

Black Economy: Its Magnitude, Effects, Government Measures and Schemes

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ABSTRACT

Parallel Economy means an illegal economic operation or otherwise known as black money. It represents a segment which is not legitimate. It practices those activities which are contrary to the principles of economic policy pursued in an economy. It is well-known that there is a large quantity of money, income and wealth which has been and is being made owned which is unaccounted in our tax system and therefore, has not suffered tax. This form of money is known as black money. Black money is not only the problem of Indian economy, but it also transcends the borders and has become a global dilemma. Recently, various studies have taken place under the Government of India to tackle the problem of black money in India. Those studies have revealed some astonishing facts about the black money market in India. In the last decade alone, India has lost approximately \$125 billion in illegal money. A study has revealed that the black money even exceeds 10% of our Gross Domestic Product. When it comes to flow of black money worldwide, India is ranked in eighth. The flow of black money can seriously affect the entire economic system of India. Black Money causes the prices of commodities to increase to a level beyond normal. People with black money are able to give bribes to the administrators and politicians for getting whatever they want. To control the generation of black money there should be a strong and appropriate legislative framework.

Key words: Black Economy, Black Money, Magnitudes, Economic Development, Swiss Account etc.

I INTRODUCTION

Black money refers to money that is not fully legitimately the property of the 'owner'. Black money may be defined as the money that is generated by activities that are kept secret in the sense and not reported to the authorities. This money is also not accounted to the fiscal authorities or you can say that taxes are not paid on this money. A white paper on black money by the Government of India suggested that there are two possible ways of generating black money in India. The first source of earning black money includes those activities which are not permitted by the law, such as crime, drug trade, terrorism, corruption and all of which are not legal in India. The second, more probable source is that the black money may have been generated through a lawful activity but accumulated by failing to declare income and pay taxes. Some of this black money ends up in illicit financial flows across international borders, such as deposits in Swiss accounts.

II REVIEW OF LITERATURE

Sukanta Sarkar, (2011), "The parallel economy in India: causes, impacts and government initiatives" The study has made an attempt to assess the overall profile of parallel economy in India, particularly in terms of causes, impacts and government initiatives. The results indicate that parallel economy has been expanding very rapidly in India as well as in developing countries. It is evident from the study that g

overnment of India already introduced various commissions for estimating black economy but estimation reports are not same. Indian government is more concerned about the prevalence of the parallel economy and various commissions are formed for controlling it but results are not so impressive. Thus, the paper suggests that recommendations of the commissions or laws should be implemented correctly for reducing bad effects of black economy.

Vladimer Papava & Ivane Javakhishvili Tbilisi, (May 2010), in their study, "The Economic Development Complex in the Black Sea area: the impact of the global Financial and Economic Crisis, states that the Black Sea Region is not as integrated economically as to allow one to outline some common development trends of all regional economies. The most of the region's nations (Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Moldova, Romania, Russia, Serbia, and Ukraine), except Greece and Turkey, are post-Communist countries. The purpose of this paper is to highlight the economic development difficulties of the post-Communist Black Sea Region and to examine the key economic problems of all the countries encompassing it in the context of the ongoing financial crisis.

John C. Bogle, (2009), Working Papers Series Perspectives - Black Monday and Black, Investors needs to be aware that rare events with an extreme impact that, afterwards, we think we could have predicted - in short, black swans - happen in the markets. Those who are trying to measure risk in the financial markets need to carefully distinguish risk, with its

probabilities, from uncertainty, which cannot be measured. We have become increasingly vulnerable to black swans because our financial economy has come to play an ever-larger role in our productive economy.

III OBJECTIVES OF STUDY

The prime and the most important objective is to understand the dimensions of black economy in Indian context, causes and measures to eradicate it. For this purpose Secondary data have been gathered from various published sources and reports.

