IMPACT OF BLACK MONEY ON THE INDIAN ECONOMY

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Abstract

"Corruption debases democracy, undermines rule of law, distorts the market, stifles economic growth, and denies many, their rightful share of economic resources of life-saving aid."

-Kofi Annan

The famous quote from the former Secretary General of the United Nations Organization amply highlights the severity of the problem of black money/ corruption being faced by the world and its dreadful effects on the economy, both at micro and macro levels. Further, it would not be out of place to state here that this problem impacts every aspect of an individual's life. This paper is an endeavor to bring forward the various facets related to 'Black Money' (BM) and its multifarious association with govt. policies and other organizational practices in India, and to highlight some of the initiatives undertaken by the Indian government (govt.) in the ways of strategized policies to curb black money and increase in corruption in the country.

Keywords

Black money; Parallel economy; Black wealth; Shadow economy; Corruption; Demonstration; Measures taken by the government; Reports on Black money.

1. Introduction

1.1 What is Black Money?

In economic theory, no single uniform definition of BM exists. However, there are multiple terms that are used interchangeably in order to connote one same expression; these include "unaccounted income", "black income", "Dirty Money", "Black Wealth", "Underground Wealth", "Black Economy", "Parallel Economy", "Shadow Economy", "Underground/Unofficial Economy". These above terms are, however, used to refer to "income on which taxes imposed by the govt. are not paid". As such, as per the National Institute of Public Finance and Policy (NIPFP) in its report on “Aspect of Black Economy”, BM can be defined “*as the aggregates of incomes which are taxable but not reported to the tax authorities*”(NIPFP, 1985).

1.2 What are the different aspects of Black Money?

In reference to “*White Paper on Black Money*” issued by the Ministry of Finance, Government of India, 2012, BM according to general dialect refers to “*money that is not fully legitimate in the hands of the owner*”. There are mainly two broad possible reasons for its cause. ***Firstly***, the money might have been acquired via illicit or unlawful means, and are punishable according to the legal framework of a country e.g., drug dealing, corruption, terrorism, or maybe through some other criminal activities. ***Secondly,*** perhaps the most common practice of BM holders is that the money might have been accumulated by non-payment of dues to the public exchequer. Such a situation arises when a person fails to report the income generated (maybe through a lawful trade activity) to concerned taxation authorities, in order to evade tax obligations or to evade payment of dues to the public exchequer. For instance, during a real estate trading of a commercial or residential property, a perpetrator might not report the full trade value to evade tax obligations. Such acts are legitimate and are punishable under the law.

A detailed understanding of both the ways in which BM arises and accumulated is pertinent to devise a plausible solution in order to curb BM in the future also. BM generated through illegitimate/ illegal activities has a fundamentally harmful effect on society. The finance ministry of India elaborated on the ‘criminal’ constituent of BM which includes income from “a range of activities, including but not limited to trafficking in counterfeit and contraband goods, smuggling, production and trade of narcotics, forgery, illegal mining, illegal felling of forests, illicit liquor trade, robbery, cheating and financial fraud, embezzlement, bank frauds, and illegal trade in arms” (NIPFP, 1985), all these activities are highly intolerable as they are a real threat to the society. They are purely illicit and are punishable under numerous legislative acts by various states of law. The second aspect of BM is more complex and entails rigorous modifications and redesigning of current policies and reforms, that can encourage people to obey tax-related laws and regulations and also discourage the operating economic agents from producing, stockpiling, and illegally parking that unaccounted wealth outside the country.

Finance Ministry of India (2012) further described the term BM in addition to money generated through illegitimate sources as “BM includes legal income that has been generated via legal trade activities but has been concealed from tax authorities, in order to:

- to evade payment of taxes (income tax, excise duty, sales tax, stamp duty, etc.);
- to evade payment of other statutory contributions;
- to evade compliance with the provisions of industrial laws; and/or
- to evade compliance with other laws and administrative procedures".

