

Demonetization and Black Money in India

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Publishing Date: June 22, 2018

Abstract

Demonetization was a bold step by the Government of India which was announced on 8th November. It was implemented to counter the problems of black money and funding to terrorist activities. The eradication of corruption is social and economic necessity. Present paper discusses severity of existence of black money and need for more transparent payment system. A simple evaluation of demonetisation is made by analysing the event in light of various relevant studies.

Various programmes as Jan Dhan Yojana, Jan Suraksha Yojana, Mudra Yojana, Stand-up India, Ujwala programme were initiated by the government to curb the poverty but due to corruption we can't rely on such initiatives. Heroic decisions and proper implementation is required to fight with this evil. Due to massive tax evasion few people pay tax in India. Indirectly honest people are paying for corrupt people. It creates social unrest and sluggish growth of economy. Demonetisation is strong and decisive required step now but results depend upon on various factors. Demonetization was facing many challenges and shortcomings.

It was a sudden attack on cash with public to nullify the black money (which was stored in the form of big dimensioned notes). But it was criticised as a big dip in currency available with public could also affect the level of aggregate demand in economy as currency is widely used for transaction in India. Demonetization of currency in circulation could result in a big squeeze in cash-in-hand for some months, the government had also set limits on daily exchange of old notes for new ones, and it was a slow process.

Monetary policy is used as an important tool to boost the economic growth in developing countries and also has been a cure in financial crisis. Moreover negative interest rate many times considered as "helicopter drops" of money. But what happened in India was just contrast of it. There had been a strong co relationship between currency in circulation and GDP in India. Currency is major lubricant for commerce. Dipali Bhargav² mentioned a very high degree co relation between growth rate of currency in circulation and the

growth rate of GDP. It was alarming condition to take some measure to check the corruption and enhance the tax base.

Keywords: *Demonetization, Black Money, GDP.*

Introduction

It was not the first attempt for demonetisation but already two attempts of demonetisation were made out once in 1946 and another in 1978.

Ordinance was announced by than Government on 12th January in 1946. The demonetised currency notes were of Rs 500, Rs 1,000, and Rs 10,000. Ten days were given to public to get the currency changed. Time period given for exchange was lengthened many times. Total 93.7% currency was returned back to banks and 6.3% was actually demonetised or not exchanged. Chintaman D. Deshmukh who were the 1st Governor of our central bank himself admitted that it was not much effective.

In 1978, Government again demonetised Rs.1000, Rs.5000 and Rs. 10,000 notes, this action was kept confidential, Similar to the recent episode (8 Nov 2016) and an ordinance was issued to carry out the exercise. This time only 3 days were given to exchange the notes. This time 14.76% of currency notes demonetised. During the attempts of demonetisations in 1946 and 1978 enquiries were exercised for amounts of money exchanged. How much black money was brought to tax was a secret and not revealed for the public. This time 86 percent of the currency was demonetised in 2016. A substantial portion of currency returned back and this time only 1.03% of the demonetised currency was destroyed which was amount of 16,000 crore.

Table 1: Currency Details

Years	Total Currency Demonetized	Currency Deposited Back	Actual Currency Extinguished
1946	143.97 crores	134.9 crores	9.07 crores (6.03%)
1978	146 crore	124.45 crores	21.55 crores (14.76%)
2016	15.44 lakh crore	12.44 lakh crore	16,000 crores (1.03)

As we can see in table, demonetisation could not be proved as an effective tool of measure present in economy.

Estimates of Black Money in India and Discloser Schemes

Black money is not in form of currency notes only. Substantial proportion of black money is parked in real estate and also invested in precious metals. During the demonetised agents are also get activate in economy to make the black money white by providing accounts in banks. Prices in real estate were hit badly due to demonetisation.

(<https://www.ceicdata.com/en/indicator/india/real-residential-property-price-index>). The black money was also invested in various other options. As revealed by Securities and Exchange Board of India, the premium collected by Life Insurance Corporation of India got a sudden hike. It increased by 142 % (year on year) when demonetisation was on peak (November 2016). Total collection of this premium was dominated by ‘single premium’ policies it was around 85%. Such premium is paid once in lump sum and no need to pay monthly, quarterly or annually. Total yearly collections too increased by 46 per cent. Investment in various mutual funds also increased suddenly.

Table 2: Black Money (As Percentage of GDP)

Year	Chopra's estimates Wanchoo Method	Own Method	Gupta & Gupta's estimates	Gupta & Mehta's estimates	Ghosh et.al's estimates	Rangnekar's estimates
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1970-71	4.8	5.2	22.3	—	7.6	—
1971-72	5.1	3.2	28.7	—	7.8	—
1972-73	4.0	3.8	31.9	—	7.8	—
1973-74	4.9	8.1	27.1	—	7.4	9.9
1974-75	5.9	12.4	20.9	13.8	8.1	9.3
1975-76	5.6	9.9	25.0	—	8.4	10.0
1976-77	5.7	10.2	37.6	—	8.7	11.3
1977-78	—	—	38.4	—	8.7	12.1
1978-79	—	—	48.1	19.8	—	13.5
1979-80	—	—	—	—	—	14.4

