

Black Money and Demonetisation

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ABSTRACT

The recent demonetization of high value currency by the Government of India was with objective to unearth the black money, and to curb the corruption, counterfeit currency as well as terror financing. Black money is that money on which tax is not paid to the government and which goes unaccounted in the duration of country's tax assessment period causing big revenue losses to the government. The biggest mission of demonetization is described as fighting black money. India's economy historically holds a big parallel economy where unreported income is the norm. It is argued that demonetization of higher currency notes can help curbing black money in the country and this decision was considered as biggest cleanliness drive against the black money in the history of Indian economy. The effectiveness of demonetization against black money depends upon the follow-up and supportive measures were made by the government. This paper discusses the various sources of Black money and the Immediate and Long term effect of demonetization on black money and tries to address the issues whether this project can effectively address the problem of black money.

Keywords:- Demonetization, Black money, Economy.

INTRODUCTION

India being the largest democracy in the world with a population of over 1.25 crores has to cater to the need of a greatly diverse society. Since Independence measures have been taken by different governments in order to achieve high rate of economic growth. The efforts taken in this direction have been subdued by the rising population accompanied by corruption in the society. 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 black money which nullifies the efforts of economic development by any government.

Black money is the money earned from illegal sources which has not been disclosed to the government. A black money proceeds are usually received in cash from underground economic activity and, as such, is not taxed. According to National Institute of Public Finance and Policy (NIPFP) defines- "Black Money is the aggregate of incomes which are taxable but not reported to authorities." Black money is linked to corruption, crime, illegal activities and the black economy. The

concept of black money is about illegally obtained through political and/or bureaucratic corruption, bribery at levels of the government, semi-government, autonomous or semi-autonomous offices or organizations, as well as money amassed by businesspeople through smuggling, black marketing, shady deals, profiteering, money amassed by labour leaders, student leaders, through extortion – and especially, money amassed by functionaries of the ruling government party and its various organs, and their families, relatives and cronies. There is no clear data on the quantum of black money in Indian economy. Estimates vary from 10 to 40 per cent of GDP, i.e. anywhere between \$100 billion to over \$400 billion. According to the Government of India (2012), the extent of black money is somewhere between \$500 billion and \$1400 billion. As per Swiss Banking Association Report, the total deposit of India in Swiss Bank is \$ 1,456 billion.

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 aim is to wash the stock of "black money" out of the economy and get it into the banked and taxable part of the economy.

REVIEW OF LITERATURE

The issue of black money has been well-explored. The National Institute of Public Finance and Policy has been active in research about black money. Their 1983 survey of estimates of Black Money led to a report on Aspects of Black Money in 1985. 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. 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.

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. The Report of 2012 titled Measures to tackle Black Money in India and Abroad and the 2012 White Paper on Black Money by Ministry of Finance covers the various research studies and updates them. These studies however have not been able to determine a consistent estimation of the black economy. The estimates, including from other sources, vary from 15% to 45% of the total economy.

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. They were 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. There are two important issues with respect to the present demonetization. First, that the notes ceased to be legal tender from midnight of 8th November just 4 hours after announcement. So in effect the only places where they will be accepted will be banks. Second, even the banks have been given time until when they can accept the notes – 30th December. Third, the cash swap carries restriction. Thus, in effect the announcement forces these notes into the bank deposits within a short period of time.

STRATEGIES FOR THE REMOVAL OF BLACK MONEY

As per RBI estimates, 15 billion notes of 500 denominations (approx. Rs. 7853.75 billion) and 6 billion notes of 1000 denominations (approx. Rs. 6325.68 billion) exist. In addition, RBI estimates that fake 0.2 million notes of Rs. 500 and 0.15million notes of Rs. 1000 were discovered. The actual number of fake notes in circulation will be higher. Demonetization is a currency side step. The effectiveness of demonetization against black money depends upon the follow-up and supportive measures were made by the government. The first principle is that remove the systemic pain that leads to creation of black money in the first place. The approaches can be summarized as under:

- Establish identity of persons (through PAN Card, Aadhar Card etc.) operating in the country – citizens and foreigners.
- Enable low the cost direct bank transfers (Implementation of NEFT/IMPS/RTGS and other formats) including direct transfers of

subsidies to the beneficiaries under the Aadhar scheme.