Nevertheless, substantial value of BM is produced via lawful economic activities, which are unaccounted/ undisclosed/ unreported to the tax authorities as per the applicable rules and regulations. This leads to conversion of such income into BM. There is a possibility that the owners do not report or disclose information about their income to evasion of payable taxes or to escape from compliance requirements as required by applicable laws. A good illustration for this would be if an industry owner misreports by not disclosing the correct quantity of production and only reports part of the production, as the owner wants to hide theft of electricity committed by the said industry then this would ultimately lead to tax evasion. A self-explanatory model explicating such genesis of BM via manipulation of account to evade tax is mentioned in Figure 1.

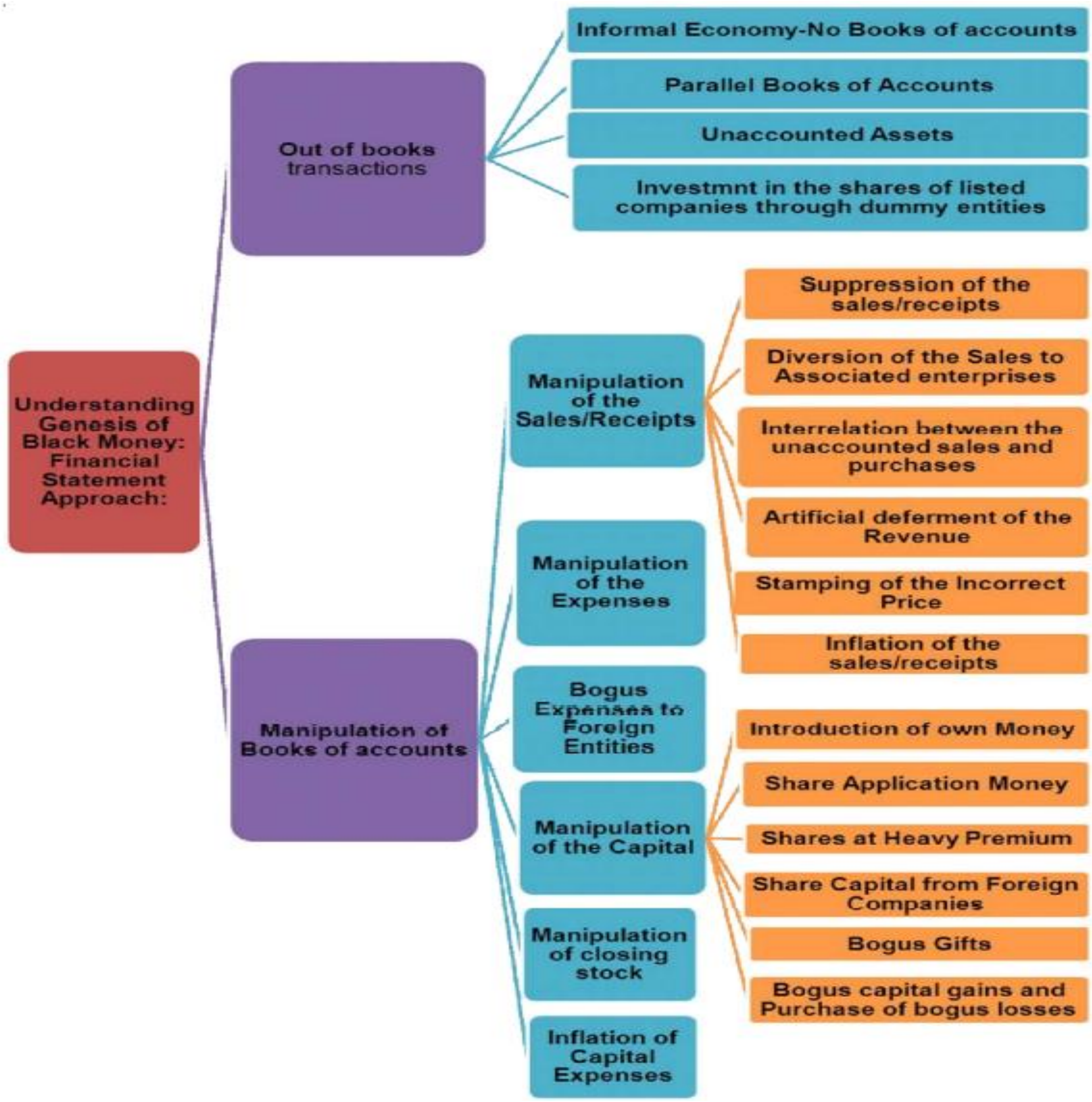

Figure 1: Genesis of Black Money – Books of Accounts Approach

Source: Ministry of Finance, India

Summarizing the above discussion, it may be said that in layman's terms, and for the aim of the paper, *BM* may be well-defined as an income, from whatsoever source, undisclosed by an individual or any entity to the govt. The term also includes undisclosed foreign income and assets. As the income is not disclosed, no tax is paid to the govt. and no revenue is thus generated from such undisclosed income for the govt.

