Black markets easily make available to the people all that they need either at cheap prices or all that is difficult to get and/or short of supply, at higher prices. It amounts to losses to the domestic industries and eventually to the government, as it is not possible for the white marketers to sell their goods either at cheap prices, and/or without authentic legal permits and formalities.

**5. Criminalization:** Deteriorating law and order is a result of the growing black economy. This is due to the reason that there is a

close nexus between illegality and criminalization.

**6. Underestimation of the National Income:** The black market is illegal in nature and all the transactions that happen therein, are off the record. In the absence of any authentic record, it is very difficult for the government to correctly estimate the actual economic status of the country. Consequently, it becomes immensely difficult for the government to plan and implement policies for the country's economic development.

**7. Deliberate Creation of Shortage:** Black markets lead to immense monetary gains for its players, sometimes, deliberate shortages of certain necessary commodities are created in the established markets. These goods are then sold in the black markets, and despite the elevated prices, the demand does not diminish. This leads to high profits, often in cash, which go unnoticed.

**8. Underestimation of Employment Data:** Black markets are a big part of the informal economy of the world, and millions of people are employed in these markets. However, it is not possible for any economic statistics to estimate the exact number of employed people in the country, as those employed in the black markets, are often marked as unemployed.

#### **Govt. Steps to Curb Shadow Economy:**

The menace of ever raising black money in Indian economy is very high. It is a well known fact that tax evasion generate black money. It is estimated that the volume of black money in 1991 has crossed over Rs. 1,00,000 crores. At present this is estimated to be about 1 trillion USD. Such staggering extent of black money has activated a parallel economy in the country and it affects the vital sectors of the economy. The Government in the past has already tried certain measures with little success. If steps are not taken immediately to reduce the black money, it may ruin the entire economy of the country. The important remedial measures for controlling black money are given below:

**1. Measures to check tax evasion:** The government has undertaken various measures to check tax evasion by plugging loopholes in tax laws based on the recommendations of various Commissions and Committees appointed over a period of time.

**2. Voluntary Disclosure Schemes:** The Government may adopt the policy that those who voluntarily disclose their black income of the past to the taxation authorities will not be punished and penalties may be waived or minimized. The following image shows the amount of undisclosed income detected during the period 2006-2012.

**3. Lokpal and Lokayukta Bill, 2013:** Lokpal and Lokayukta Bill, 2011 was passed by the Parliament in December 2013. The Bill seeks to establish an anti-corruption watchdog that will have within its purview even the office of prime minister.

**4. Raids:** Income tax department's powers have to be considerably enlarged and it should be empowered to conduct raids on the premises and properties of the taxpayers or any other individuals and can seize the unaccounted income and wealth and take necessary legal actions against the tax evaders.

**5. Rationalization of Controls:** Since ill-devised controls are major causes of black money, it is essential to rationalize the control system. Government has taken some steps in this direction by easing the licensing policy etc. But still there are many cumbersome rules and formalities and unnecessary control in many areas, which need to be effectively rationalized.

**6. Taxation Reforms:** India needs a rationalized tax structure. Prof. Kaldor, Wanchoo Committee and many others including the authors of the NIPFP Report have recommended a reduction in marginal tax rates, simplification of tax structure, taxation laws and improvements in tax administration.

**7. Vigorous Prosecution:** The Wanchoo Committee also recommended that the department should completely reorient itself to a more vigorous prosecution policy in order to instill a wholesome respect for the tax-laws in the minds of the taxpayers.

**8. Special Bearer Bonds:** In 1981 and 1991 the Government has introduced a scheme of Special Bearer Bonds to drag black money into the treasury's coffer. It is advocated to unearth black money. But it is to be modified suitably according to the prevailing economic conditions.

**9. Rewards and Awards:** In order to encourage the honest taxpayers and create a positive attitude in the minds of the people towards the payment of tax, this can be adopted. The income tax department has introduced a special award scheme for the first time in Tamil Nadu for the 1994-95 assessment year, to encourage and recognize prompt tax payers and also create greater awareness in the minds of tax paying public.

**10. Demonetization:** The demonetisation of ₹500 and ₹1000 banknotes was a step taken by the Government of India 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 demonetisation was done in an effort to stop counterfeiting of the current banknotes allegedly used for funding terrorism, as well as a crackdown on black money in the country. The move is also aimed at reducing corruption, drug menace and smuggling.

#### **Conclusion:**

To sum up, it can be stated that In India, the extent of black money is quite significant. Though it is quite difficult to estimate the quantum of black money with accuracy but many attempts have so far been made in India for quantifying it and in most of the cases the findings appear to be far from reality. The existence of such huge quantum of black money in India results in not only revenue losses, but also availability of less resources for investment in priority areas. The Government has undertaken various measures to control the menace of parallel economy or black economy in the country. But still govt. needs more steps immediately to reduce the black money otherwise it may ruin the entire economy of the country

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