

Parallel Economy in India: A Critical Analysis of Some Recent Developments

P. Saniya

Amrita School of Arts and Science, Mysuru, Karnataka, India

Abstract: A major issue that the Indian economic system has been facing since independence is the question of ‘unaccounted’ or ‘black’ money Acharya and Madhur. The dimension of this problem has been so substantial that the term ‘Parallel Economy’ Contini is being used to draw attention to the fact that the amount of unaccounted money generated in the economy is estimated to be almost equal to and sometimes more than the accounted or formal economy !Several expert committees have been formed from time to time to examine this issue and to recommend suitable policy measures to unearth this huge sum so as to channel the same for development purposes and to get a better macro picture of the economy. The present study is a modest attempt at analysing the several policy measures initiated by the previous lame duck government and the present political dispensation which came into power in 2014. The recent amnesty scheme which ended on 30th Sept 2015 has not been much of a success. Attempted in this study are the following: the various schemes/measures initiated earlier reasons for such failures; salient features of the present amnesty measures initiated in 2015. A brief analysis of the same and drawing appropriate conclusions from earlier experiences and suggest a new/modified course of action to unearth the same.

Key words: Parallel economy, black money, formal economy, duck government, amnesty

INTRODUCTION

India is one of the two nations observed and looked forward by the world as upcoming powers, the other being China. In the journey to become a developed nation, India faces several crises such as over population, poverty, unemployment, illiteracy etc. A major goal of all the successive governments, irrespective of their political ideology is to ensure that these are tackled effectively through various plans and programmes, especially the successive 5 years plans and the new government’s change in nomenclature of planning commission as NITI ayog which are often cited among discussions and considered strongly by the changing governments through various plans and policies. There is something else which is least considered among the genre but possessing immense destructive power and consequence, demanding immediate action-Black Money! The term has different connotations which include unaccounted money, illegal economy, unsanctioned economy, evaded money (McKinnon, 1973) and looking at the magnitude of the money in circulation also referred to as parallel economy! We will use all these expressions in this study in an interchangeable manner.

Parallel economy means functioning of an unsanctioned sector in the economy whose main objectives is to run parallel. This is variously referred to as ‘unaccounted economy’ or Illegal economy is tax-evaded economy. It is possible to convert illegal

economy or black money into white money and vice versa. It is a truism accepted the world over that payment of taxes due to the government is indeed not a happy thing to do, since the tax payer does not get any ‘quid pro quo’. Bhagwati *et al.* (1992). What are the contours of this global menace, applied in the Indian context, need a deeper analysis in order to adopt appropriate policy response is a major goal of this study.

Objectives of the study: Though there are several studies made with regard to the issue of parallel economy both in the global and the Indian contexts, the current study aims both at a retrospective and a contemporary analysis of the problem and the policy response currently adopted by the Government of India in particular. Specifically, the study aims at exploring the following issues:

- Sources of unaccounted money and modus operandi of generation of unaccounted money
- Amount of unaccounted money in the Indian economy as estimated by different committees
- Consequences of such a huge accumulation of unaccounted money
- Policy responses of the government of India to these recommendations
- Effectiveness of these policies
- Current government’s policy with regard to such financial instruments as anticipatory notes, etc
- A proposed policy to tackle this illegal source of money

Black economy and its estimates

Definition of parallel economy: Parallel economy signifies the functioning of an unsanctioned sector in the economy where the objective of such economy is to run parallel which is against the social objectives. Parallel economy is termed as ‘black economy’, ‘unaccounted economy’, ‘illegal economy’, ‘subterranean economy’, ‘shadow economy’ or ‘unsanctioned economy’.

Wealth earned through illegal means, the term black money would also include legal income that is concealed from public authorities:

- To evade tax payment (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 such as the Industrial Dispute Act 1947, Minimum Wages Act 1948, Payment of Bonus Act 1936, Factories Act 1948 and Contract Labour (Regulation and Abolition) Act 1970
- To evade compliance with other laws and administrative procedures (McCubbins *et al.*, 1987)

According to an estimate by Suraj B. Gupta the size of black money was over 50% of GDP in 1987-88. It is also stated that annual rate of growth of black money is higher than the annual growth rate of GDP.

According to Global Financial Integrity Study of 2009, \$1.5 trillion belongs to Indians were parked in safe havens abroad. The \$1.5 trillion is approximately Rs. 70 lakh crore which is more than the national income of around Rs. 50 lakh crore.