Source: White Paper- Black Money 2012*

Various methods were adopted by experts and estimate of black money were presented. Various discloser schemes were introduced in India. Voluntary Disclosure Scheme initiated in 1951 and it was called Tyagi Scheme. The amount disclosed

under the scheme was Rs 70 crore, tax collection remained 11 crore. Another Voluntary Disclosure Scheme was announced in 1965. It was a ‘Sixty-Forty Scheme’ as if any amount will be disclosed 60% will be paid as tax and remaining 40% can be

retained by the disclosing person. The rate of tax was very high so only RS 52.11 crore were disclosed and Rs 29 crore were collected as tax. Under Voluntary Disclosure Scheme, 1975 total tax collected was Rs 241 crore. Due to failure of successive schemes Government announced another scheme but it was not called a Disclosure Scheme. Under this scheme discloser of wealth or income (unaccounted) if before 31st March 1986 they can save themselves by paying due tax on that. NIPFP estimated black money during 1985 – 1987 to be 20 percent of the GDP. It was 1, 00,000 crore in amount (Sarkar.S, 2010)¹

Once more Voluntary Disclosure of Income Scheme was announced by government in 1997. It was quoted as golden chance for tax evaders. Tax rate under this scheme was 30 % for individual and it was 35 % percent for companies. Tax realisation

stood Rs 9,729 crore and declarations was to INR 33,697 crore, it was only 0.79 percent of the GDP. Government has been announcing various modes to enable tax evaders to make their black money white one.

Tax GDP Ratio in India

Baum, S. Gupta, E Kimani, and S Tapsoba (2017)³ studies the relationship between the tax revenue to GDP ratio and presence of the corruption. They also found positive relationship between rate of inflation and tax GDP ratio. As with a higher inflation nominal income also increases and income earner enters into taxpaying slabs. It means with the passage of time as we are allowing some inflation for the growth of economy, automatically tax GDP ratio will increase.

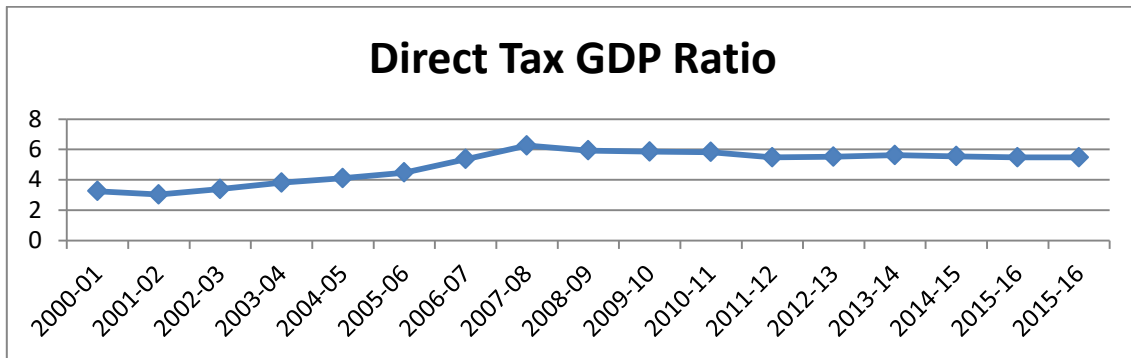


Figure 1: Direct Tax GDP Ratio

Source: Annual Report (2016-17), Ministry of Finance (Budget Division)

Direct tax GDP ratio was highest in 2007-08; it was 6.26 till 2015-16. But now NITI Aayog has forecasts that direct tax to GDP ratio at 5.8 per cent in 2017-18, 6 per cent in 2018-19 and 6.3 per cent in 2019-20 r, compared to 5.6 per cent in 2016-17. As per statement released from NITI Aayog indirect tax to GDP ratio is going to rise

progressively, it will reach to 5.7 per cent in 2017-18, 5.8 per cent in 2018-19 and 5.9 per cent in and 2019-20 as against 5.6 per cent in 2016-17. It is stated by Niti Aayog that demonetisation and other financial reforms by the government will have a significant implication on increasing the tax kitty.

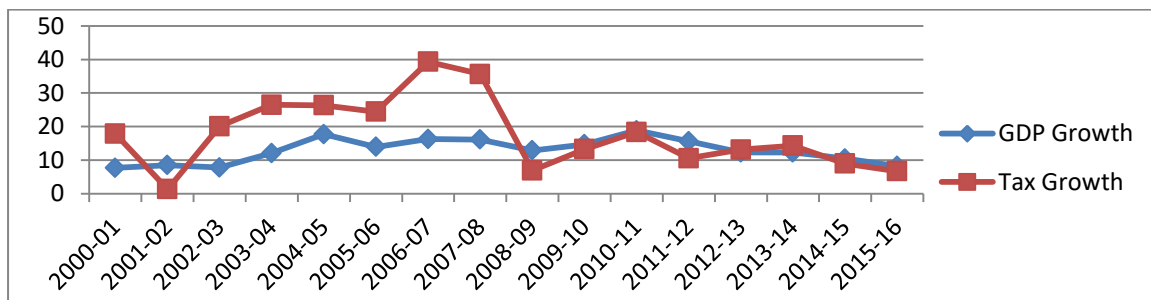


Figure 2: Growth rates of GDP and Tax

Source: Annual Report (2016-17), Ministry of Finance (Budget Division)

Tax GDP ratio was 5.1 % in 2014 and 5 % in 2015 here in diagram comparison of India's tax GDP

ratio with other countries is exhibited. As we see that it is very low in India.