The whole concept of BM has become very important in the recent times as the same was made an important election issue by the ruling govt. of the day by highlighting the adverse impact that

BM has on the growth and development of the common man. Therefore, it is inevitable to state that the manifestation of BM can have devastating consequences in our social, economic and political space, good governance, administration of public policy, and on the socio-economic growth of the country.

1.3. Objectives of the Study

The paper is an attempt to make a significant role in the ongoing debate related to BM, plus help foster comprehensive political consensus to address the menace in the future. Thus, the following are the underlying objectives:

- To study the definition of the concept itself.
- To understand and place on the table certain facets and dimensions of BM and the complexities therein.
- To explore different modes of generation of BM.
- To study the impact of BM on the India Economy.
- To identify steps taken to curb the menace of BM.

1.4. Research Design

- Descriptive/ informative approach is employed in this research article and wherever deemed necessary, that of research. Further, for better understanding, the research paper uses a question-answer approach to highlight important aspects of the subject.
- Data Collection- Secondary

2. What are the estimates of Black money in India?

Just like the definition of BM, there is no uniform estimate or well-accepted methodology for its genesis or accumulation. Over a period of time, various attempts were made to estimate the amount of parallel economy running in the country (based on numerous assumptions). Despite various reports that have been submitted in estimating the extent of BM circulating in the economy, there exists a wide variation in the figures submitted, highlighting the non-uniformity, and non-consensus of the approaches used along with numerous limitations. Some of those methods/ approaches are:

I. **Input/Output method:** The most simple, individual industry or sector-based approach which estimates BM as "*the difference between the declared output and the output expected on the basis of the input/output ratio*".

II. **Survey Approach:** As the name suggests, sample surveys are carried out to evaluate the consumption pattern of that sample population. The results are then evaluated with the total consumption of the country.

III. **Fiscal Approach**: Estimation of BM for each sector of the economy is separately evaluated and then added up to assess the total unaccounted wealth accumulated in the economy as a whole.

IV. **Kaldor's approach**: Prof. Nicholas Kaldor submitted a report in 1956 estimating the value of BM in the economy. His report "estimated non-salary income on the basis of the break-up of national income into (i) Wages and salaries, (ii) Income of the self-employed, and (iii) Profit, interest, rent, etc. Excluding wages and salaries from the contribution to the net domestic product, he derived total non-salary income. An estimate of the actual non-salary income assessed to tax was made for each sector in order to arrive at the total non-salary income assessed to tax. The difference between the estimated non-salary income above the exemption limit and the actual non-salary income assessed to tax measures the size of 'black' income" (Ministry of Finance, 2012).

V. **Wanchoo Committee's Estimate**: Shri K.N.Wanchoo, is the Ex-Chief Justice of India (Supreme Court) who chaired the committee in December 1971. According to the report, "the estimated income on which tax has been (black income) would probably be Rs. 700 crores and Rs. 1000 crores for the years 1961-62 and 1965-66 respectively. Projecting this estimate further to 1968-69 on the basis of percentage increase in national income from 1961-62 to 1968-69, the income on which tax was evaded for 1968-69, the income on which tax was evaded for 1968-69 can be estimated at a figure of Rs. 1800 crores" (Datt and Sundharam, 2004).

VI. **Rangnekar's Estimate:** Dr. D.K. Rangnakar (member of Wanchoo Committee) further discussed BM estimation in his report (1982) that, "tax evaded income for 1961-62 was the order of Rs. 1,150 crores, as compared to the Wanchoo Committee's estimate of Rs. 850 crores. For 1965-66, it was Rs. 2,300 crores, as against Rs. 1,216 crores estimated by DTEC. The projections of BM for 1968-69 and 1969-70 were Rs. 2,833 crores and Rs. 3,080 crores respectively" (Datt and Sundharam, 2004).

