1

Introduction

THE "tentative terms of reference" for the present study were:

i. to identify the important sectors of the economy in which black money is generated;

ii. to examine the causes and conditions that give rise to and/or facilitate the generation of black money;

iii. to study the methods employed to generate black money and the channels through which concealed income is invested and spent in other ways;

iv. the methods employed to convert black money into white money;

v. to attempt a broad estimate of the volume of black money generated;

vi. to undertake any regional or sectoral surveys that may be required in connection with the above.

While these tentative terms of reference were clearly wide ranging, it was made clear to us that the Ministry of Finance attached particular importance to item (v), namely, the attempt to quantify the extent of the problem.

In view of this, and given the limited resources at our disposal, we have devoted the bulk of our time and effort to issues of quantification, with the inevitable consequence that the other items of the terms of reference have received correspondingly less attention. We have concentrated our efforts on the quantification exercises despite being fully aware of the uncertain nature of the venture. We recognized from the beginning that our results would be based on numerous assumptions and approximations, each of which could be challenged. There would be nothing to prevent critics from dismissing our estimates on these grounds. However, that is an occupational hazard of most empirical work, which is vastly magnified in the case of black money, where reliable data are, by definition, elusive. Given the unusual nature of the enterprise, we will rest content if, in the reader's judgement, we have accomplished two goals: first, that we have improved on the work of previous researchers in this field; and second, our methodology, assumptions and data are clearly spelt out so that those who follow us can improve on our results with the benefit of better data, more acceptable assumptions and, perhaps, more refined methodologies.

We should make one other general, introductory remark. Much of the qualitative discussion and views contained in this report is based on a large number of informal interviews we conducted with businessmen, civil servants, politicians, chartered accountants, lawyers, journalists, economists and revenue officials. In its nature, and especially given the topic at hand, it is difficult to assess the reliability of such interview information. On the other hand, there is no basis for ignoring these, admittedly informal data. All we can say is that we used such information with the best judgement at our command.

We turn to outline the scope of this report.

In Chapter 2 we attempt to clarify alternative connotations of black money; outline and contrast different concepts of black income, and illustrate these conceptual distinctions through a consideration of some specific transactions. Chapter 3 reviews alternative methods of estimating the scale of black income that have been advanced in the literature and undertakes a critical survey of some recent applications of several of these methods to India. In Chapter 4 we essay a monetary approach to estimating the dimensions of black income in India. Though the venture yields some interesting results, our doubts about the methodology are strong enough to conclude the chapter on an agnostic note. In Chapter 5 we undertake a fiscal approach to estimating black income in India. At the macro level this chapter contains the heart of our quantitative work. Despite all their problems we believe that the estimates presented in this chapter are, for the concept of black income under consideration, better grounded than any other available estimate. Supporting methodological details and data are given in Appendix 1 at the end of the report. Appendix 2, which is also associated with this chapter, considers the issue of bias in the official estimates of national income and product.

The next three chapters continue to dwell on quantification, but the focus shifts from the economy-wide level to specific sectors and classes of transaction. The goal of these chapters is threefold: to generate some estimates of black income at the sectoral level, to develop some methodologies which may be of more general interest and to shed light on some of the methods of black income generation. Chapter 6 considers sugar as an example of a commodity producing sector. Chapter 7 deals with black incomes in the form of undeclared capital gains in urban real estate. The detailed description of the sugar case study is given in Appendix 3. Chapter 8 gives a brief accout of black income generation through public expenditures.

In the next chapter, 9, we turn to the underlying causes of black income generation. The chapter does not attempt to break fresh ground; rather it reviews and synthesizes existing literature in this area. Chapter 10 takes up *one* of the factors underlying tax evasion—namely, the effectiveness of deterrence—and attempts to provide some fresh information and analysis on this relatively neglected causal factor.

Chapter 11 contains a qualitative account of some aspects of the working of the black economy, including the principal methods of black income generation, the main sectors and activities where it is generated, the important channels for spending black income and some of the more common methods of converting "black" into "white"

The next two chapters consider issues that, strictly speaking, fall outside the terms of reference of the study. But we felt that for the sake of completeness some coverage of these issues was necessary. Chapter 12 explores some of the possible economic consequences of sizeable black economy while Chapter 13 addresses itself to a global estimate of black income generation. Chapter 14 outlines the array of possible policies to deal with the problem of black income generation.