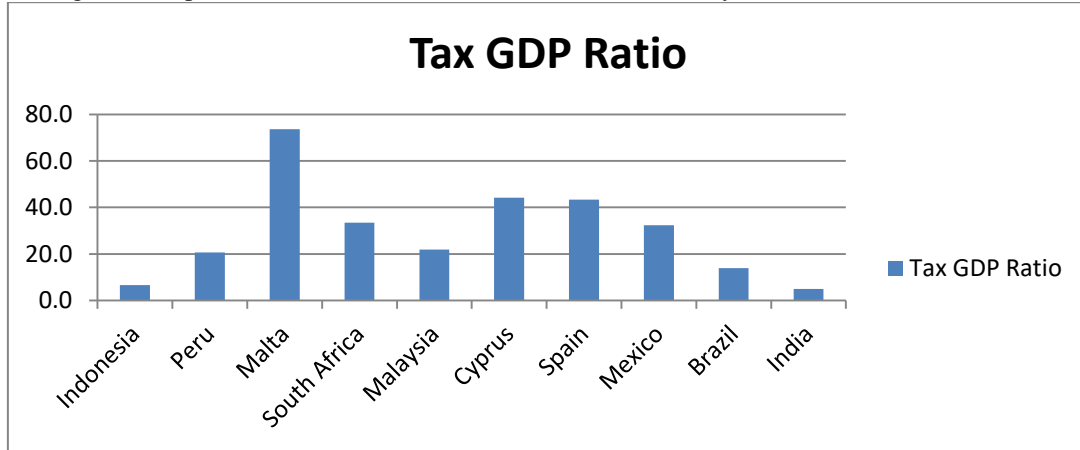


Figure 3: Tax GDP Ratio

Agriculture income is not taxable in India but contribution of agriculture in GDP is decreasing. Low tax ratio indicates severity of corruption and major instrument for this corruption is cash transactions. As such transactions have no records and tax can be evaded easily.

Cash Transactions and Tax Evasion in India

Transactions which can result in taxation are not entered in the books of account by the taxpayer called out of book transactions. Sometimes parallel books of accounts are prepared and maintained for the purpose of fulfilling legal and regulatory obligations. Under production is also reported to evade the tax.

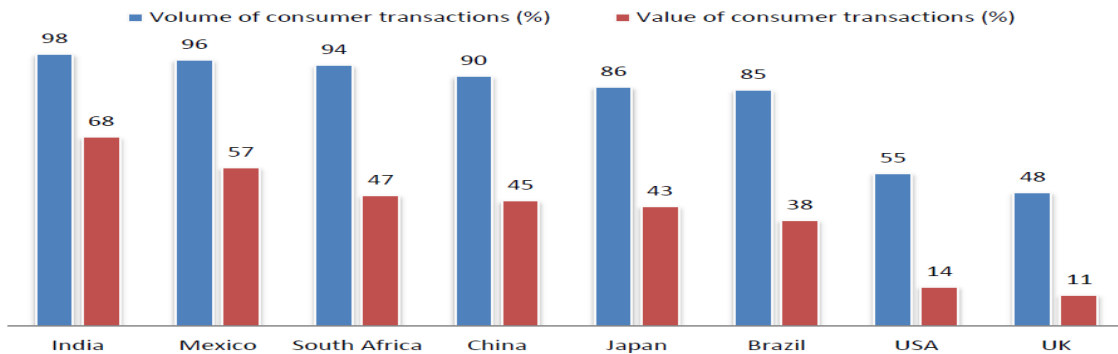


Figure 4: Consumer Transactions

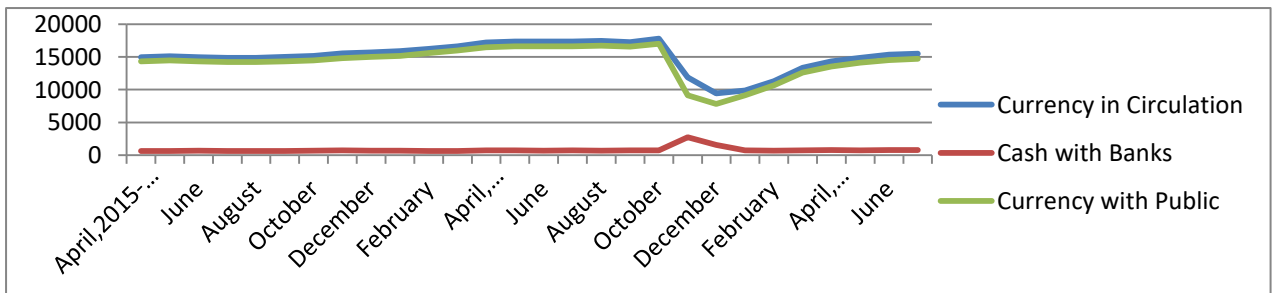


Figure 5: Currency Details

Source: Handbook of statistics on Indian economy

Immediate impact of demonetization was reduction in use of currency and people switched to other substitutes. As depicted by data currency with public dipped in November – December but started increasing in January. It was rising fast till April

