PARALLEL ECONOMY IN INFORMAL SECTOR – A CASE STUDY

Praveen Jain[1] and Bhawna Johri[2]

The phenomenon of black money or parallel economy or black money is as ancient as the genesis of the tax system. However, the term came to limelight during the second world war as a result of shortage of certain essential goods, controls and rationing. Though, black money declined with the lifting of many control after world war, yet the practice of not entering many transactions in regular books of accounts continued since it helped the parties to evade or reduce their tax liability. Impact of materialistic thoughts, where one wishes to reach on the top position in the society, has created an environment of earning more and more wealth irrespective of whether the source is moral or immoral, legal or illegal, desirable or undesirable for humanity.

Key words: Parallel Economy, Ancient, Genesis, Tax System, Moral or Immoral, Legal or Illegal and Undesirable for Humanity.

INTRODUCTION

Black money/parallel economy, today is not affecting underdeveloped and developing countries only, but the developed countries also. After attainment of independence, the world 'Black Money' has become a key word of discussions among economists, newspapers, academicians, parliamentary debates and social groups. The term is now not unknown to person, whether they are rich or below the poverty line or whether it is servicemen or businessmen or any other community.

The term is widely used. However, no dictionary gives any definition of it. So, it has been defined in different ways by persons who worked on it. Black economy, underground economy, underreported national income, unaccounted transactions, unaccounted income, parallel economy, tax evaded income are used to express the world 'Black Money'.

The term 'Tax Evasion' and 'Black Money' are closely and inextricably interlinked because tax evasion leads to the generation of black money. The word 'tax evasion' is a

[1] Honorary Secretary, Research Development Association & Research Development Research Foundation, Jaipur, Rajasthan

[2] Assistant Professor, Department of Applied Business Economics, Faculty of Commerce, Dayalbagh Educational Institute (Deemed University), Agra

composite of two words – 'Tax' and 'Evasion'. Tax is a compulsory levy on public with an object of raising revenue for the state to use for the benefit of all persons. It was in the year 1513 when the word 'evade' was used for the first time. It means to avoid one's liability to state resulting in loss of revenue activities of escaping from the payment of tax by adopting illegal means is known as 'Tax Evasion. Therefore, tax evasion is an illegal way of avoiding payment of tax by concealment of facts.

Continuously increasing public expenditure for economic development of a country has necessitated the use of 'taxation' as a primary source of internal finance by government of developing countries. The three primary objectives of planning are – growth, redistribution and stabilization. So, taxes must be paid for socio-economic development of the country. But there are persons in the country who do not contribute their part and adopt unfair means to conceal the income for the tax purpose. This tax evaded income lads to the generation of black money, which disturbs our socio-economic infrastructure and condemns our cultural values and politics of principles. So, black money is money accumulated by not paying the taxes imposed by the government. Therefore, black money involves two players : one is the tax evader who does not pay taxes, the other is the government which decides what taxes should be paid and at that rate. It is widely accepted that it is the legitimate duty of the government to levy taxes in any manner it deems fit. It is equally well accepted that not paying such taxes is a crime. Both of these propositions are axiomatic truths of the political economy.

There are some basic features of black money. One, black money has to be hidden, and therefore, not all of it can be spent. That is why, it is locked away as gold or stashed away in Swiss Banks. Two, as a corollary to the above, a significant part of black income is converted into black capital Thus, even this black capital has to be hidden and hence I not freely available to be invested most profitably. It bwets economic growth and reduces demand-causing thereby much harm to the opportunities, the holders of black money would have had otherwise, to invest their wealth profitably for each one of these reasons, black money should be considered as a mug's game. On the basis of above discussion it can be concluded beyond doubt that existence and generation of black money seriously hampers the growth and progress of an economy.

Few facts should be kept in mind:

(i) Paying taxes is not a moral issue, it is a social contract in which the tax gatherer promises to provide public services to the tax payer. So government officials should undertake only those activities where they can spend money more efficiently and more effectively than tax-payers can. Moreover, there should be effective representation where the taxpayer has a voice in the way the taxes are spent. Mere national representation where elected representatives act like dictators will not do.

