

Curbing Black Money: Is Demonetization the right move?

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Abstract

The recent move by the government to demonetize Rs.500 and Rs.1000 notes by replacing them with new currency has taken the entire nation by surprise. Government intends to tackle the nuisance of black money, corruption, terror funding and fake currency. In fact, the issue of black money is so huge that it has almost nullified all efforts of development made in past. It seems to be such a devil which disrupts the overall efforts made by India so far. This research paper discusses the concept, current status and reasons behind generation of black money and throws light on the impact of demonetization in curbing the black money.

I. INTRODUCTION

The enormity of parallel / black economy in India is mind boggling. This disrupts the internal equilibrium & harmony within the country's economic system. It is also known by different names such as illegal economy, tax evaded economy, unaccounted economy or black economy. Even after 70 years of independence, India is still struggling with issues like unemployment, poverty and massive corruption. The major reason can be attributed to the generation of parallel economy which nullifies the efforts of economic development. For the purpose of transformation of Indian economy, Demonetization is considered to be government's bold step and in India, it has been done after a long time. Previously it has been done twice. The first was on 12th January, 1946, when Rs. 1000, Rs. 5,000 and Rs. 10,000 notes were taken out of circulation. However they were again

reintroduced in 1954. The second phase was implemented on 16th January, 1978, when an ordinance was promulgated to phase out notes with demonetization of Rs. 1000, Rs. 5,000 and Rs.10, 000. This time, demonetization took place on 8th November, 2016 of Rs. 500 and Rs.1, 000. currency notes after 8 p.m in night giving very less time for hoarders to convert their stock of illegal tender money into legal tender money. Now there is a need to study the impact of demonetization on Indian economy. This research paper has been divided into three main sections. First one concentrates on the concept, current status and reasons behind generation of black money, second one focuses on demonetization, its concept, scope and expected outcomes. Final section covers concluding remarks.

II. REVIEW OF LITERATURE

- Sarkar Sukanta (2010) in his article “Parallel economy in India: Causes, impacts & government initiatives” stressed that the main cause behind generation of black money is the country’s political system which lacks in implementation of policies. He recommended of having stringent laws to curb the issues of parallel economy in our country.
- Aggarwal CA Lalit Mohan (2012) in his edited article “White Paper on Black Money” also cited the reason that violation of laws by government officials leads to criminal acts and aids in generating black money and can cause harm to the Indian economy.
- Vijay Kumar Singh (2009) in his article “Money laundering in India- Problems & Perspectives” stressed that it is very difficult to control the issue of black money and the reason behind this is only due to poor implementations of laws. Law prevails but politicians are not allowing it to implement.
- Guru Arpit; Kahanijow Shruti (2010) in his article “The black money income: Need for amendment in DTAA & ITEA” recommended that there is a need for amendment in existing taxation system and commented that black money is widespread everywhere in India and is being hoarded in foreign lands. They also studied how black money has terrorized Indian economy and how is it being utilized in unscrupulous ways.

III. OBJECTIVES OF THE STUDY

In the current scenario, when demonetization drive in India has created a lot of hue and cry about the preparedness for handling such a large scale initiative, it becomes relevant to assess the reasons behind this bold step. This research paper serves the purpose of evaluating this initiative from the perspective of tackling the problem of a massive parallel economy in India. Following are the major research objectives:

1. To study the concept of black money and demonetization
2. To study about the reasons for existence of Black money

3. To know about the role of demonetization in curbing the problem of black money.

IV. RESEARCH METHODOLOGY

Present study is based upon secondary data source. The data has been collected through various journals, books, magazines, which are related to the study. Another source has been internet and newspaper articles and reports related to black money and demonetization.

V. CONCEPTUALIZATION

5.1 Black Money

Black money can be described by various terminologies like unaccounted income, black income, black wealth, underground wealth, and at economy level it is known as black economy, parallel economy or shadow economy. In the nut shell, all these terms refer to an income on which ideally one should have paid tax but tries to evade it by various means. In a common parlance, black money refers to the money which is generated through illegitimate means or by bypassing taxation system

As per the definition proposed by National Institute of Public Finance and Policy (NIPFP) “Black Money is the aggregate of incomes which are taxable but not reported to authorities.”