VII. **Chopra's Estimate:** India's renowned economist, Dr. O.P. Chopra estimated in his study the extent of the shadow economy running in the country. The foremost assumptions were, "I. Only non-salary income is concealed; II. Taxes other than income tax are evaded and the study is restricted to only that part of income that is subject to income tax. Thus, tax evasion which may be due to (a) non-payment or under-payment of excise duty, (b) sales tax, (c) customs duties, or (d) substituting agricultural income for non-agricultural income is not captured; III. The efficiency of the tax administration remains unchanged; IV. The ratio of non-salary income above the exemption limit to total non-salary income has remained the same; and V. The ratio of non-salary income to total income accruing from various sectors of the economy remains the same". The above study was based on two main hypotheses, such as, *first*, tax evasion is usually higher when the rate of tax is high. *Second*, high prices lead to high unaccounted income. The findings of the study made a significant contribution in that "funds were diverted to the non-taxable agriculture sector to convert unaccounted (black) income into legal (white) income. The estimated unaccounted income was to have increased from ` 916 crores in 1960-61, i.e., 6.5 percent of the gross national product (GNP) at factor cost, to ` 8098 crores in 1976-77 (11.4 percent of GNP)" (Ministry of Finance, 2012).

VIII. **National Institute of Public Finance and Policy (NIPFP) report:** The study uses the '*minimum estimate approach'* under the guidance of Dr. S. Acharya (1985), i.e., the minimum amount of under-declaration of proceeds made in the relevant sector. While calculating the BM global estimate, the study limited to 6 areas: "i. factor incomes received either openly or covertly while participating in the production of goods and services, ii. 'black' income generated in relation to capital receipts on sale of an asset, iii. 'black' income generated in fixed capital formation in the public sector, iv. 'black' income generated in relation to the private corporate sector, v. 'black' income generated in relation to export, and vi. 'black' income generated through over-invoicing of imports by the private sector and sale of import licenses". The study further argued that BM generated in India in the years 1983-84 was not less than 18 % of GDP at factor cost or 16 % of GDP at market prices. The main drawback of the study was to exclude BM generated via illegal activities such as corruption, bribes, illegal trades, smuggling, etc.

IX. **World Bank Report**: In 2010, '*The World Bank Development Research Group and Europe and Central Asia Region Human Development Economics* Unit assessed the value of 'Shadow Economies' of 162 countries from the period 1999 to 2007. The report stated that "the weighted average size of the shadow economy (as a percentage of 'official' GDP) of these 162 countries in 2007 was 31 percent as compared to 34 percent in 1999. For India, these figures were 20.7 percent and 23.2 percent respectively, comparing favorably with the world average".

3. What is the impact of Black Money on the Economy?

BM has, *inter alia*, the following adverse impacts on the Economy:

I. **Tax Income Deficit**: When there is unaccounted cash circulating in the economy, the govt. fails to collect tax on such unaccounted money. Therefore, the BM is actually eating up a major part of the tax revenues, which the govt. intends to utilize it for the development of society and the country as a whole. The govt. balances this deficit by increasing taxes, decreasing subsidies, and borrowing from other sources, which leads to a further increase in the govt. debt. If the govt. is unable to balance this deficit, it decreases spending which affects development. According to a recent report by NIPFP, the amount of unaccounted accumulated wealth is expected to exceed 10% of the total GDP of the country through various sectors of the economy majorly in real estate, mining, telecom, etc.

II. **Unruly Inflation:** Inflation increases when BM is circulating in an economy, the reason being that the amount of money circulating in an economic system is much more than expected by the govt. It leads to an increase in the prices of commodities to levels beyond reasonable limits, for the reason that the people with surplus money (i.e., people having BM) are willing to spend much more on the same commodity. Albeit, if govt. of India attempts to regulate the credit flow in the economy by employing necessary measures, the value of BM present distraught the measure taken, resulting in pressures on the economy.

III. **Accentuating Economic Inequality**: When the perpetrators withhold money from the deserving population and the govt. increases tax rate to fill the deficit, the burden falls on the people who are diligently following the law to pay the tax on time. The rich become richer and the poor become poorer because rich people further increase the tax evasion amount and liability falls on the shoulders of the middle-income group. This results in economic inequality.

