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Shades of black in India's economy.

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It's black, is undesirable for the economy, and a problem that India has been fighting for the past five decades. Yet it still plagues the country and rules anywhere between 40 percent and 70 percent of the Indian economy.

That's the black or shadow economy -- the part of the economy which remains off the books, out of the gaze of taxmen and government number-crunchers.

Successive governments have tried to unearth this huge amount of unaccounted money with limited success, and this year too, India's Finance Minister, P Chidambaram, in his 2005 Budget, tried again. Borrowing the idea from Brazil, Chidambaram has proposed a tax of 0.1 percent on cash withdrawals of Rs 10,000 (about $220) or more from Indian banks that could involve 446 million bank accounts in the country.

And like it did in Brazil in the initial stages, this initiative too has drawn vociferous protests from citizens, with many terming it as not only preposterous but plainly impractical.

Still the minister justifies the tax, stating that he is prepared to walk down this slippery slope because the Indian economy is facing a new trend of "large cash transactions especially withdrawals of cash, which leave no trail and presumably become part of the black economy," he said in his budget speech, adding later in a TV interview that "you have no idea how big the problem is."

Indeed, although the country has been always grappling with this problem for decades with little success, a burgeoning economy with an ambition of a scorching 8 percent growth in the coming years -- which for instance would need an investment of $150 billion in infrastructure alone in the next five years -- has made it mandatory for India to tap and unearth black money yet again.

"An Indian is affected at every step by the black economy," says Arun Kumar, a university professor who has written a book on the country's shadow economy. "The education of a child, a visit to a doctor, policemen who extort money...electricity or water departments all demand black payments." But black money is not only an economic phenomenon. Kumar says that it has political, social and historical dimensions too.

Although it is almost impossible to measure black money in an economic system with any precision, according to Kumar, black economy accounted for around 40 percent of India's GDP in 1995, "which must have gone up by now." Of the estimated 40 percent, around 32 percent was supposedly generated through tax evasion and the remaining through outlawed activities. Other estimates have pitched the percentage of black money being as high as 70 percent of GDP.

For that matter, black economics is a global problem. The Economist's estimated that in 1998 the world's shadow (black or underground) economy was the reason behind the missing $9 trillion-worth of output -- a volume of output almost equivalent to another America.

Later, a study by Friedrich Schneider, an economics professor at the Johannes Kepler University in Linz, Austria that attempted to measure the size of the shadow economy in no fewer than 76 developed and emerging economies, revealed that underground activity is equivalent to 15 percent of officially reported GDP, on average, in rich economies, and around one-third of GDP in emerging ones.

Among the rich economies, Italy, Spain and Belgium boasted the biggest unrecorded activity, at 23 percent to 28 percent of GDP, while Nigeria and Thailand had the world's largest black economies, both accounting for more than 70 percent of official GDP. Linz also said that the shadow economy in emerging economies is not driven so much by the incentive to evade taxes, which tend to be lower than in rich economies, as by a desire to evade the law. For instance, Thailand's thriving shadow economy largely consists of crime: gambling, narcotics and the sex industry.

But in India, interestingly, the major contributor to the generation of black economy is the government itself. According to the local rating agency ICRIER, government controls, government expenditures and taxes have been the "major source of black money creation."

ICRIER says that the government control and licensing system was taken to its peak during the seventies and resulted in the infamous license-permit-quota raj. And though a gradual process of de-control started in the eighties, with a major spurt taking place in the early nineties, have resulted in dismantling of that licensed regime, "process is far from complete."

"The control mentality has pervaded every sector of the economy and every control is viewed by the majority of enforcers either as an opportunity to generate funds for themselves, or as an imposition on their normal relaxed schedule," says Arvind Virmani director of ICRIER.

The second and perhaps most important source of black money generation is the government expenditure system. Critics say that almost 30 percent of the government's social expenditure involves intangible objectives -- such as employment generation and poverty alleviation -- where the possibility of siphoning off is huge.

The third source of black money generation is, of course, tax evasion and corruption in the tax bureaucracy.
These are some of the reasons then, fear experts, that Chidambaram's proposal will fail yet again. But, "there are several other large obstacles to cashlessness as well," says H P Ranina, a Bombay-based tax expert. For instance **banks don't exist across much of the hinterland India which makes a huge proportion of the country's one billion people conduct their daily lives without access to bank accounts or any form of cashless financial services.**

Apart from the lack of geographical penetration, there are other good reasons why India is predominantly a cash-economy and will remain that way for a long time. **Much of the urban population cannot offer proof of residence, which is mandatory for opening bank-accounts.**

Nevertheless, on the positive side, the tax will be a useful driver of a plastic economy which is growing by leaps and bounds and it may provide a push for e-commerce through mobile telephony as well. The combined penetration of credit and debit cards is now around 65 million.

By 2010, if a 2004 McKinsey estimate of the Asian banking industry is to be believed, India could have over 165 million plastic users -- 35 million credit and 130 million debit card.

For the rest however, perhaps bank ATMs would start vending Rs. 9999 vouchers that could be redeemed in cash!