and moderately after that. It was the time when availability of currency was enough in the market but still currency with public remained less than that was before demonetization.

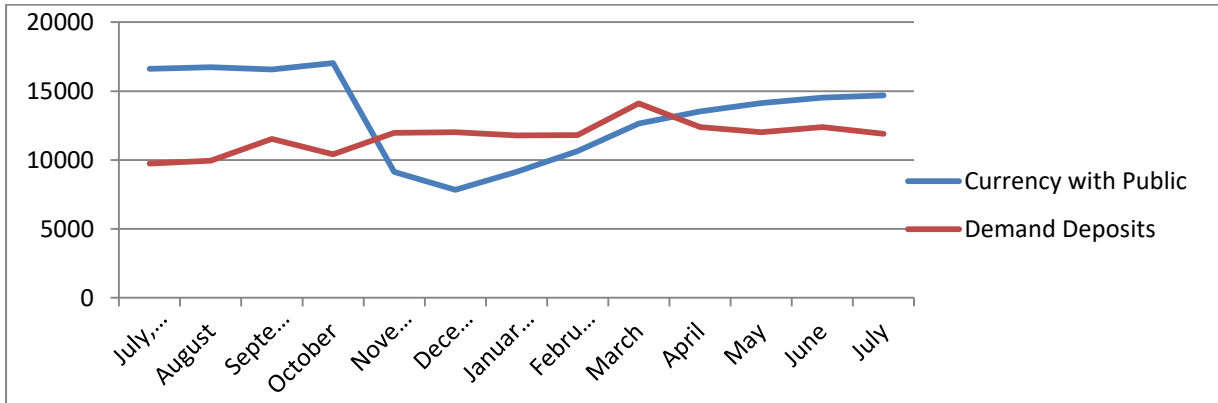


Figure 6: Demand Deposits and Currency with Public

Source: Handbook of statistics on Indian economy

Banking habits of people in India had been poor as people use more currency and less demand deposits, currency ratio remained less than unity in India before demonitisation but suddenly reduced during the demonitisation. As we can see in diagram that after the normalisation of currency notes in circulation currency crossed the demand deposits again but still the gap between currency

and demand deposits is narrower. We cant dream of cashless economy until unless we overcome the problems as illitracy, non connectivity of internet, week cyber security and frouds related to internet banking. During the demonitisation people were compled to switch to other modes of payments. As they got the ease of cash could not stay on digital payment system.

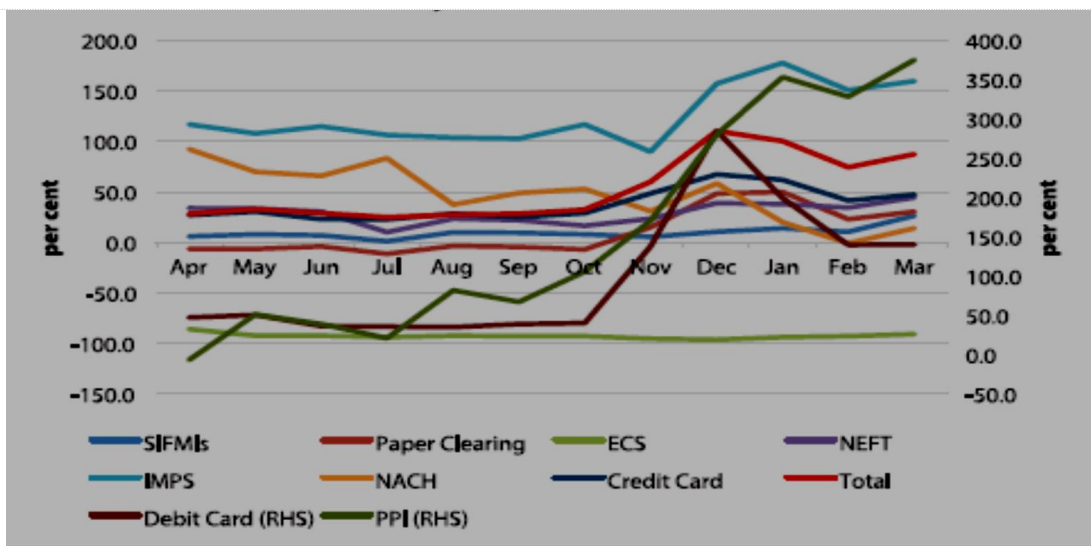


Figure 7: Y-O-Y Growth Rate in Volume of Payment 2016-17

Source: Digital Payments - Trends, Issues & Challenges 2017 launched by NITI AYOOG