- Enable electronic register of assets (Underway through electronic land records, digitization of revenue records)
- Reform tax system so that cost of compliance is lower than cost of tax evasion. (through initiatives such as Saral forms, e-filing, self-declaration etc.) Indirect tax system through simplification (GST).
- Widen the net for disclosure by filing Income Tax return. (auto-processing returns for tax refunds)
- Regulations that increase costs for black money creating activities.(Prevention of Corruption Act etc.)
- Create attribution chain for funds entering and exiting the country (such as through P-Notes, FDI, Prevention of Money Laundering Act etc.)
- Create e-trails of both incomes and expenditure.
- Control on holding of cash and physical money including Indian and foreign money.

IMPACT OF DEMONETIZATION ON INDIAN ECONOMY

(1) GDP:-

Immediate Effect -The immediate effect of demonetization is on the GDP. India’s GDP which grew at 7.6% in FY 2015-16 is likely to slow down by 0.5% to 1.5% as per reports of various agencies. This is due to less availability of cash in cash-intensive sectors like manufacturing and real estate. GDP formation will be effected with the reduction in consumption demand.

Consumption ↓ → Production ↓ → Employment ↓ → Growth ↓ → Tax revenue ↓

Long term impact - With a tax net widening after restriction on cash economy, GDP in the long-term likely to get a boost.

(2) Interest rates:-

Immediate Effect - With Banks flush with cash, interest rates may come down in the short-term.

Long term impact- If demonetization boots formal banking and more cash continues to come in the system, interest rates may fall further during long term.

(3) Inflation:-

Immediate Effect -likely to come down due to low demand owing to liquidity problem.

Long term impact- Since effect of lower demand can have a lagging impact on inflation, prices may remain flat or fall in the long term.

(4) G-sec yield:-

Immediate Effect -Yields likely to fall as liquidity in the banking system means interest rates are likely to fall as immediate effect.

Long term -Likely to remain flat to positive depending on how inflation plays out and how's the country's fiscal situation in the long term.

(5) Liquidity :-

Immediate impact :-positive due to higher (tremendously higher) bank deposits.

Long term impact :-neutral, as RBI will suck out excess liquidity through open market operations

(6) Other factors

Immediate Effect: –

(a)Certain sections of the society namely agriculture sector, small traders, households, SME's, daily wage earners etc. will face short term disruptions due to absence of liquid cash.(b)Money supply will reduce in the short-run until the new 500Rs. & 2000Rs. gets widely circulated in the market.(c)Negative impact on disposable income and the consumption patterns of the people is expected.(d)Less currency circulation will reduce inflation. (e)Short term recession in sectors like real-estate, construction material, textile, handicrafts etc. (f) Rate of capital formation growth will go down as no investments will take place.

Long-term impacts:-

(a) Government revenue will boost up as more earnings would be declared. The unbanked people will move to banking like Jan-dhan contributing towards government's efforts of financial inclusion. (b)Demonetization will set accountability in motion as service/sales tax is not paid by people like local photographers, tailors etc. and thus their income goes unaccounted. (c)Collection of higher taxes will help in nation building like development of roads, infrastructure, transportation and many others. (d)Increase in nation developmental projects will demand more labor and other skilled manpower which will give rise to employment opportunities. (e) It will bring more business in taxation i.e. GST benefits. (f) Cash in system will boost educational loans and business loans thus bringing more opportunities. (g) It will lead to better business environment, less corruption and transparency. (h) Substantial increase in the demand of Digital transactions system, E-wallets, usage of plastic money, online transactions using E-banking etc. (i) Gold imports will be reduced because of the investments in gold by people as an alternative to cash deposit in the bank.

CONCLUSION:-

Black money is a menace which definitely brings down the economy of the nation. There is no doubt that

existence of black money has a significant impact on social, economic and political levels of our lives which has a significant effect on the institutions of governance and conduct of public policy in the country. 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.

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