

Black Money: A Curse of the Nation

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1. Introduction

Ever since the Second World War, a perceptible decline in ethical and moral values has been occurred all over our planet. The results are soaring crime, dishonesty, drug addiction and corruption. While these ills afflict the entire globe, they are particularly virulent in the Third World; their economic consequences are also destructive in a developing country.

The developed world indeed suffers from some corruption, but in the underdeveloped world the degradation is beyond description. One measure of this corruption is popularly known as black money, which is a misnomer because money earned is neither black nor white. It is either earned honestly or dishonestly. Dishonest income or wealth is what popularly called black money, black income, unaccounted income, dirty money, underground wealth, parallel economy, shadow economy, unofficial economy, and black wealth; in reality it is corrupt money.

The phenomenon of corrupt money is a curse on the Third World. It effectively destroys all efforts and planning designed to eradicate poverty. A simple example will tell us how.

Since the end of Second World War, the Third World has received billions of dollars of loans and aid money from the developed world. If this money has been properly utilized, much of the poverty would have been vanished by now. Instead, so much of this money went into pockets of the officials and political leaders, who became rich enough to open Swiss bank accounts that the underdeveloped world is now stuck with a trillion dollar debt, and its citizens are living in hopeless conditions. Such are the conditions of the corrupt money syndrome. We observed the same syndromes in Bangladesh since liberation in 1971.

Government of Bangladesh have regularly condemned the corrupt money, perhaps because the problem is among the worst in the country and is growing first; but it should be remembered that black money infects the entire Third World and to

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some extent, the developed world.

The corrupt money i.e. shadow economy or parallel economy which may be defined in terms of all transactions intentionally left undocumented. Intentional undocumented is important here, because thousands of transactions go unreported in the normal course of business. But only those willfully unreported, either to avoid taxes or to hide the sources of income and wealth, constitute the shadow money.

The term 'Shadow' does not imply that this alternative economy operates independently of its regular counterpart. On the contrary, the two are closely meshed. Whenever the paying party uses legally earned, properly documented money and receiving party fails to record its receipt in any transaction, the shadow economy swells by that amount. Of course, the reverse scenario results in a corresponding shrinkage of the shadow money. Incidentally, this suggests that the growth of the parallel economy can be estimated simply from the discrepancy between expenditure and income figures in national accounts.

2. Review of Estimates of the Corrupt Money

Since our concern is primarily with the size of the black economy, we would like to have an estimate of the amount of corrupt wealth outstanding at a point in time. However, it is very hard to measure. Therefore, almost all estimates of the shadow economy focus on black incomes are actually measures of the growth of the shadow economy rather than of its absolute size at any time.

Even this modest endeavor seems condemn from the start. The shadow economy is a hidden arena whose operation is completely undocumented. A direct and accurate measurement of this problem is clearly impossible. Missing data is a common feature. Consequently, the estimate is always an approximation to the actual value. That's why, in all cases of estimation at some stage of computation, missing data is replaced by conjecture. Clearly, the quality of these estimates rests on the validity of these conjectures.

Nicholas Kaldor (1954) was the first who reported on Indian Tax Reform that the transactions are suppressed primarily for the purpose of tax evasion. He assumed that most of the earnings are corrupt money due to inclusion of non-salaried incomes (profit, interest, rent, and self-employed income) that was above the tax-exemption limit whereas salaried incomes would have already been taxed at source. Using these assumptions i.e. excluding salaries and wages, he estimated what should be the taxable non-salaried income. He then compared this estimate with the non-salaried income actually assessed to tax. The difference was his measure of corrupt income for that year.

This method was accepted by the Direct Taxes Enquiry Committee (also known as Wanchoo Committee) with some structural changes. However, the Committee

computed black income only for the year 1961-62 and 1965-66 and the figures were Rs. 811 crore and 1000 crore respectively on which tax was evaded. Projecting this estimate further to 1968-69, he estimated black income amounting Rs. 1800 crore over the income which escaped income tax.

Rangnekar argued that the structural changes made by WC's methodology had led to an underestimation of black incomes and offered an alternative estimates that were on the average about 3% higher than those of the committee. According to him, tax-evaded income for 1961-62 was Rs. 1150 crore as compared to WC's estimate of Rs. 811 crore. For 1965-66, it was 2,350 crore against 1000 crore estimated by the WC. The projections for 1968-69 and 1969-70 were 2833 crore and 3080 crore respectively.

