THE DRIVERS AND DYNAMICS OF MONEY LAUNDERING MECHANISMS

THE CASE OF INDIA

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This thesis is a presentation of my original research work. Wherever contributions of others are involved, every effort is made to indicate this clearly, with due reference to the literature, and acknowledgement of collaborative research and discussions. The work was done under the guidance of Dr Ronen Palan and Professor Richard Murphy at City, University of London.

Signed Shreeya Kashyap

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ABSTRACT

This thesis examines the fundamental institutional changes and continuities in the Indian economy from an institutional-structural lens, i.e., India's economic reforms of 1991. These reforms signaled a paradigm shift resulting in significant changes in monetary and fiscal policy. This study acknowledges preexisting systems of money laundering and explores whether, or not the introduction of open market reforms in India has facilitated the emergence of more complex money laundering mechanisms. These include capital flight and development of sophisticated book-entry mechanisms, all benefiting from convergence since the 1990s of IT technology, globalisation and free-market policies. The analysis traces the pre-existing practices related to money laundering including money transfer mechanisms of *hundi* and *hawala*. Furthermore, it provides rich empirical evidence to show how the Indian economy can be thought of as a complex eco-system in which the formal, the informal and the black (illegal) are continuously connected through the novel and interesting mechanisms that this study brings to light – namely 'de-laundering' and 'parking.'

The thesis relies on primary and secondary literature as well as qualitative interviews with a range of policymakers, politicians, Members of Parliament, members of state legislatures, bureaucrats, business leaders, finance professionals, lawyers and accountants. These included actual players in the chain of money laundering and 'de-laundering'. I argue that the existence of the black economy, as well as mechanisms of money laundering, are rooted in the socio-economic fabric of the Indian economy. I link the Indian black economy and money laundering to a nexus between politicians, businessmen and bureaucrats. This argument is illustrated through an analysis of selected mini-case studies from different sectors of the economy. The analysis shows that the black and the white economy are linked, and that money goes through cycles of laundering and de-laundering as it moves back and forth from black to white.

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PREFACE AND ACKNOWLEDGMENT

The idea for this thesis came to me unexpectedly, during an afternoon module session at the University of Warwick in 2012. The topic of the week was tax havens and my module guide Dr Owen Wilson showed the class an intriguing documentary on the same. I remember thinking how wonderful it would be to analyse the issue of tax havens in the context of India. I am thankful to Dr Wilson for interacting with me during those initial weeks and helping shape my fledgling ideas regarding shadow economies and flight of capital.

The inception of my proposal had the plight of Indian economy at its heart. What began as a tea time debate over the ills of flight of capital and crony capitalism, led to a deeper study of the political economy focussing on tax havens and money laundering in developing economies; particularly India, post-economic liberalisation. I have grown up in an era where politics in India has become a dark word; synonymous with corruption. I have seen the impact of political cronyism leading to a policy paralysis in my country over the last two decades. It is this that has always inspired and driven me to work in the field of politics and political economy. My love for international politics grew exponentially during the second year of my undergraduate degree in political science at Delhi University. It was during a lecture on social contract theory that I discovered my passion for studying the relationship between the citizen and the state, which is the foundation of modern-day democracy. It was then, that I decided to pursue my masters in International Political Economy (IPE), to study the interdependent relationship between states and markets. Consequently, I pursued my Masters in Political Economy at the University of Warwick. During my masters, I realised that an interdisciplinary approach is imperative to understand any contemporary policy issue.
I found a real-world manifestation of my belief on a daily basis at my job, working as a project associate under Dr Rathin Roy with the Department of Economic Affairs (DEA), Ministry of Finance (Govt. of India). I dealt with issues concerning G-20 countries which includes monetary policy formulation, Taxation and International Tax Co-operation with particular emphasis on tax evasion and ‘base erosion and profit shifting’ (BEPS). I am extremely thankful to Dr Roy, who gave me valuable inputs on my initial ideas and