Other than this, black money also comprises of that type of legitimate income which is concealed or hidden from public authorities for the purpose of tax evasion, to evade payment of other governmental or statutory contributions and to evade compliance with the provisions of various industrial and other laws and administrative procedures applicable in the country. No doubt that generation of black money in social, economic and political sphere has a devastating effect on the demeanor of public policy and the institutions of governance in the country. Black money combined with counterfeit currency also acts as a catalyst for crime and terrorism.

5.2 Size of Black economy

While there is no official estimate of quantum of black money in India or abroad, a 2010 World Bank Report on shadow economies estimated it at 31 per cent of GDP of 162 countries with India's estimate pegged at 20.7 per cent of GDP. There have been other estimates which have placed size of India's parallel economy at higher levels including a recent FICCI report which has estimated it to as high as 75 per cent of GDP. As per a study conducted by Chandan Sharma, black economy as a percentage of GDP is quite substantial in India. However, on a positive note, study also indicates that fiscal reforms in important areas in 1990s helped in reducing the size of the black economy. Specifically, it was as large as 64% of the reported GDP in 1970s, in terms of current market value it was 280 billion Indian rupees. The size had gone down to 44% in 1997, but increase to 7000 billion rupees in value terms. More importantly, it has been constantly around 50% of GDP in the last two decades. In the last year of analysis, 2013,

it was 52% of GDP, which is around 60000 billion in Indian currency, while in terms of U.S. dollar, it was 957 billion.

According to the 3rd report published in May, 2012, Swiss National Bank estimates total deposits by various countries. Her also, India tops the chart, again reinstating the fact that a huge sum of black money is finding its way out of the country.

Table 1: Huge sum of black money is finding its way

Country	Money Deposited
INDIA	\$ 1,456 billion
RUSSIA	\$ 470 billion
UK	\$ 390 billion
UKRAINE	\$ 100 billion
CHINA	\$ 96 billion

Source: 2012 Report by Swiss National Bank

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.

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.

5.3 Reasons for Black Money’s Existence

The black economy in developing countries, such as India, is apparently large due to the inefficiency in the tax system and regulation. Black or parallel economy is generated by maintaining out of books transactions or two parallel books of accounts. Under reporting of production figures also contributes to black money. It is also generated by illegitimate ways such as drug trafficking, weapons trading, terrorism, and selling counterfeit or stolen goods. The foremost reason for the existence of black money is corruption in every field of society. Another major reason which forces innocent and honest people into illegal acts is that our country is plagued with many retrograde practices. One example is that if somebody wishes to conduct an all white transaction of selling a land in India, he will have to settle for a price which is approximately 40% lower than the market rate. The reason is that in a land deal, a significant proportion of amount is settled in cash as this has become the norm over time. Apart from this, black money also continues due to “Demonstration Effect” as in modern world, people want to live a life which is approved and appreciated by others. In today’s materialistic world people want to maintain a high status in society and for this they do not hesitate to resort to any means to generate money.

VI. DEMONETIZATION

In simple terms, demonetization is the process of removal of currency for the purpose of general usage or circulation. It can also be understood as withdrawal of currency by Reserve Bank of India as legal mode of monetary transaction. As per Investopedia, it is the act of stripping a currency unit of its status as legal tender. The usual process involves either introducing new notes or coins of the same currency or completely replacing the old currency with new currency. The government aims to bring the unaccounted money back to the formal banking sector by allowing limited exchange and unlimited deposit of old notes in bank accounts till the end of 2016.

6.1 Earlier Instances of Demonetization

Demonetization is a radical monetary step in which a currency unit's status as a legal tender is declared invalid. This is usually done whenever there is a change of national currency, replacing the old unit with a new one. Such a step, for example, was taken when the European Monetary Union nations decided to adopt Euro as their currency. However, the old currencies were allowed to convert into Euros for a period of time in order to ensure a smooth transition through demonetization. Zimbabwe, Fiji, Singapore and Philippines were other countries to have opted for currency demonetization. In 1982, Ghana announced the decision to demonetize its 50-cedi currency notes so as to check corruption and money laundering. 80% of the currency of Myanmar was demonetized in 1987 to regulate black money and even faced massive protests. Soviet Union also demonetized their higher denomination currency in 1991. In 2010, North Korea also demonetized its currency which resulted in its economic slowdown in the short-term.

In the history of independent India, Demonetization is not a novel concept. The first time such currency ban occurred in January 1946 when the government withdrew Rs. 500, Rs 1000 and Rs 10,000 from circulation for the same reason of restricting black money. However, this move did not affect majority of population as they were not privileged to own such a large sum of money and only a small fraction of citizens were affected. The second such decision was taken in 1978 by the Janata dal government under the leadership of the then Prime Minister Shri. Moraji Desai. However, there was very low compliance due to lack of cooperation from many authorities and people.