IV. **Negative Impact on National Growth**: One of the most severe impacts of BM is that it ceases the GDP growth of a country, because of lack of funds available to the govt. The NIPFP has briefly estimated the value of BM in India at around Rs 37,000 Crores, which is a touch over 1/5th of GDP. In keeping with published reports, and IMF survey of the unaccounted sector of the economy (in various countries) has estimated BM in India at 50% of GNP. Since, there is lack of funds available for the development and welfare of the society, govt. require loans from World Bank and/ or other's countries, which ultimately increases the liability of foreign debt and further results in declines in the economic growth of the country.

V. **Parallel Economy**: Parallel economy means operation of an unofficial sector in an economy that runs parallel and in contradiction with the objectives of sanctioned/ official sector in the same economy. BM leads to the creation of such Parallel Economy, which is considered to be a menace to official economy, the magnitude of BM is large, complex, and alarming. Along with the ramifications of the ‘parallel economy, the rise in BM in the economy is accentuating income inequalities and also breeding a new class of ‘black’ rich in a society that is already harshly stratified (Sukanta Sarkar, 2010).

4. How are Legislations dealing with Black Money?

The responsibility of addressing the challenge of BM and its corollary is collectively shared by various govt. agencies under various ministries of the govt. of India and state govts. It includes different tax departments to ensure the enforcement of various laws related to tax. Some of the important agencies are as follows:

S. No.	Name of Government Agencies
1	Central Board of Direct Taxation (CBDT) and the Central Board of Excise and Customs (CBEC)
2	Enforcement Directorate (ED);
3	Financial Intelligence Unit (FIU)
4	Economic Offences Wing of the State Police
5	Central Bureau of Investigation (CBI)
6	Serious Frauds Investigation Office (SFIO)
7	Narcotics Control Bureau (NCB)
8	Central Economic Intelligence Bureau (CEIB)
9	National Investigation Agency (NIA)
10	High Level Committee (HLC)

Source: Ministry of Finance, India

There are certain legislations as well, which are used to fight the menace of BM. This Paper discusses only the important legislation in a bit of detail.

a. Prevention of Money Laundering Act, 2002

The Act was enacted to restrain money laundering and to confiscate the property derived from BM, or involved in, money laundering and for matters connected therewith or incidental thereto.

"To strengthen the provisions of the PMLA, amendments were carried out in 2009. These amendments have introduced new definitions to clarify and strengthen the Act and strengthened provisions related to the attachment of property involved in money laundering and its seizure and confiscation. More offenses have been added in Parts A and B of the Schedule to the Act, including those pertaining to insider trading and market manipulation as well as smuggling of antiques, terrorism funding, human trafficking other than prostitution, and a wider range of environmental crimes. A new category of offenses with cross-border implications has been introduced as Part C." (Sukanta Sarkar, 2010).

b. The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

The most recent step taken by the Govt. of India is the enactment of this legislation. It is considered to be strict legislation with stringent provisions. The salient features of this legislation are as follows:

i. **Scope**: Above act applies to every person residing in India. Provisions of the same are applicable to every undeclared foreign income and asset.

ii. **Rate of Tax**: Flat 30% tax rate will be imposed on foreign income/ assets which are not disclosed as per applicable laws. The Act does not allow for exemption/ deduction/ set off of any carried forward losses, which was allowed under the existing Income-tax Act, of 1961.

iii. **Penalty**: Stringent penalizations are imposed on the violators of this Act. Penalty up to thrice the value of tax payable on proceeds/assets located outside India and not disclosed would be imposed. This is over and above the 30% flat tax rate already imposed as above.

iv. **Prosecution**: Stringent punishments were insinuated under the bill for violators. Plus. 3-10 years of rigorous imprisonment along with a heavy-duty charge will be imposed on defaulters who wilfully try to evade tax in regards to any foreign income/ asset.