(ii) The government must have the credibility that it will treat all contracts as sacred, and that it will protect faithfully all rightfully and legally earned property. This ill wither away the feeling of insecurity amongst wealthy class and thus encourage legal wealth accumulation.

(iii) Tax regulation should be simple, transparent and unambiguous. Tax should be so collected that it will not normally produce large amounts of black money as a by-product. Moreover, Taxmen should command an excellent reputation for integrity, those that do not must be weeded out.

The aforementioned facts serve as a check list to find out the causes as well as the extent and magnitable of black money in a particular economy.

REVIEW OF LITERATURE

Looking into the fact that black money has serious implications for an economy, almost every country of the world tries to curb the evils practices of tax evasion and accumulation of black money. At the same time, a numerable of studies are conducted from time to time to estimate the extent and level of black money in a particular country. This helps in determining the impact of black money on the growth and development of a country as well as to enable the policy makers to frame a suitable policy to curb this practice in future.

India is no exception to this. A number of studies have been conducted in India to study the volume and impact of black money in India. Various committees appointed by the government and several working groups as well as individuals conducted studies to estimate the size of black money for a particular period on the basis of different approaches. They have come out with different estimates of its size due to their different definitions of black money and different methods used in it. Estimations of the selected studies are being reproduced below:

Prof. N. Kaldor, Wanchoo Committee, D.K. Rangnekar and O.P. Chopra estimated the tax evaded income using 'Tax Approach.'

Prof. Nicholas Kalder, economic adviser of the British government, estimated the tax evaded income and the resulting loss of income tax revenue for the first time in 1956. He described the difference between assessable non-salary and non-agricultural income as actually reported for tax purpose, as the tax evaded income. He estimated Rs. 600 crore as the tax evaded income for the year 1953-54. Applying average rate of income tax (30 to 50%) at that time of the tax evaded income, he calculated the loss of revenue of Rs.200-300 crore as the tax to the government.

After making some minor changes in the method of Prof. Kaldor, **Wanchoo Committee** provided the estimates of tax evaded income for the years 1961-62, 1965-66 and 1968-69 as Rs. 700 crore, Rs. 1000 crore and Rs. 1400 crore respectively.

Dr D.K. Rangnekar, a member of Wanchoo Committee, not being satisfied with the above estimates. Gave his own estimates. He estimated the tax evaded income as Rs. 1150 crore, Rs. 2350 crore and Rs.2833 crore for the above three years respectively. It was Rs. 3080 crore for the year 1969-70. He further provided estimates of tax evaded income for the years 1973-74, 1974-75, 1975-76, 1977-78 1978-79, 1979-80 to 1980-81 as Rs. 5801 crore, Rs. 6422 crore, Rs. 7366 crore, Rs. 9016 crore, Rs. 10855 crore, Rs. 13145 crore, Rs. 15342 crore and Rs. 18241 crore respectively.

O.P. Chopra used the method adopted by Kaldor and Wanchoo Committee after making some changes and gave estimates of tax evaded income for the period 1960-61 to 1976-77 as ranging from Rs. 916 crore in 1960-61 to Rs. 8098 crore in 1976-77.

Although all these studies suffered from many shortcomings such as complete rely on official published data, underestimation of income lack of estimation of tax evasion by salary income group, they have solved a great complex problem in the field of estimating tax evaded income.

A report published by NIPFP (National Institute of Public Finance & Policy) measured tax evaded income for 1975-76 and 1980-81 as Rs. 7959 crore and Rs. 17209 crore. The discrepancy between income assessable for tx was worked out to calculate tax evaded income. After making some adjustments (due to underestimation of official GDP and illegal transfer from pubic expenditure) in tax evaded income, total tax evaded income, total tax evaded income was calculated as mentioned above. After making some further adjustments, in the above figures, the report provides 'global' estimates of tax evaded Income. Global estimates of black income for 1975-76 was Rs. 9958 crore to Rs. 11870 crore and for 1980-81 it was Rs. 20362 crore to rs. 23678 crore. The report also provided estimates of black money generated in 1983-84 as Rs. 31584 crore to Rs. 36786 crore.