The demonetization drive conducted in 2016 has had the maximum impact so far as it has affected entire country irrespective of income level, education, caste, gender, occupation of people. As per RBI handbook on Statistics of Indian Economy 2015-16, a total of Rs.16.42 lakh crore worth of currency was in circulation as at end-March 2016. Of this, Rs.14.18 lakh crore 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. In terms of number of notes in circulation, Rs.500 and Rs.1000 denomination notes represent about 2200 crore notes, which were about 26 per cent of total notes in circulation.

6.2 Expected Outcomes

The major expectation from this demonetization drive at such a large scale is to move towards cashless structure of economy. According to a report by The Economic Times (2016), coins and notes could eventually be replaced by bytes and bitcoins, thus upgrading the process of investment, earning and spending, by functioning in a virtual economy. This is very much possible in a country which has more than one billion smartphone users, however the success depends hugely on development of requisite infrastructure in the country which should be able to support internet based digital transactions. Also there is an immediate need for innovative technology which does not entirely depend on internet.

As people have been compelled to deposit the old currency in banks, this move should result in raising the funds available in banks for issuing loans at attractive credit terms. With large sum of cash at the disposal of the banks, the borrowing of money will get cheaper providing impetus to economic growth favoring small and medium scale business set ups. This move will result into increase in government revenue as hard cash held as black money is now part of the system which is traceable and taxable.

Another advantage of this demonetization drive is that the counterfeit currency will have no value till the time new currency also becomes the victim. This will also restrict the funding of terrorist and other illegal activities.

However, this is only the positive side of story. Few other facts and figures which create doubt in our mind are also very much relevant to consider. As per a report Pew Research Centre, in 2015 only 22 percent of adults have access to internet. This means that majority of population is unable to use online banking. And only 17 percent of Indians have access to mobile phone banking.

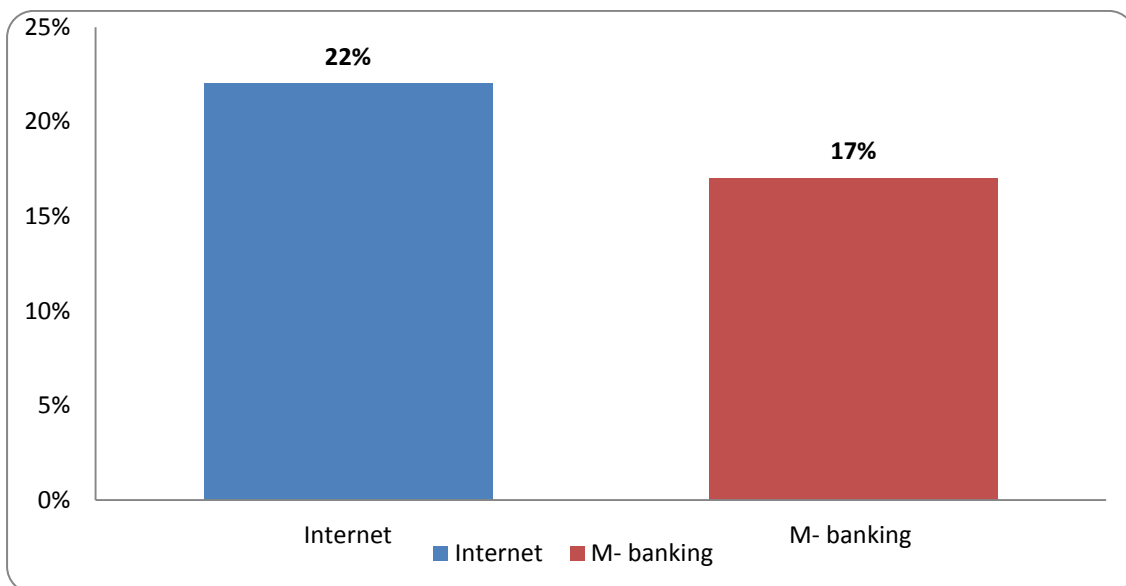


Chart 1: Percentage of Indian Population having access to Internet & M-banking Population

Data Source: Pew Research Centre, 2015

VII. EFFECTS OF DEMONETIZATION ON BLACK MONEY

It can be studied under two headings: (a) direct or immediate and (b) long term.