Failure to furnish a return in respect of foreign assets and bank accounts or income will be punishable with rigorous imprisonment for a term of six months to seven years. The same term of punishment is prescribed for cases where although the assessee has filed a return of income, but has not disclosed the foreign asset or has furnished inaccurate particulars of the same. The above provisions will also apply to beneficial owners or beneficiaries of such illegal foreign assets.
Abetment or inducement of another person to make a false return or a false account or statement or declaration under the Act will be punishable with rigorous imprisonment from six months to seven years. This provision will also apply to banks and financial institutions aiding in the concealment of foreign income or assets of resident Indians or falsification of documents.

Table 1: Outcomes of government measures against black money

Year	Measure	Outcome
1951	Voluntary Disclosure Scheme (*Tyagi Scheme*)	₹702 million of income disclosure and ₹200 million of tax collected
1965	Sixty-forty Scheme	₹521.8 million of income disclosure and ₹300.8 million of tax collected
1965	Income Disclosure Scheme	₹1450 million of income was disclosed and ₹194.5 million of tax was collected
1965	National Defence Gold Bonds	₹180 million of income was disclosed
1965	National Defence Remittance Scheme	₹700 million of income was disclosed
1975	Voluntary Disclosure Scheme	₹7440 million of income was disclosed and ₹2410 million of tax was collected
1978	Demonetization	25% of the ₹1000 notes did not return to the banks, thus eliminated
1981	Bearer Bond	₹9.64 billion of fund was disclosed through investment in such bond
1985-1986	Seven CBDT Circulars	₹107.78 billion of income was disclosed with a collection of ₹5 billion income tax
1991	NHB Deposit Scheme	₹600 million of fund was invested in such deposit scheme
1991	Remittances in Foreign Exchange (Immunities) Scheme, 1991 and India Development Bonds Scheme, 1991	The Remittance Scheme brought in about ₹ 22 billion while India Development Bonds ₹ 45 billion
1993	Gold Bond Scheme	₹ 18.07 billion of fund was invested
1997	Voluntary Disclosure Income Scheme	Over 3,50,000 people disclosed their income and assets.₹ 333.39 billion of income was disclosed and ₹ 95.84 billion of income tax was collected
2015	Black Money Act	₹41.64 billion of income was disclosed and ₹ 24.88 of income tax was collected
2015	The Benami Transactions (Amendment) Act, 2015	Crackdown on *benami* transactions so far yielded ₹6 billion till mid-2017
2015	Abolition of Wealth Tax	Not estimated or obtained
2016	Income Declaration Scheme	₹652.50 billion of income was disclosed and ₹300 billion of income tax was collected
2016	Demonetization	RBI reported that only 1% of the banned notes did not return
2016	Pradhan Mantri Garib Kalyan Yojana	₹50 billion deposited under the scheme
2017	GST	Figures cannot be separately estimated
2018	Electoral Bonds	Figures cannot be estimated or obtained

Source: Ghosh, 2017; Arindam Gupta, 2018

5. Concluding Remarks

In light of the above discussion, it can be safely concluded that Black Money has a severe impact on the common man by impacting the competitive economy. Black Money impacts the economy in the following ways:

- By creating a tax income deficit
- It leads to irrepressible inflation
- Creates and increased the economic inequality
- Adversely impacts the national growth
- Creation of parallel economy.

Nevertheless, it is evident that the govt. is taking steps to curb the menace of BM by enacting stringent legislation. However, it is noted that there is not much innovation in the recent BM legislation. The offenses and prosecutions as provided under the BM Act have been already covered under the Income Tax Act, 1961. The provision in which an Indian resident fails to disclose his income earned outside India and is liable for criminal prosecution is already captured in the Income Tax Act. The existing Income Tax Act has detailed provisions vis-à-vis investigation, prosecution, penalty, and sentencing for persons in breach of any such provisions. Further, the stringent provision where there is a presumption of a guilty mind was already prevalent in the Income Tax Act.

It appears that the only genuine innovation is the BM Act forms part of the concluding section, wherein it is stated that the offenses under the BM Act become offenses under the PMLA. This linkage basically enables law enforcement agencies to attach and confiscate the assets of the tax evader. However, the important question which requires an answer is could the same result would have been achieved by providing the same linkage under the Income Tax Act, 1961 and the PMLA, which would have the added value of bringing all tax evasion (not just the foreign ones) under the money laundering laws. It seems the govt. is serious about fighting BM. How successful is the govt. in curbing the menace of BM by enacting legislation? Only time will tell.

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