

# Black Money Unraveled

Aman Agarwal, director and professor of finance at the Indian Institute of Finance Business School provides insights into black money control by government and banks:

**Unnati Narang: India tops the list for black money in the entire world with almost \$1456 billion of black money in Swiss banks. Who is to be blamed for this? How can the culprits be booked?**

**Prof Aman Agarwal:** In 2007-08 it was estimated that \$2.5 trillion worth of black money is generated through formal channels alone. This was 8% of the world GDP for the year 2007 without including any illicit trade such as smuggling, drug trafficking or women related crimes. India accounts for one third of the total money laundering that takes place globally. India does not have an efficient administrative system that could be held accountable and responsible. Nonetheless, regulators need to tighten up. As of now, there is no special regulation in the Indian judiciary or the Indian Penal Code to tackle financial frauds. The starting point in any such case should be to bring the laundered money back into the system. The focus of the Indian judiciary has always been on penalizing in the first instance, instead of taking corrective action. India needs to enforce existing rules and regulations better. Fortunately the government has these two bodies – the Financial Intelligence Unit and the Directorate of Enforcement. What is missing is accountability. An administrative reform bill that has been passed but not yet enforced is expected to take care of this.

**To what degree is the global banking system responsible for the growth of black money? What are the flaws in the regulatory systems that make it possible?**

It is first important to understand the difference between money laundering and black money. Money laundering takes place when black or illicit money is con-



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verted into good money. On the other hand, black money (30% to 40% of money laundered) is any money earned on which you do not pay taxes. Black money cannot be controlled by the banking system. At the same time, there are other purely cash based dealings for which banking system cannot identify whether money is good or bad. The major flaw in the global banking systems is that they have converted

the remuneration packages into fixed and variable components. While bonuses do incentivize staff, they also create scope for frauds. It is creating a mechanism to fool the system. This segment is called wealth management. Through this activity, large amounts of money come in huge chunks of deposits and are placed in different kinds of assets by wealth managers working on bonus basis. A lot of black money gets routed by these wealth managers. There has been a lot of emphasis, especially in Europe, to make Swiss banks transparent. As a result, a large amount of money in the last few years has now moved to Singapore, which enjoys similar benefits.

**Do you think some amount of black money transactions is good for a country like India, where the unorganized sector is almost 80% of the economy?**

When one looks back at India's economic history, a positive factor is that black money has acted like a buffer against any international recession. There was a time when taxes in India were as high as 98% of the income. Even the most patriotic businessmen were forced to indulge into non declaration of income. As a result, almost 60% to 70% income of a business is black money. They can't suddenly change gears and make disclosure even if they want to, because it would arouse suspicion. The reason some amount of black money is good is that it makes the economy recession proof. In fact, the actual GDP growth rate of India would be 12% to 13% due to this parallel economy. The unorganized sector is not generating black money per se. Most such people are actually below the tax slab and would otherwise also not have to pay tax. At the



same time, because there is no appropriate system to observe how many people are in the unorganized sector, it is leading to creation of fraud, and in turn, black money. Companies find it easy to create dummy employees and show fake salaries. Such leakages from the system create black money. However, at the macro scale, the unorganized sector is a minuscule part of the bigger problem.

**What are some of the unique characteristics of black money as an asset class? Apart from tax savings, are there any other significant returns from it?**

One of the most important aspects of black money is shield it provides against recession. Between 1996 and 1998, a large number of Indians were turned away by the US because of the nuclear crisis. Again in 1997, almost 500,000 people came back to India from South East Asia. They were all absorbed in the economy. Yet, economic figures did not change at all. GDP kept growing because there was no significant fall in spending. These people had enough backing in the form of black money to meet their immediate needs. Apart from this shield effect, it has no major benefit.

**What is the relationship between fake currency and black money?**

The common man is often ignorant about the difference between real and fake currency. While there is no direct relationship between fake currency and black money, once counterfeits get into circulation, it starts fuelling inflation making RBI policies ineffective. The central bank only plans to suck out money depending on figures and statistics available with them. If the money supply is actually much higher owing to fake notes, the bank will not be able to control it.

**Do you think it is important for the governments to step in and incentivize anti money laundering practices for banks?**

In conjunction with the central bank, the government has a critical role to first educate people about what is right and what is wrong. A lot of people end up generat-

ing black money not knowing that they are doing so. People, in general, want to be honest. It is the scare of regulations and systems that discourages them.

In democracies like India, it is very difficult to introduce streamlined systems in one shot. One has to lay down steps, introduce them in a progressive manner with policy frameworks. In case of an autocracy, most systems are easily streamlined. Secondly, in a democracy, a large number of agencies such as media work independently. In other setups, the explosion of information or transparency factor diminishes. India is criticized and known to be the most corrupt in the world. Other countries might have the same levels of corruption, but it doesn't get exposed.

**How do you suggest creating a standard framework to enable banks to curb money laundering?**

All banks have systems which allow them to identify the magnitude of flow of money. In most developed stock exchanges, there is a system that when a stock triggers below or above a limit, trading stops and a team investigates the cause of such a fall or spike. Similar systems are needed by banks to check extremely huge deposits. The other practice that needs to be monitored is creation of multiple accounts with small sums of money, used as a laundering tool. These two things are easy to track in intelligence systems in banks. However, human will is needed. Officials are deterred by bonuses prevailing in banking systems.

**Recent reports stated that Indians could be using Mauritius as a route for bringing back black money to India. What steps do you recommend to prevent misuse of loose tax frameworks?**

There is nothing wrong with money coming back into India from other countries; it need not be bad money. At the same time, any such sums must be monitored and checked carefully for their source. What is more important is to make international tax havens less lucrative.

[narang.unnati@gmail.com](mailto:narang.unnati@gmail.com)

## NEWS

### CITIBANK

#### RBI imposes ₹25 lakh fine on Citibank

The Reserve Bank of India imposed a penalty of ₹25 lakh on Citibank for violation of anti money laundering (AML) and know your customer norms that led to a 400-crore fraud at one of its branches in Gurgaon. In December 2010, a Citibank employee, Shivraj Puri, was accused of luring 40 high net-worth individuals and corporate entities to invest in bogus investment schemes, promising returns beyond normal securities available in the market while diverting funds to wagering in the stock market. Puri, who perpetrated the ₹400-crore fraud, not only duped a string of wealthy individuals, but also duped the Munjals-controlled Hero group to invest close to 200 crore in the sham investment scheme that promised a high rate of return.

#### Citibank China accelerates branch expansion

China is an important market for banking giant Citibank and the company is set to rapidly increase its presence in the country, according to bank CEO Ou Zhaolun. The bank has spared no efforts to invest in China and will accelerate the establishment of new branches and increase business this year and in the near future, Ou said. The bank is planning to establish at least two branches and 20 sub-branches each year.

#### Hackers take Citibank for \$2.7 million

Citibank admitted that hackers stole \$2.7 million from exposed accounts in May, at a time when similar incidents are prompting worldwide governments to crack down on cyber-crimes. The bank said hackers lifted the millions from 3400 accounts. The bank promised to reimburse customers in full, adding those affected already have new cards. Hackers broke into the bank, exposing more than 360,000 accounts and stealing funds from less than one percent of Citi's customer base.

