ISSN (O) : 2456-6675, ISSN (P) : 0972-8058

BOOK-SCAN

Title: Understanding the Black Economy and Black Money in India
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Publisher: ALEPH Book Company.
Date: 6 Feb., 2017

Effulgence
Vol. 15 No. 2
July-December, 2017
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http://effulgence.rdias.ac.in/user/default.aspx
https://dx.doi.org/10.33601/effulgence.rdias/v15/i2/2017/107-109

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INTRODUCTION

It is a short, kindle-size book of 112 pages, where he has brought to fore many diverse facets of black money in our country and make some very fascinating observations. The book is an insightful read for the simple reason that it narrated in a very comprehendible and common man language keeping the in-depth economic analysis of the complex phenomenon of demonetization to be understood by all effected.

On 8th November, 2016 the government announced the demonetization of all Rs 500 and Rs 1,000 notes citing two reasons — it wanted to eliminate counterfeit currency used by terrorists and smugglers, and it wanted to destroy the black economy by forcing the 'de-hoarding' of cash held by those generating black income.

Prof. Kumar has completely appreciated the objectives of the government, but according to him the scheme was imposed on the country with little or no forethought. First, it must be understood that the black money the government was targeting is only about 1 per cent of the black wealth held in the country and only 3.5 per cent of the black income generated in 2016. Even if the government managed to suck out all the black cash in circulation, it would not have much effect on the black economy which involves various activities in which black incomes are generated. It does not stop these activities from continuing. Moreover, 80 per cent of the Rs 500 and Rs1, 000 notes (which constituted 86 per cent of the cash in circulation) was not black money, but rather white money used by businesses and common citizens. Not only do a vast majority of Indians, rich and poor, use cash and not credit cards for daily financial transactions but businesses need it for working capital to buy raw materials, pay wages and other requirements for production and sales. What made the situation worse was the inept execution of the demonetization scheme. If over 85 per cent of a country's currency is demonetized at one go, replacing it will take months if not years. The capacity to print notes is limited, especially if smaller denomination notes are required. ATMs had to be reconfigured to take in the new notes (as they were of different dimensions than the ones they were replacing) and this apparently was not thought of and took much longer than anticipated. To top it was the sloppiness of execution .The book points out is the fallacious thinking behind the scheme, including

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following factors -

- Only a small amount of the black economy would be affected by the demonetization…
- Much of the money that was demonetized was not black cash.
- According to the Pew Research Centre, in 2015, only 22 per cent of adults in India had access to the internet. This means the vast majority who do not have access to the internet will be unable to use online banking.
- Only 17 per cent of Indians have access to smart phones and consequently to mobile phone banking.
- In a population of 1.3 billion and counting, there are 24.5 million credit cards and 661.8 million debit cards. A fairly large number of Indians do not have access to credit or debit cards. Most small businesses do not have card readers so the cashless economy the prime minister and his cheerleaders have been talking of cannot become a reality overnight.
- It is unlikely that black marketeers and other generators of black money will suffer because the biggest fish were able to quickly convert whatever black cash they had into white. Some of the avenues used, according to media reports, were the purchase of jewelry, cash donations to temples, conversion of old notes to new notes with the connivance of corrupt bank officials and circulation through the Jan Dhan accounts of the poor. In other words, despite the massive exercise of demonetization, the total amount of black cash that has been demobilized is very small.
- It was not explained why, when high currency notes were being demonetized for being the choice of currency for black income generators to hoard — currency of even higher denomination (the Rs2,000 note) was being introduced. Surely, this would be even easier to hoard?
- Anticipations were that the scheme would nullify the counterfeit currency which is thought to be used to finance terrorist activity. However, what doesn't seem to have been taken into account is that each counterfeit note can only be used by a terrorist once to finance terrorist activity; counterfeit currency is therefore constantly being generated and the onetime extinguishing of counterfeit currency does not solve the problem. Moreover, if the old notes could be counterfeited it is likely that the same will happen to the new notes. It must also be understood that terrorist activity is not just financed with Indian currency; it can be and is fuelled by dollars, gold, diamonds, drugs and so on. Terrorism is a continuing problem, not a one-off thing.

The book concludes that the demonetization scheme will not solve the problem of the black economy. Rather, we see that the economy has been impacted in a different manner. The livelihoods of the poor and small traders who depend overwhelmingly on cash have been especially hit hard. They have had to cut down expenditures, leading to decline in demand across the economy. The well-off sections facing uncertainty have also become judicious and discretionary in their spending expenditure on things like white goods. All this has impacted agriculture, services and industry. As the profits of industries decline, they may not be able to pay their loans soon so that the NPAs (nonperforming assets) in banks will rise. As a result of this, the capacity of the banks to lend will decline further. Businesses facing excess capacity and uncertainty have also cut back investment. Ever since demonetization was announced, unemployment has risen, investment has fallen, banks are facing difficulties and the crisis in agriculture has been aggravated in spite of a good monsoon. All this leads to the emergence of almost recessionary conditions in the economy.

Deposits by people in banks is a temporary deposit and can only be seen as short-term lending although it was believed that when banks become flush with funds they could give these out as loans. It was argued that interest rates could be lowered so as to boost investment. But as soon as enough cash is available people will withdraw their money. Further, the bankers were too busy dealing with cash and handling serpentine queues, to focus on lending. Regarding lower interest rates leading to an increase in investment, this is unlikely to take place since when capacity utilization is low, investments do not take place. In the US, Eurozone, etc., in spite of interest rates being close to zero, investment did not revive for a long time after the 2007 economic meltdown.

Further, it has been argued that the budget could stand to benefit through increased tax collection as the black economy declines. However, as explained, the black economy is unlikely to be impacted by demonetization. Even if there is an effect, it will be not very significant. The bigger impact is likely to be the advent of recessionary conditions and a decline in production and incomes which will adversely affect tax collection, leading to an increase in deficit and additional problems for the government.

Nevertheless, there could be some benefit over the medium term. The organized sector and some sections of the unorganized sector may move towards using less cash. The government is pushing hard for it and so are the companies involved in electronic banking and related financial companies. Even though all this will take time, it could help make the economy more efficient in the medium run. The proponents of this move expect that people using electronic transfers of money will leave a trail which will make it more difficult to generate black incomes. If this comes about, the demonetization would have been of some use, but all this lies in the future and there is no guarantee that it will happen. Moreover, this move could have been initiated independently of demonetization and with adequate preparation.

The book concludes that the demonetization scheme has had deleterious short, mid-term and long-term effects. Meanwhile, illegal activities, black markets and real estate scams, the production of spurious drugs, capitation fees and various other components of the black economy will carry on albeit, after a brief hiatus.