J.C. Sandesara provided estimates of black money from 1953-54 to 1978-79 using 'currency demand deposit approach.' He used 1950-51, 1951-52 and 1952-53 as the base period and calculated average C/D ratio for the period. The estimate for the period 1953-54 to 1963-64 were positive and showed tax evaded income in these years. The estimates varied from Rs. 35 crore in 1956-57 to Rs. 1943 crore in 1960-61. However, the method adopted by him comes into question in the remaining period of the study for which it gave negative estimates. The amount of black money varied from Rs. (-) 916 crore in 1964-65 to Rs. (-) 63412 crore in 1978-79. The negative estimates have aroused a note of interrogation before the study method.

Gupta and Gupta used 'the transaction method.' Developed by Feige on the basis Irving Fisher's quantity theory of money, to estimate black money for the period 1967-68 to 1978-79. Average of 1949-50 to 1951-52 ratios were used as base year ratio. He provided estimates of black money as ranging from Rs. 3034 crore in 1967-68 to Rs. 46867 crore in 1978-79. However his study was criticized both on theoretical as well as empirical grounds. Declining Cash to Demand Deposit ratio in the study period, assumption of no existence of black money during the base period and exceptionally high estimates of black money for 1978-79 were the points of criticism.

S.N. Prasad applied transactions approach with some modifications to estimate the black money in India. The study provides estimates of black money in India for he years 1953-54, 1961-62, 1965-66, 1968-69, 1969-70, 1977-78, 1978-79 and 1979-80 as Rs. 849 crore Rs. 1574 crore, Rs. 2326 crore, Rs. 2849 crore, Rs.9630 crore, Rs.9903 crore and Rs. 12611 crore respectively. The study indicates that the rate of growth in black income has been slow in fifties and sixties but it has accelerated during the last decade. However, assumptions of Prasad's study wer also challenges on various grounds.

S.B. Metha provided estimates of black money in India for 1980-81,using three different techniques. In his study, he took 1970-71 as the base year for the current price index and assumed that there were no existence of black money in the base year. The three techniques game him estimates of black money as Rs. 47280 crore, Rs. 54990 crore and Rs. 51284 crore. Having three different amount of lack money, Mehta says the amount of black money for 1980-81 may be anywhere between Rs. 47280 crore and Rs. 55000 crore.

To quote Tax Reforms Committee (1991), ". . .not more than 30-35 per cent of legally taxable income is being disclosed." In this connections the Finance Minister also pointed out in his 1997-98 budget speech, "It is inexplicable that in a country o over 900 million people, only 12 million people are assessed to income tax and what is worse, only about 12,000 assesses are in the tax bracket of income above Rs. 10 lakh.

Besides above studies, **Taxable Enquiry Commission** (1953-54) estimated that the difference between the income as originally returned and hat disclosed later to the department was approximately 600 per cent. Further a study made by **Central Board of Revenue** estimated tax evasion at Rs. 20 to 30 crore for the year 1953-54. Another study conducted by **Direct Taxes Enquiry Commission** (1971) estimated the amount of tax evasion at Rs. 470 crore for 1968-69 while the income on which tax evaded was estimated at Rs. 1400 crore for the same year.

Foregoing discussion gives a clear indication of alarming levels of income tax evasion in the Indian economy. As stated earlier, this black economy is bound to have adverse effect on the socio-economic infrastructure and cultural values of our country.

Here a point worth consideration is that though a number of researchers have been devoted to the topic of 'Black Money and Tax evasion' and a number of suggestions have also been given from time to time to curb this practice yet their scope has been limited to the measurement of black money generated in formal limited to the measurement of black money generated in formal organized sector only. Unfortunately, no concrete steps have been taken to trace the existence of black money in the informal sector which constitutes a significant component of Indian economy. Virtually, no research has been conducted to study the extent of black money in the informal sector.