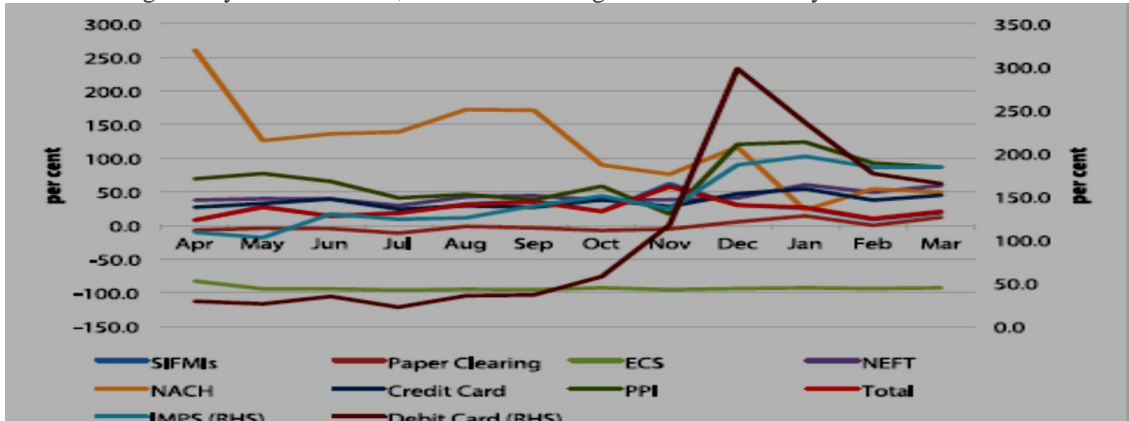


Figure 8: Y-O-Y Growth Rate in Value of Payment 2016-17

Source: Digital Payments - Trends, Issues & Challenges 2017 launched by NITI AYOOG

The diagrams above mentioned, show the trends of use of various methods of payments. Electronic Clearing System is a method which enables quick transfer of funds from one bank to another. RTGS here is Real Time Gross Settlement and it is the facility for transactions in debt market, on real time basis, transferring funds and securities from one account to another. NEFT is National Electronic Fund Transfer. This is the new and improvised version of ECS and it enables clearing across the country electronically, twice a day. Pre-Paid Instruments (PPIs) facilitates purchasing of goods and services by making payments in advance. National Automated Clearing House is suitable for transfer of huge amount usually corporate and financial institutions made such payments.

A ceiling on cash transaction can check black money to a huge extent. The government has taken a step to fix a ceiling of Rs 2 lakh on all the cash transactions. Earlier ceiling of Rs 3 lakh was proposed in Budget 2017-18 but now it is lower than that. If someone is found violating, will be penalised and he has to pay a fine just equal to the amount of transaction.

In same line one more step taken by government was introducing a penal Section 271DA. The

purpose was to promote the digital payment system in the economy. It was criticised on account of ambiguity but later on tax department cleared the confusion by releasing a statement that ceiling of 2 lakhs will not be applicable on withdrawals from banks⁴.

Demonetization was no doubt an important step to check the corruption; it was implemented with combination of various other schemes as Jan Dhan Yojna, Adhar Card, Digital India etc. BHIM application was launched for easy transfers of money.

According to National Payments Corporation of India (NPCI) released a statement that due to various efforts made by NPCI during the demonetization Unified Payments Interface (UPI) crossed the 10 million transactions till June of 2017. It has recorded ten times increase only in eleven months. Here we can't ignore the substantial contribution by BHIM application, its downloads crossed 11 crore till mid of January 2017. Lotteries and concessions on digital payment were announced, Lucky Grahak Yojana and DigiDhan Vyapar Yojana are worth mentioning here.