O. P. Chopra used the Wanchoo method with some modifications to estimate unaccounted incomes for a period of 18 years, i.e. 1961-62 to 1977-78. Chopra's methodology marked a significant departure from the WC. The crucial finding of his study was that the ratio of uncounted income to GNP went up, whereas the WC assumes this ratio to have remained constant. As a consequence, after 1973-74, there was wide divergence between the estimates of the WC and those of Chopra. According to Chopra, tax evasion is more at high rate of tax. He also observed that increase in price lead to an increase in unaccounted income. Further, he gave a significant finding that funds were diverted to non-taxable agricultural sector to convert black income into legal (white) income. However, Chopra's estimates were unexpectedly pleasant. As a fraction of GNP, black income grew by only 4.4% over the 18 year period from 6.1% in 1961-67 to 10.5% in 1977-78.

It is noted that Kaldor's method is the basis of all these estimates. But the conjecture involved in each case is quite different. For setting the conjecture, the analyst requires a large leap of imagination, explaining the significant difference in estimates generated by this method.

In 1979, Feige proposed an alternative estimation technique that is not only theoretically much sounder than Kaldor's but also less demanding on the analyst's imagination. The technique is based on two relationships, the first was an identity and the second was a behavioral specification.

If all transactions are paid for by cash or check (collectively called MI) are added up, their sum should equal to the nominal value of total economic activities, both legal and illegal. If we hypothesize that the turnover rate of money remains roughly unchanged over time, the ratio of total transactions to actual GNP must remain more or less constant. Therefore, if the ratio of MI to reported GNP were to increase significantly over time, it must mean that the reported GNP is falling below actual GNP, i.e. the black economy is expanding.

For this technique to become operational, two informational requirements have to be met. First, it is essential to have data on the total volume of transactions for the

year under study. Second, one needs an estimate of the true ratio of the money supply to actual GNP. This is where the analyst's conjecture comes in. The analyst should select a bench mark where the black activity was low i.e. the reported GNP reflected the true GNP against which to measure future ratios. This is the hypothesis in the model.

This technique was first applied to Indian data in 1982 by P. Gupta and S. Gupta. They selected the years 1949-50, 1950-51 and 1951-52 to provide them with a reference ratio because of their conjecture that in these years, following the black market era of WWII and preceding the planning era starting in 1952, the black economy was at its weakest. Using the average ratio for these three years, they proceeded to compute black incomes for the period 1967-68 to 1978-79. The results were frightening. By their computations, black incomes had grown over this period from a mere 9.5% of GNP to an astonishing 48.8% of GNP. Over a corresponding period, Chopra's estimates using the modified WC method showed an increase from 5.7% to only 10.5%.

National Institute of Public Finance and Policy (NIPFP) conducted a study on black economy in India under the guidance of S. Achaya (1985). The study defined black money as the aggregate of incomes i.e. unaccounted incomes which were taxable but not reported to the tax authority. As there was lack of sufficient data, the NIPFP study abandoned any attempt at providing exact estimates of black income, followed "the minimum estimate approach". In particular, it completely ignored incomes generated in illegal activities like smuggling and bribery despite their obvious significance, because of the difficulties in measuring them. The study considered six well known and easily quantified sources of black income, such as production of goods and services, gains from the sale of assets, export-import activity, and fixed capital formation in the public and private corporate sectors. The study concluded that black income in India was at least 15-18% of GNP in 1975-76, and was 18-21% in 1980-81 as well as in 1983-84. It is interesting to note that this "at least" estimate for 1975-76 is greater than the corresponding estimate based on the WC methodology (10% of GNP).

Besides, Individual methods uses input/output ratio along with the input to calculate the true output. It estimates black money as the difference between the declared output and the output expected on the basis of the input/output ratio. Though this method is simple but useful if applied to a uniform industry or a specific sector of the economy. The assumption is that input/output ratio remains stable in a uniform sector but changes according to its nature. It ignores the structural changes in the economy including those related to technology. So, changing the input/output ratio according to the nature of the sector, this method is likely to be of much helpful.