MATERIALS AND METHODS

Global estimates: According to news reported in Financial Express Sally. Estimation of unrecorded and black money, circulating in the economy has changed to a wide extent from time to time. It was Rs. 3034 crore in 1967-68. But it has risen to Rs. 46867 by 1978-79 >5 times in just 12 years. In 1967 = 98, unaccounted money was estimated to be 9.5% of GDP, rising to 50% in GDP in 1978-79 and 50.8% in 1987-88. By one count, the rate of growth in the parallel economy was higher than that of GDP in the period from 1980-81-1987-89; the former rose by 46.7% and the latter by 40%. India was ranked 91 for corruption by Transparency International which publishes a Corruption Perception Index Sampford (2006) covering 146 countries. Some Rs. 21,000 crore annually is

Table 1: Parallel economy estimates in developed countries

Country	Parallel Economy (as % of GDP)
Italy, Spain, Greece, Belgium and Portugal	25-30
Sweden, Norway, Denmark, Ireland, France, The Netherlands, Germany and Britain	14-24
Japan, USA, Austria and Switzerland	7-10

Table 2: Estimates of parallel economy in developing countries

Country	Parallel economy (as % of GDP)
Nigeria and Egypt	67-76
Tunisia and Morocco	38-45
Guatemala, Mexico, Peru and Panama	40-51
Chile, Costa Rica, Venezuela, Brazil, Paraguay	26-36
Philippines, Sri Lanka, Malaysia and South Korea	39-50
Thailand	72
Hong Kong and Singapore	14

estimated to exchange hands in the form of bribery in the country which indicates the extent of the problem. For example, the real estate sector, high taxes result in widespread cash transactions and under-declaration of deals which skews market information and hurts the process of capital allocation (Table 1). The existence of black money is injurious not just for tax revenues. It distorts the systematic resource allocation process and upsets the accuracy of economic forecasts (Table 2). Good economic management requires precise and reliable data. Industry, meanwhile, needs a business environment that is free of arbitrary controls Golaszewski and Ramadge (1988) that may squeeze out bribes (Table 1).

Black money in india: India is similarly hit by parallel economy for a long time. People are not ready to pay their taxes and try to escape from taxes by every way possible. Big business, service holders everyone always try to pay lower taxes and eventually nothing at all. Think about a school teacher who tries to go home early not giving enough potential in the school because he knows when he will reach home a huge number of students will be waiting for private coaching. Doctors skip hospital hours and go for private practicing as for these they do not have to pay taxes. Hidden economy also includes bribing, black marketing. Mukherji *et al.* (1980) fake currency, etc.

India is the world’s corrupt country and corruption is not a new thing in India. India has more money in Swiss bank when compared to all other countries combined. Recently due to international pressure, Swiss government agreed to disclose the account holder’s name only if the respective government ask for it.

According to Swiss Banking Association report, 2006 details bank deposits in the territory of Switzerland by nationals of following countries:

- Top five countries
- India-\$1,458 billion
- Russia-\$ 470 billion
- UK-\$ 390 billion
- Ukraine-\$ 100 billion
- China-\$ 97 billion

Approximately, 600 people in India are having legal property more than Rs.100 crore. In 250 year Britishers looted 350 lakh crore whereas Indian himself looted 330 crore. Around 70 lakh crore only deposited in Swiss bank. Economic policies have to go through major consequences as a result of the existence of a parallel economy. As this activity is unrecorded, the official national income accounts statistics do not accurately represent the true state of a nation's economy. Given that these statistics are used to generate economic policies and thus act as an essential guide to policy, if the guide is significantly in error, so also might the policy. Fiege has described this phenomenon as the unobserved income hypothesis. Hall (1979) (UIH) and suggests that systematic biases, unwittingly introduced into the official data have fundamentally distorted our perception of economic realities. A distorted information system leads rational individuals and well intended policy makers to undertake actions that transform initial statistical illusions into real economic maladies.

Sources of black money in India: The studies identify the different sources of black income as follows:

- Income tax evasion
- Corporation tax evasion
- Excise duty evasion
- Black income from exports
- Custom duty evasion
- Bribes, illegal commissions
- Evasion of state taxes
- Unaccounted stock-market profit
- Goods supply to black market
- Interest earned from unorganised credit markets

Effects of black economy

False information about the economy: The 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 losses it's worth, because they are based on macro-economic parameters which completely ignore the black money.

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."

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 resources 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.

Misguiding on resource allocation: Block 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.

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.

Tax evasion: In March 1970, an enquiry committee was appointed under the chairmanship of Mr. Justice K.N. Wanchoo, former Chief Justice of Supreme Court to study the problem of black money, tax evasion, tax avoidance and tax arrears.

According to the Wanchoo Committee Report, "black money denotes not only unaccounted currency which is either hoarded or is in circulation outside disclosed

trading channels but also its investment in gold, jewellery and even precious stones made secretly and in land and buildings and business assets over and above the amounts shown in the books". It can be easily seen that tax evasion is the Mother of Black Money.

RESULTS AND DISCUSSION

Causes of generating black money: There are many reasons for the creation of black money in India. Some of them are as follows.

Controls and licensing system: Black money is increasing in India for the reasons of controls, permits, quotas and licenses.

Higher rates of taxes: Higher rates of taxes has resulted a growing tendency of tax evasion among the tax payers. Tax evasion is common in income tax, corporate tax, corporation tax, union excise duties, custom duties, sales tax, etc.