(A) Direct or immediate effects

The immediate effect of demonetization can be seen through the netting of black money deposited in the banking system in the form of banned Rs 500 and Rs 1000 notes from November 10 onwards. It was observed that approx. Rs 12 lakh crore of the Rs 15.44 lakh crore demonetized currency has been deposited in the banks. From this, Rs 1.5 to 2 lakh crore was identified as black income. Out of this, approx Rs 1.2 lakh crores to be collected as taxes at 50% to 85% tax rate e.g If Rs 2 lakh crore is revealed as black money out of demonetisation, it will amount to around 1.75% of India's GDP. According to National Institute of Public Finance and Policy (NIPFP), black income amounts to nearly 40% of the country's GDP.

Direct effect also depends upon "The Benami Act" which prescribes imprisonment up to seven years for having Benami property besides confiscation of the property and the "Pradhan Mantri Garib Kalyan Cess" which was income Declaration Scheme with a black money declaration option from December 17, 2016 to March 31st 2017 with tax rate of 50%. This 50% comprises of:

(a) 30 percent tax

(b) 33% cess called 'Pradhan Mantri Garib Kalyan Cess' (33% of 30%; this means a total of 10%).

(c) 10 percent penalty

(B) Long term effects of demonetization on black money: Demonetization is a strategic move implemented by government with long term vision. The entire mission was dealt with highest level of secrecy to ensure that maximum amount of black money can be converted into regular system. The long term impact expected by this drive can be summarized as follows:

- It would act as a major step towards a more transparent and corruption free India which would in turn make India more attractive for FDIs.
- It would give a boost to Government revenue, as more earnings would be declared and lot of unaccounted money will come in the main stream. This will also lead to more accountability on part of citizens to declare income correctly.
- The increased revenue would enable government to take up more developmental projects to upgrade infrastructure and facilitate in better utilization of funds.
- It would help every citizen to have a bank account. Various schemes like Jan-Dhan are contributing towards government's efforts of financial inclusion.
- India would eventually move towards a cashless economy. There would be substantial increase in the demand of Digital transactions system, E-wallets, usage of plastic money, online transactions using E-banking etc.
- Development of cashless economy would make it possible to monitor all transactions online, hence leading to more transparency in all kinds of transactions.

- It would lead to better business environment, less corruption and transparency

VIII. CONCLUSION

In summary, demonetization is a measure that temporarily brings into the system the unaccounted money and generates additional taxes in the near future. It is very much possible that the impact may be a one-off hit to black money. As soon as the restrictions on withdrawing cash are lifted, the cash-based economy, legal as well as illegal, will resume unless there is a real incentive for going cashless. It is doubtful that demonetization drive will prove as a preventive measure for generating or holding black money in the future. This intervention is a one-time draining of this current stock of black money but unless the root causes of corruption are removed, corruption will continue. The key deciding factor for impact on the black economy will be the degree of workarounds available. Demonetization will place a temporary brake on illegal transactions in cash until operators figure out alternative ways of financing such transactions. That's why; demonetization has to be supported with more streamlined and integrated tax system. While this initiative is expected to expose the existing stock of black money which was held in the form of hard cash, there is a need to make sure that black money does not re-emerge in any other form in future. To accomplish this objective, stringent measures and monitoring is essential. There is a need to control the issuance of newly launched large denomination currency especially of Rs.2000. At the same time, innovative reformatory measures are required so that people have little incentives to get involved in black money.

The recent announcements by government in the union budget 2017-18 are a positive step towards this direction. Some of these measures taken by current government are encouraging cashless transactions, banning cash transactions beyond Rs. 3 lac in value, restructuring the taxation system by reducing tax burden on lower and middle income groups and taking necessary steps to implement GST while keeping the overall tax administration very simple. The overall taxation system and administration of public sector authorities should be such that it becomes convenient for law abiding citizens to follow rules and they feel motivated to abandon illegal transactions. Government should promote the use of technology. E-Governance is an effective tool to ensure fair and transparent transactions in lesser time, hence can contribute in combating corruption. These measures, along with the use of other advanced technology like involving more of biometric surveillance and a close attention towards those instances where people are trying to mend the law in order to gain personal advantage is the need of the hour. It can be concluded that, although demonetization is a positive step towards a more transparent, digital economy but it has to be supported by many other reformatory measures.

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