So a detailed study of informal sector of Indian economy is the need of the hour to provide estimated increase to the tax revenue of the government by bringing them into net and also to take concrete measures to ensure their contribution to taxes and thus in establishment of welfare state.

The present study **The Black Money and Informal Sector in India** is an attempt in this direction. The research project will be based on the case study of four major cities of India like Jaipur, Delhi, Mumbai, and Ahmedabad in order to estimate the sie of total tax evaded income in the informal sector and resultant loss of revenue to the government.

OBJECTIVES OF THE STUDY

(i) To estimate total income and tax liability of informal sector in the four cities – Jaipur, Delhi, Mumbai and Ahmedabad – and thereby determine the tax evaded income in these cities.

(ii) To estimate the extent of tax evasion in the whole informal sector of India on the basis of its measurement in four cities and determine its impact on revenue of the government.

(iii) To examine and evaluate the tax evasion practices prevailing in the informal sector.

(iv) To provide suitable suggestions and policy implications emanating from the study.

RESEARCH METHODOLOGY

The proposed study will make use of Tax Approach and Survey Method. The discrepancy between taxable income and income and actually reported for the tax purpose will give us tax evaded income or black money under the tax approach. So the proposed approach may be called "Tax Survey Method."

SOURCE OF DATA

The case study is mainly on primary data. Data for taxable income were collected from individuals in the informal sector through application of survey method. Schedules and personal oral investigation method was used to collect information about income and expenditure of persons in the informal sector. The total number of persons engaged in every sector was based on the secondary data, taken from registers of members of associations and organizations related to each trade. To know the income actually reported for the tax purpose, data has been collected from Income Tax Department.

The chapter scheme of the case study were as under:

(1) Introduction and Review of Literature

(2) Research Metodology
(3) Eating places and Retail Traders
(4) Vocations
(5) Estimates of Black Money
(6) Summary, Conclusion and Suggestions

The contents of proposed chapters will be as follows:

I. Introduction and Review of Literature

The prologue

Black Money: Its Meaning

Tax Evasion vs. Black Money

Various Modes of Tax Evasion

Tax Evasion: Important Causes

Black Money Generation: Its consequences

Various Estimates of Black Money in India/Review of Related Literature

Government, measures to counter tax evasion

II. Research Methodology

Problems in the Measurements of Black Money

Approaches to estimate the size of Black Money

Purpose of the Study

Black Money vs. Informal Sector: A brief discussion

Hypothesis of the study

Methodology

Sources of Data

Steps in Analysis and Statistical Methods

Limitations of the Study

III. Eating Places and Retail Traders

This chapter analyses total income and tax liability of retain traders like bakeries, florists, juice/vegetable/fruit vendors, shoe makers, panwalas etc. and also of eating places like canteens, roadside dhabas, tea stalls, chat-pakauri walas etc. in detail.

IV. An Elaborated Analysis Of Total Income And Tax Liability

Vocations like hair dressers, beauty parlors, autorickshaws, taxi cars, jewelers, washermen and drycleaners, contractors, marriage homes etc.has undertaken in this chapter.

V. Estimates of Black Money

This chapter will present consolidated position of informal sector in each of the four cities as emerged from the detailed analysis. On the basis of estimates of black money generated for the four cities, an effort has made to give generalized estimate of black money, generated in the informal sector of the whole country. A detailed review of the tax evasion practices adopted by the people operating in informal sector has also undertaken.

VI. Summary, Conclusions and Suggestions

The chapter will present a brief summary of discussion done under previous chapters. Thereafter broad conclusions emerging from the study has been detailed. In the end, suggestions will be given for prevention and detection of black money generation in the informal sector in particular and the Indian economy in general.

So, the proposed study plans to do an exhaustive analysis of the extent and magnitude of tax evasion as well as tax evasion practices prevailing in the informal sector of Indian economy. The suggestions emerging from the study will have important policy implications for the policy makers, economists and tax administrations.

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