Ineffective enforcement of tax laws: In India, the enforcement of tax laws in respect of income tax, sales tax, excise duty, stamp duty, etc., is quite weak. This has led to enormous unrestrained evasion of taxes and piling up of black money.

Funding of political parties: There is an upward tendency of supporting of political parties with the help of black money. Big trade houses are donating an enormous amount of black money to the political parties, especially the ruling party with the sole objective to tame the political leadership for deriving undue profit by manipulating policy decisions.

Second world war after influence: During the time of Second World War, a lot of the Indian industry found circumstances favourable for black marketing. Supply industrial goods from the traditional supplies of the West were cut-off which resulted severe shortages in many essential fields. This formed the sentiment of making of marketing money out of shortages and not out of extension of the business activities.

Inflation: The addition in prices of commodities like petrol, etc., in international market, boost in prices of commodities due to high increase in duties and taxes imposed by the government, the conspicuous utilization created by people with unaccountable money, diverting resources from manufacture to speculation all these is the root of inflation which in turn creates black money.

Agricultural income: The reluctance to bring agricultural earnings in the realm of income tax has also contributed to creation of black money. Big industrial houses, over the past few decades have entered the agriculture sector in a big way by acquiring big farms. The black money accrued from other sources is sought to be transformed into white by viewing it on the agricultural returns account.

Privatization: Privatization has opened up a new area to the private sector as well as to ministers and bureaucrats for making black money. It is expected that many scams come to light for making black money through privatization.

Transactions in urban real estates: Real estate transaction is a significant source of generating black money in India.

Other factors: Generation of black income in a country like India also results from other different activities like smuggling, property deals, bribery, kickbacks, commissions, concealment of income by professionals, artists etc. In this way an enormous amounts of black income incessantly results in enhancement of the area and activities of parallel economy.

Government measures

Penalties and prosecutions: To stop tax evasion, tax laws also provide monetary penalties for the prosecution (and imprisonment) of tax evaders.

Settlement commission: Following the recommendation of the Wanchoo Committee, the settlement commission was established in 1976. Its objective was to provide a mechanism for the quick and final disposal of these cases where tax evader was willing to make confession and face the consequences.

Voluntary Disclosure of Income Scheme (VDIS): Finance Minister P. Chidambaram has introduced Voluntary Disclosure of Income Scheme (VDIS) while presenting the annual budget for 1997-98. That was introduced on 1st July 1997 and closed on 31st December 1997. The main Slogan of the Scheme "30% tax and 100% mental relief" and was quite successful in achieving a good result. The Government gave assurance that the source of amount disclosed (in cash and valuables) under the scheme will not be investigated.

Highlights of VDIS-1997: The highlights of VDIS-1997 are as follows. Under the scheme individuals were required to pay a tax of 30% and the companies were

required to pay a tax of 35% on the Disclosed income. It is help to yield tax revenue of Rs. 10,500 crores which is an unprecedented revenue gain from any VDIS scheme launched in India. A record of 4.66 Lakh persons or corporations made disclosures of income amounting to over Rs. 33,000 crores which implied large per unit disclosures by individuals as well as corporations.

Statutory provision: Compulsory filing of tax returns by everyone with taxable income, compulsory maintenance of accounts by businessmen and professionals and their compulsory audit, if income or turnover exceeds a specific limit, compulsory canalising of transactions involving payment exceeding Rs. 10.000 through banks, etc.

Tax Raids and Seizures: Raids are conducted from time to time by the tax enforcement machinery, on the premises of the people who are suspected of possessing black money. After the raids, wide publicity is usually given to the amount of money and other assets that are seized.

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.

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 upto January 31, 1992. The Government announced the rebate of income tax on the income earned as interest on the bond.

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

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

Scheme four: Under this scheme, the government amended clause 273A of the income tax act for giving one more chance to the people having black money to declare it, but this opportunity can be availed by persons only once in their life.

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.

CONCLUSION

Parallel economy is a new threat for the Indian economy. In India parallel economy is expanding very rapidly. Government of India introduced commissions under Kaldor, Wanchoo, Rangnekar, Chopra and Gupta for estimating black economy. There are many factors like Controls and Licensing System, Higher Rates of Taxes, Ineffective Enforcement of Tax Laws, Inflation, Funding of political parties etc. that influence its growth. In India amount of black money are increasing continuously which badly impacts the economic growth of the nation. Such money is a new challenge for Indian economy. Indian economy is badly affected by black money as it is underestimating GDP, increasing inequality of income, increasing illegal activities etc. Over the past 50 years, the government has at various times announced several schemes offering opportunities to bring black money overboard but the result are not so effective. Some of these schemes are: introducing the scheme of Special Bearer Bonds, demonetizing high denomination currency notes, stringent raids and scheme of voluntary disclosures. These instruments are expected to reduce the volume of the black economy.

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