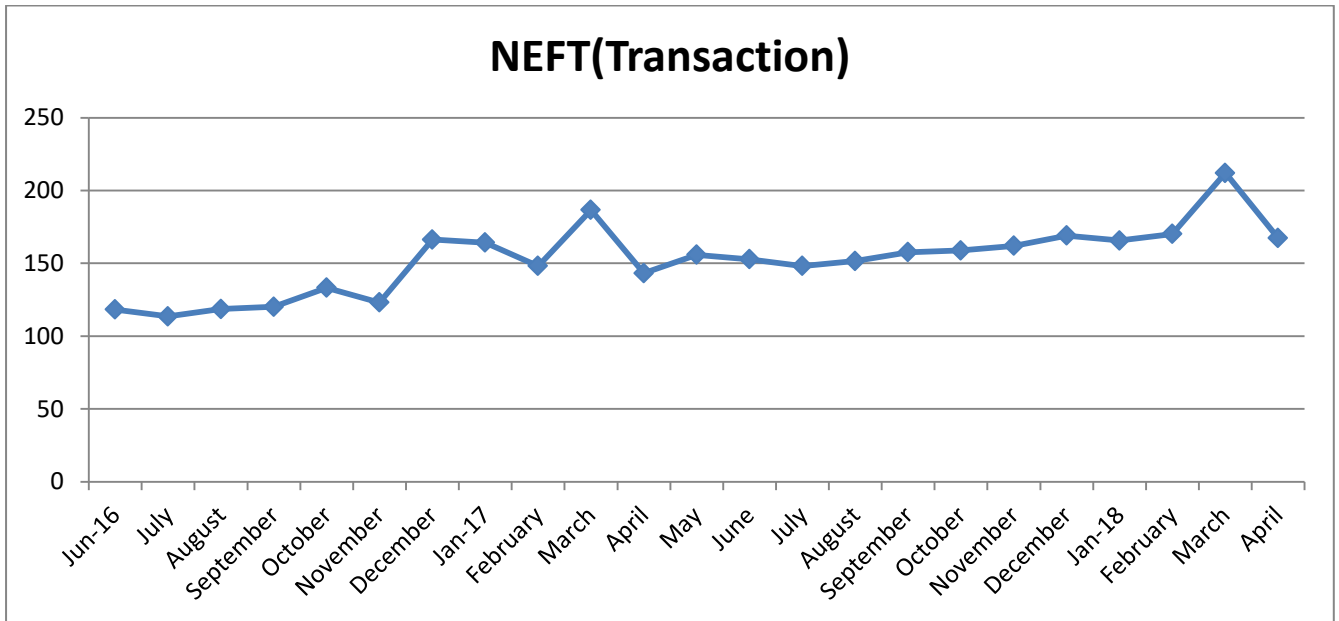


Figure 9: NEFT (Transactions)

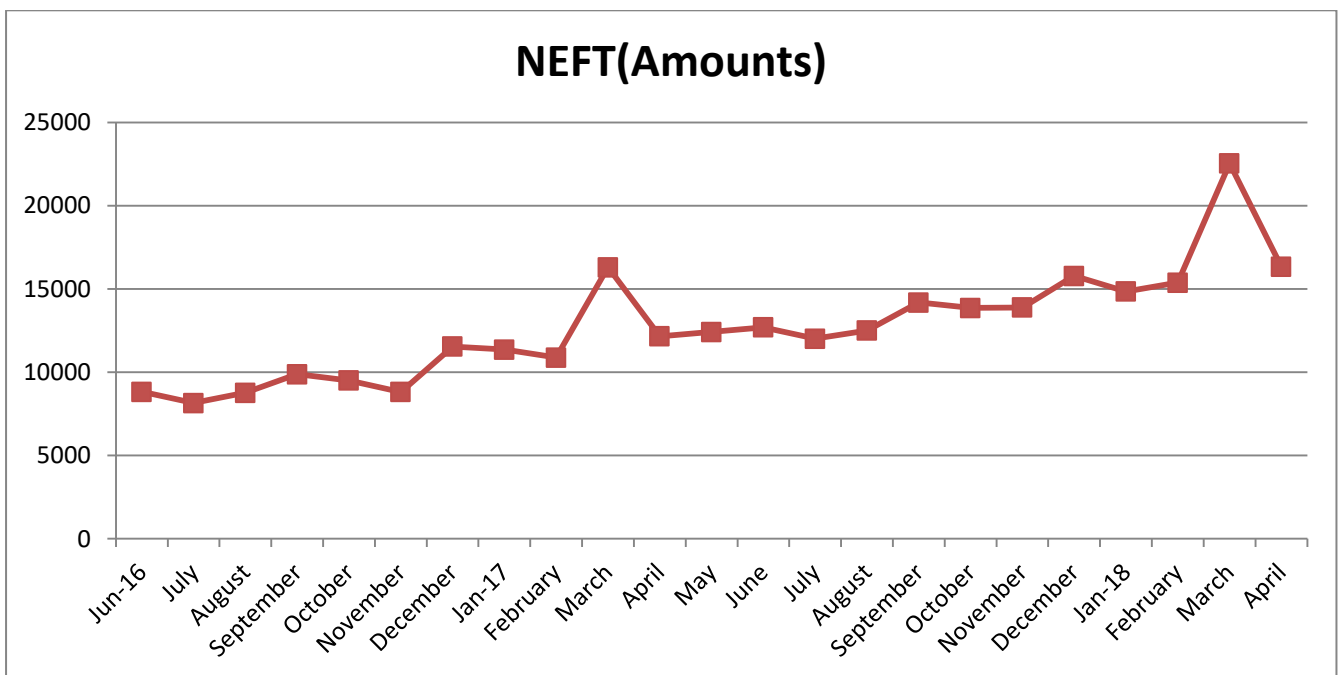


Figure 10: NEFT (Amounts)