Another method of estimation of black money is the survey approach wherein

sample surveys are carried out. They may be on the consumption pattern of a representative population sample, which is then compared to the total consumption of the country. In this method, problems consist in getting a truly representative sample, unambiguous set of questions and the willingness of persons in the sample size to reveal true facts. But the people in the sample are generally unwilling to admit any illegality before the interviewers.

There is also the “fiscal approach” method for estimating black money. The underlying basis of this approach is to view the economy as comprising several sectors. Black money generation from each sector when added would give the size of the black economy. However, identifying the black component in different sectors is not uniform. It is continuously changing due to change in technology.

It is a fact that money is needed to circulate incomes in both the black and accounted economies. But underground (or hidden) transactions are undertaken only in the form of cash payment, so as to leave no traces for the authorities. Consequently, it increases circulation of money i.e. velocity of money. As the official economy is known, the difference between that amount and the money in circulation could be assumed to be the circulating “black money”. Using this currency demand approach i. e. velocity of money, Tanzi (1983) developed a model for estimating underground economy. However, the assumption that National Accounting System (NAS) represent accounted incomes accurately is not always true. Large proportion of income, such as those falling in the unorganized sector, are not accurately captured in NAS, thus there may be upward bias in the estimate of black money. Using this model, Haque (2013) estimated underground economy of Bangladesh was only 7% of GDP in 1973. In 2010 it stood at 62.75% of GDP.

Corruption is a form of taxation and regulation. Because, it can employ manpower independently for their own purpose or introduce them in the public institutions like that of the official procedures. It increases the underground economy. As a consequence, the size of official market decreases and drives the entrepreneurs underground. Some may believe that underground economy should sustain because it increases standard of living of a group of people in the society, provides jobs for the unskilled persons in the public sectors! But it will reduce the quality and quantity of publicly provided goods and services lower than the average. Where underground activities are high, revenue generation will be low. It increases income inequality and poverty. Friedman et al. (1999) believe that institutional aspects are more important than taxes in promoting underground economies. He reported that when regulations are lax and rule of law is weak, bureaucrats make decisions on individual cases without supervision. This creates corruption, which causes firms to become unofficial.

Tanzi observed that an increase in the size of underground economy will therefore increase the demand for currency. It imposes a burden on the economy, and results

in tax distortions and erroneous measurement of macroeconomic variables.

The Economic Times of India (June 29, 2011) writes that only an estimated one million out of 150 million populations of Bangladesh pay any taxes. Finance ministry accounted black money up to 80% of GDP. In recent years, the government has offered tax evaders to declare their black money on payment of minimal tax. Economists hold the view that this decision becomes a major factor behind the persistent inflation through shifting of resources to profligate consumption. This slows down infrastructure developments and anti-poverty programmes. It also creates great inequalities between the honest tax payers and the tax evaders. This increases poverty and corruption rather than alleviate them. This, in fact, really influences the growth of black money with no hope of its end. The remedial measures are nothing but enameling the extreme danger by the so-called boosting the state's income from revenue collection. These are mostly abortive like operation, chemotherapy or radio-therapy practiced in the treatment of cancer which can do nothing but increases sufferings both physical and mental.

3. Conclusion.

The problem of corruption is not with intentions but with their implementation. But no rules and regulations that now prevail in the economy of Bangladesh were capable to control the bureaucratic parasitic monopolies those hinder the development. Those stifling rules and regulations must have to go. New economic policies with new priorities and investment pattern must replace them. The abject poverty of general masses should not be blamed on growing population. For its development, the country should be free from the curse of black money.

Finally, there is an element that is not entirely within government control. That is the revival of moral strength and values. The importance of this factor cannot be overstated. Unless people turn to loftier aspirations of spirit, and recognize the baseness of a cultural ethos that condones the marketing of integrity and trust, the allure of illicit wealth will continue to play upon their minds. The government can, however, play a significant role in this moral transformation. Since much of the fatalism regarding morality is inspired by the blatant greed of those in political and bureaucratic power, a new standard of official honesty should set the tone for the new morality. This transformation must spring not from fewer opportunities, but from a genuine desire of the mass people to be the honest.

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