IV BLACK MONEY IN INDIA

According to a report released by Global Financial Integrity (GFI) in December 2012, India is among the top 10 developing countries in the world with a black money outflow of \$1.6 billion (Rs. 8,720 crore) in 2010. Total outflow of black money from India since independence until 2010 was \$232 billion, generally in the form of corruption, bribery and kickbacks. The cumulative value of illicit assets held by Indians during the same period is estimated to be \$487 billion. The BJP, in a 2011 report, had estimated India's black economy being worth around \$500 billion and \$1.4 trillion or about between Rs. 27.5 lakh crore and Rs. 74 lakh crore, while US think-tank Global Financial Integrity had estimated India had lost \$123 billion (Rs. 6.76 lakh crore) in "black money" in 2001-10. This is money that is earned and transferred illegally abroad in tax havens, such as the Cayman Islands, typically to avoid taxes. In the post-reform period of 1991-2008, deregulation and liberalization accelerated the outflow of illicit money from the Indian economy. About a third of India's black money transactions are believed to be in real estate, followed by manufacturing and shopping for gold and consumer goods. If hidden incomes of Rs. 25 lakh crore were to be disclosed and taxed at 30%, it would generate Rs. 8.5 lakh crore, enough to build a 2,000-bed super-specialty hospital in each of India's 626 districts.

V BLACK MONEY OF INDIA IN SWISS ACCOUNTS

India has slipped to 70th position in terms of foreign money lying with Swiss banks and accounts for a meagre 0.10 per cent of total global wealth held in the country's banking system. An article in the reputed newspaper "The Hindu" in 2010 revealed that unofficial estimates indicate that Indians had over US\$1456 billion in black money stored in Swiss banks (approximately USD 1.4 trillion). While some news reports claimed that

data provided by the Swiss Banking Association Report (2006) showed India has more black money than the rest of the world combined, a more recent report quoted the SBA's Head of International Communications as saying that no such official Swiss Banking Association statistics exist. Another report said that Indian-owned Swiss bank account assets are worth 13 times the countries national debt. These allegations have been denied by the Swiss Bankers Association. James Nason of Swiss Bankers Association in an interview about alleged black money from India holds that "The (black money) figures were rapidly picked up in the Indian media and in Indian opposition circles, and circulated as gospel truth. However, this story was a complete fabrication. The Swiss Bankers Association never published such a report. Anyone claiming to have such figures (for India) should be forced to identify their source and explain the methodology used to produce them."

In a separate study by Global Financial Integrity concludes, "Media reports circulating in India that Indian nationals held around US\$1.4 trillion in illicit external assets are widely off the mark compared to the estimates found by their study." The report claims that the amounts are significantly smaller, only about 1.5% of India's GDP on average per annum basis 1948-2008. This includes corruption, criminal activities bribery and kickbacks, trade mispricing and efforts to shelter wealth by Indians from India's tax authorities. According to a report, published in May 2012, Swiss National Bank estimates that the total amount of deposits in all Swiss banks, at the end of 2010, by citizens of India were CHF 1.95 billion (INR 92.95 billion, US\$ 2.1 billion). The Swiss Ministry of External Affairs has confirmed these figures upon request for information by the Indian Ministry of External Affairs. This amount is about 700 fold less than the alleged \$1.4 trillion in some media reports. The report also provided a comparison of the deposits held by Indians and by citizens of other nations in Swiss banks. Total deposits held by citizens of India constitute only 0.13 per cent of the total bank deposits of citizens of all countries. Further, the share of Indians in the total bank deposits of citizens of all countries in Swiss banks has reduced from 0.29 per cent in 2006 to 0.13 per cent in 2010. In 2011, according to the data provided by Swiss Bank, India is topping the list almost \$1500 billion of its black money deposited with them, followed by Russia \$470 billion. The amount of black money is increasing day by day at very rapid speed.

VI CAUSES OF GENERATING BLACK MONEY IN INDIA

One of the most important causes of generating black money in India are as follows: 1. Unrealistic Tax Laws and Tax Frauds 2. Different Rates of Excise Duty 3. Control Policy 4. Quota System 5. Scarcity 6. Inflation 7. Elections in the Democratic Systems and Political Funding 8. Real Estate Transactions 9. Privatization 10. Agricultural Income.

VII IMPACTS OF BLACK MONEY ON INDIAN ECONOMY

The flow of black money can seriously affect the entire economic system of India. Some important impacts are discussed here:

(a) Less Tax for the Government—Many times, the Indian Government has failed to collect the estimated amount of tax from the people of our country and for this, credit has to go to the black money driven underground economy. Recently, a report was submitted to the Finance Ministry of India that divides the spread of black money in different sectors like real estate, mining, telecom etc. The study, headed by NIPFP chief P. Kavita Rao, explains how illicit wealth is likely to exceed 10% of GDP.

(b) Uncontrollable Inflation—When black money is out in the market, the amount of money in the system is higher than the Government expects. This causes the prices of commodities to increase to a level beyond normal. This is a direct result of people having more money offering more money on specific items. Even if the Government tries to control the credit flow in the market by taking necessary measures, the amount of black money present upsets the move, resulting in some sort of pressure on the economy.