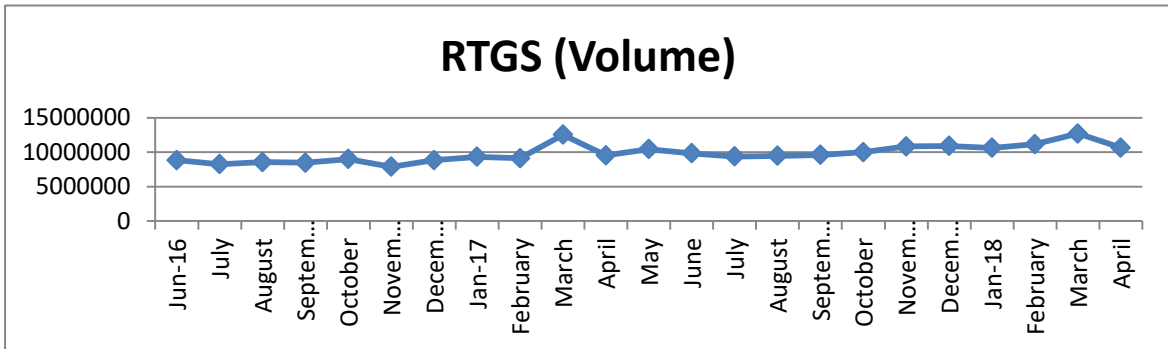


Figure 11: RTGS (Volume)

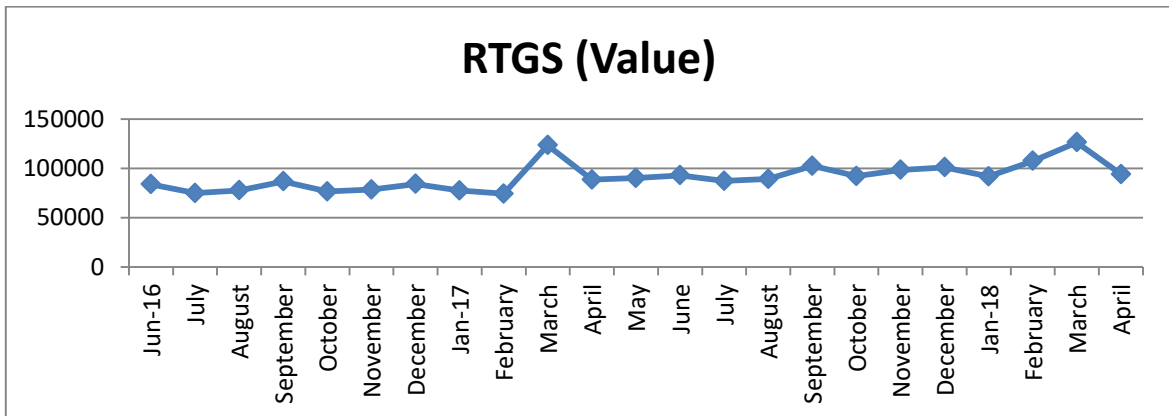


Figure 12: RTGS (Value)

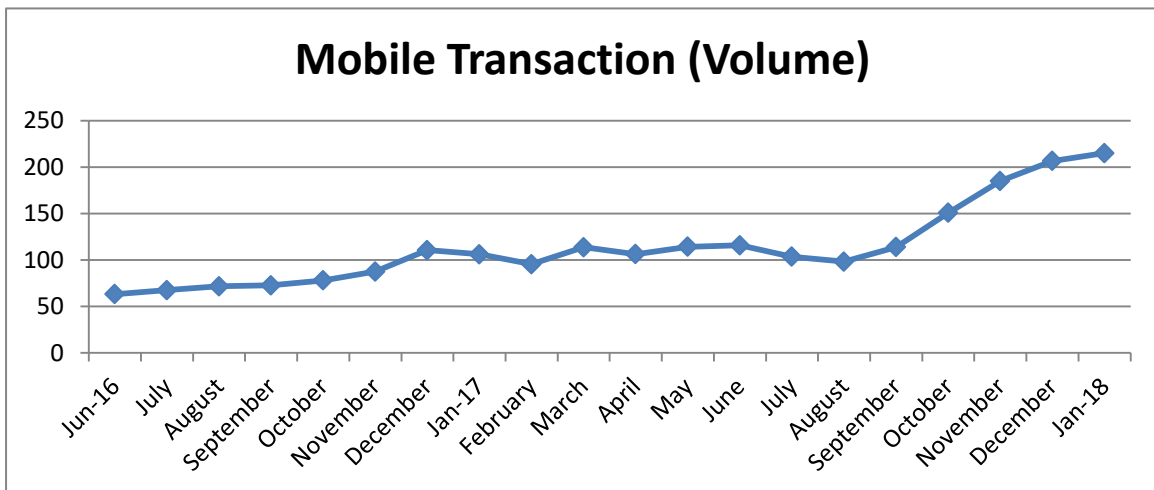


Figure 13: Mobile Transaction (Volume)