(c) Leads to Mass Poverty—The distribution of wealth and income in our country have been severely affected by the growth of underground economy. The common people get affected indirectly in so many ways. The tax evaders are keeping the money away from the deserved. If all the black money in the tax havens is recovered and used by the Indian government, all the outstanding liabilities of the country could be paid off and money would still be left for spending.

(d) Lack of Technology—Due to the existence of black money, India is facing the problem of shortage of capital. This has the direct impact on the up gradation of technology in all sectors. The major reason behind such backwardness is the parallel economy.

(e) Impact on Growth by moving investments on Gold, Stones and Jewellery—People who are looking to turn black money into white money are largely investing in precious metals like Gold and other jewelry. There are people who believe that almost 70% of the total gold investment in our country is black money. One reason for people to invest in gold is that it is hard to trace. People in black market may buy gold bars, coins, jewellery etc because one can buy gold easily and can be converted back to money anytime. This flow of underground money has caused Indian economy to stall on its growth. It is estimated that if all the money in the underground economy could be diverted to our main economy, our economy would grow by more than thrice in no time.

(f) Corruption—While corruption creates black money in the economy, it can also be a result of the growing underground market. People with black money are able to bribe the administrators and politicians to get what they want. By doing this, they are able to get what they want and others are pushed down the stack.

(g) Inflated Real Estate—When people with deep pockets are ready to pay more for a piece of land, the price of surrounding land also tends to increase; thus artificially inflating the prices of an entire area. Generally, people involved in black money market are always ready to pay more for a piece of land as this helps in converting their coloured money to legal money.

(h) Transfer of Indian Funds Abroad to Safe Heavens—The black money generated in India is kept in foreign tax havens. For this, money has to be transferred from India to other countries through secret channels. Under-invoicing of exports and over-invoicing of imports are two of the main methods used by black money holders for transferring money overseas.

(i) Encourages Anti-Social Activity—It is no doubt that black money is a curse to any country. Black money is always promoting anti-social activities in the society. Bribery, mentioned earlier, is only one example. The anti-social effects of black money include activities like terrorism, a huge threat already to our country.

VIII EFFECTS OF BLACK ECONOMY

The effects of black money are discussed under the following heads:

(a) False Information about the Economy: The most important effect of black money is providing false information about the actual economy because it remains outside the purview of the economic policies. The presence of a sizeable black

money casts doubts on the validity of the data on national income estimates, per capita income, and distribution of income, consumption, savings and investment. The economic planning loses its worth, because they are based on macro-economic parameters which completely ignore the black money.

(b) Impact on Fiscal System: Government is fully based on tax revenue. Evasion of taxes has serious consequences for the economy's fiscal system. In long-run consequence of such revenue loss is to reduce the built-in elasticity of the tax system. To raise a given target of revenue the Government is obliged to depend increasingly on discretionary hikes in tax rates or to expand the array of taxes. Direct Taxes Enquiry Committee in this connection mentioned "Black money and tax evasion, which go hand in hand, have also the effect of seriously undermining the equity concept of taxation and warping its progressiveness. Together, they throw a greater burden to the economy."

(c) Create Inequalities: The black money creates inequalities among people. The excess of money leads to purchase non-essential articles, which gives demonstration effect. The overall consumption pattern is tilted in favour of rich and elite classes.

A rise in the overall consumption on non-essential products leaves less resource for investment in priority areas. These distortions in the product-mix in favour of non-essential consumption have adverse effects on production and thus they distort the objectives of planning.

(d) Mis-guiding on Resource Allocation: Black money distorts resource allocation in the economy and often leads to wasteful and often leads to wasteful use of money. It leads to conspicuous consumption and in turn results in the diversion of large funds to unproductive channels which ultimately put the economy out of order.

(e) Implications for Monetary Policy: The black money related to the stock of 'black liquidity'. The stock of 'black liquidity' is defined as the accumulation of black savings (from black incomes) in the form of cash and other readily convertible assets such as gold and silver.

It is the 'black liquidity' which creates a lot of problems for monetary authorities to regulate the economy. The existence of sizable 'black liquidity' in our country misguides the Government to diverting credit from more urgent to the less urgent.

IX MEASURES TAKEN BY THE GOVERNMENT OF INDIA

The government has introduced compulsory reporting in case assets held abroad and also started tax collection at source in case of purchases in cash of gold in certain cases. The Government of India is working with fervor to bring up all the black money in our country. Different strategies have been formulated to curb the problem of black money in India.

(a) Lower Tax Slabs for encouraging Voluntary Compliance-In the early '70s, the tax rates were high that it encouraged many people to be involved in tax evasion. Since this became an evident reason for increasing black money, Government took steps to reduce the tax rates. However, the fact remains that with lowering of tax rates and introduction of new laws, new opportunities opened up for tax evasion. A global presence of black money also started to help these people in pursuing the crime.

(b) Introduction of Tax Deduction at Source on high Value Transactions-In the recent budget, the Finance Minister introduced TDS, Tax Deducted at Source, to all transactions involving immovable assets above Rs 50lakh. He also introduced a new tax, Commodities Transaction Tax or CTT, hoping it will help in keeping a trail of bullion trade.

(c) Special Bearer Bonds-These were special bonds introduced by Indian Government in 1981 to make use of the 'unaccounted' money for constructive purposes. Black money holders could convert their money to these bonds and could enjoy the freedom from any enquiry or investigation about sources of these funds. It carried 2% interest and had a lock in period of 10 years.

(d) Amnesty Scheme-The Amnesty Schemes, introduced by the Finance Ministry from time to time, allows tax defaulters to pay a tax, waiving the penalty and interest. Using these schemes, a defaulter could disclose their wealth and convert them to legal money. No more questions will be asked. These schemes help Government to rake up the taxes and bring huge amount to legal money back into the Indian market.

(e) Punishment to Corrupt Officials-The Government of India has taken and continues to take stringent actions against those involved in corruption. The actions against the Telecom Minister A.Raja, during his tenure the 2G spectrum scam took place, is an example. The Government is keen to inflict of insecurity to those involved with corruption and black money market. If Government continues to act strong against the corrupted, India will soon be a better country and maybe even a world leader in economy.

The law in our country, even today, has some loop holes which tax evaders take advantage. The lawmakers in the country have to come forward with better and strict laws regarding tax payment and to control flow of black money. If Government does not take proper timely action, the trend is only going to grow up.

X SCHEMES FOR THE DISCLOSURE OF BLACK MONEY

The Government of India introduced a series of 5 new schemes on 1st October 1991 to unearth the black money and to improve foreign exchange reserves in the country. The schemes are as follows;

(a) Scheme One: State Bank of India issued Bharat Development Bond in which Non-Residential Indians (NRIs) were permitted to deposit foreign reserves of US dollar and British Pound (no upper limit) for 5 years. These bonds were sold up to January 31, 1992. The Government announced the rebate of income tax on the income earned as interest on the bond.

(b) Scheme Two: The Government introduced a scheme to promote the inflow of foreign currency in the country. Under this scheme any person residing in foreign country could send unlimited foreign exchange to any Indian citizen without declaring its source.

This scheme was open up to January 31, 1992. Under this scheme, the inflow amount of foreign exchange was exempted from various taxes and Foreign Exchange Regulation Act restrictions.

(c) Scheme Three: Under this scheme, any person could deposit his black money up to January 31, 1992 in National Housing Bank. The depositor was authorized to withdraw the 60% of deposited amount but the remaining 40% was to be used for constructing low cost houses for poor people.

(d) Scheme Four: Under this scheme, the Government amended clause 273A of the Income Tax Act to give one more chance to the person having black money to declare it, but this opportunity can be availed by persons only once in their life.

(e) Scheme Five: This scheme provided for exemption from penalties on declared black money and assets if the tax payer declared his black money at the time of his tax assessment.

In continuing that, the Government of India also introduced the Gold Bond Scheme in 15th March 1993 to unearth black money.

XI CONCLUSION

Black money or the illegal money circulating in the parallel economy is a big menace for the Indian economy. It is also an originator of big loss in the tax-revenues for the government of India. Because of the existence of the black money in Indian economy, the per capita income of the people has not been growing in line with the other advanced countries despite the liberal measures taken by the government of India since early 1990s. Even after several decades of economic planning and push in the right direction, India still continues. It is really a difficult task to eradicate completely black money which has permeated every section of society and every sector of economy. Nevertheless, the measures enlisted above can go a long way to bring down the black economy to manageable proportion over a period of time.

The evil of black money is big indeed with very bad consequences for the economy. It is, therefore, necessary that we find out its causes, and discuss the steps taken by the government to curb it.

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