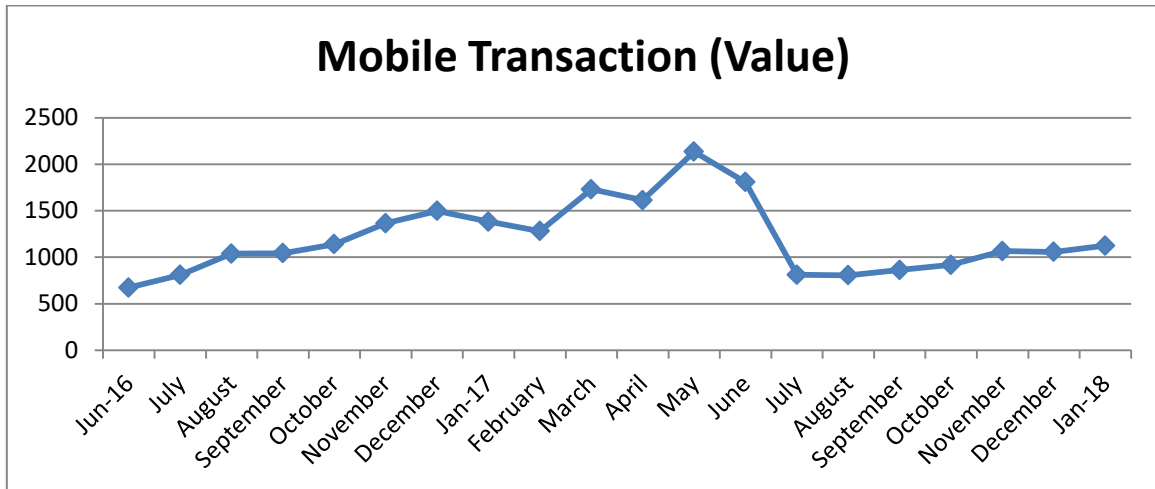


Figure 14: Mobile Transactions (Volume)

We can see increasing trends after the event of demonetisation in various modes of transactions. Mobile banking had changed our lives by easing the payment system. People like to pay small amounts through mobile banking as we can see the difference between value and volume of mobile transactions.

Despite these positive results it was highly criticised for pulling the growth of economy. But according to Punam Devi (2018)⁵ It was big

squeeze of money form the economy and may affect the growth of economy but there was not a sharp decline. There are various positive signs as increasing consumption expenditure and capital formation. The demand from people which have access to digital medium of exchange would remain unaffected. Increase in growth of GDP in Q2 (2017-18) over Q1 is a recovery which will go ahead.

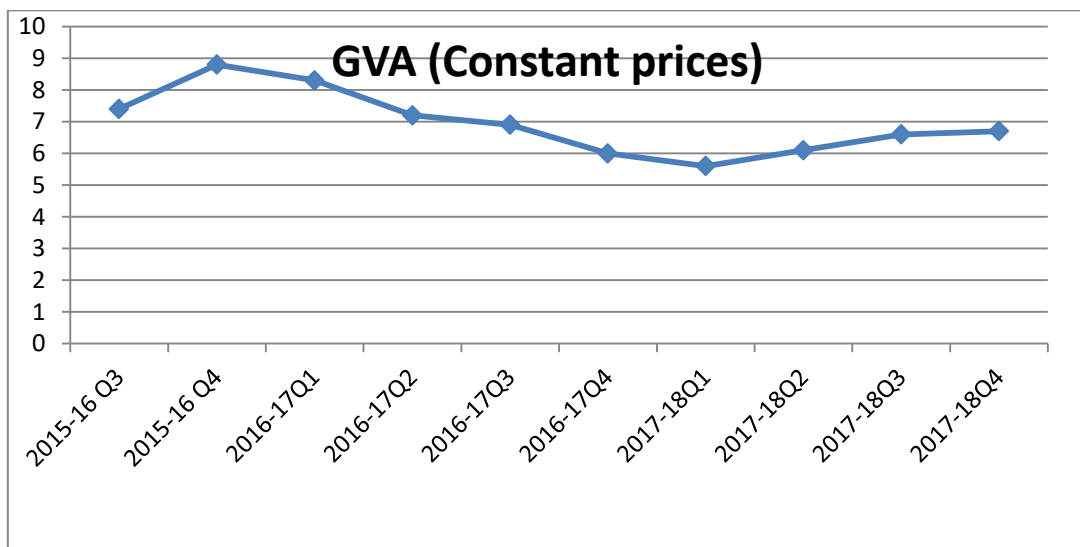


Figure 15: GVA (Constant Prices)

Source: Central Statistics Office

We can see the recovery phase in above diagram. Impact of demonetisation on growth was short lived. Due to lack of currency people postponed the purchases and not all buying plans cancelled. When

banks were flushed with currency they are very much likely to lend on a lower rate of interest. Another side can be increase in investment and thus strongly pushing recovery.

Conclusion

Demonetisation was welcomed with huge criticisms. It was better than other attempts made in past as this time it was launched in a combo of various other schemes which made it more logical. Massive use of currency and vary low tax GDP ratio exhibited an alarming situation. Growth is not sacrificed but it was a short term shock and recovered soon. Demonetisation could not be fully successful but have a remarkable impact on digital payments and also affected demand elasticity of currency which resulted in improvement in monetary transmission mechanism in India. Banking habits of people improved and more flexible payment system was introduced.

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