eventually inspired me to pursue a PhD in Political economy from the United Kingdom. I am also thankful to Dr Govinda Rao, Dr Pai Panandikar, Dr Suranjali Tandon, Ms. Vandita Sahay and Ms Swayamsiddha Panda for helping me refine my initial proposal. Finally, this thesis would not have been possible without the love and support of my caring family. My father has been a constant source of inspiration and support to me. From documenting my initial ideas to accompanying me to various Indian cities for fieldwork, he has supported me tremendously. I would also like to mention my brother who made repeated visits to London and for whose company and support I was grateful, particularly in the winter months when the research experience becomes progressively more isolating in nature. I would like to express my gratitude to my supervisor Dr Ronen Palan who has been an understanding and supportive mentor to me over the last four years of my time at City, University of London. I would also like to express my gratitude to my secondary supervisor Mr. Richard Murphy, who agreed to be my second supervisor at a very short notice. Finally, I am very thankful to my mother who has been my friend and emotional anchor in the last five years. She has been a source of constant encouragement, from the time I decided to apply for higher studies, to the final day of corrections especially during the nationwide lockdown days of the Covid-19 pandemic.

Money Terms

Throughout this thesis I use the Indian terms *lakhs* and *crores*. It provides authenticity to my research, as these terms were used by all the participants in the interviews.

To clarify:

1 lakh = 100,000

1 crore = 10 million

1 million = 10 lakhs

1 billion = 100 crores

I have employed the terms millions and billions when I quote from international sources such as FATF, IMF or World Bank reports.

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Abbreviations

ADR	American Depositary Receipt
AEOI	Automatic Exchange of Information
AES	Alternative Economic Survey
AML	Anti-Money Laundering
AMLSCU	Anti-Money Laundering and Suspicious Cases Unit
AOCD	Anti-Organised Crime Department
APG	Asia Pacific Group on Money Laundering
ARA	Assets Recovery Agency
AUSTRAC	The Australian Financial Intelligence Unit
BEPS	Base Erosion and Profit Shifting
BSP	Bahujan Samaj Party
BJP	Bhartiya Janata Party
BJD	Biju Janata Dal
CA	Chartered Accountant
CAG	Comptroller and Auditor General
CBDT	Central Board for Direct Taxes
CMS	The Centre for Media Studies
CPM	Communist Party of India
CPIM	Communist Party of India Marxist
CREDAI	The Confederation of Real Estate Developers of India
CRS	Common Reporting Standard
CSO	Central Statistics Organisation

CSR	Corporate Social Responsibility
DOS	(United States) Department of State
DYMIMIC	dynamic multiple-indicators multiple-causes
ED	Enforcement Directorate
EC	Election Commission
ECI	Election Commission of India
EEO	Election Expenditure Observer
EIC	East India Company
EPC	Engineering Procurement Construction
FATF	Financial Action Task Force
FERA	Foreign Exchange Regulations Act
FEMA	Foreign Exchange Management Act
FDI	Foreign Direct Investment
FFZ	Financial Free Zones
FICCI	Federation of Indian Chambers of Commerce and Industry
FIU	Financial Intelligence Unit
FIR	First Information Report
FTZs	Free Trade Zones
GCC	The Gulf Cooperation Council
GDP	Gross Domestic Product
GOI	Government of India
GST	Goods and Services Tax
HECI	Higher Education Commission of India
HNI	High Net Worth Individuals

HOSSPs	Hawala and Other Similar Service Providers
HUF	Hindu Undivided Family
ICAI	The Institute of Chartered Accountants of India
ICRG	International Cooperation Review Group
ICRIER	Indian Council for Research on International Economic Relations
IFT	Informal Funds Transfer system
IIPE	Illicit International Political Economy
ILC	International Labor Conference
ILO	International Labour Organisation
IMPS	Immediate Payment Service
IPE	International Political Economy
IMF	International Monetary Fund
IT	Information Technology
ITR	Income Tax Return
IVTS	Informal Value Transfer System
JAM	Jan Dhan-Aadhar-Mobile Trinity
JNU	Jawaharlal Nehru University
KYC	Know your Client
MCAA	Multilateral Competent Authority Agreement
MHRD	Ministry of Human Resource Development
ML	Money Laundering
MLA	Member of Legislative Assembly
MMRD	The Mines and Minerals Regulation and Development
MW	Megawatt

NAFTA	The North American Free Trade Agreement
NEP	New Economic Policy
NGO	Non-Government Organisation
NPO	Non-Profit Organisation
NIFM	The National Institute of Financial Management
NIPFP	National Institute of Public Finance and Policy
NMDC	National Mineral Development Corporation
NRI	Non-Resident Indian
NSSO	National Sample Survey Organization
OECD	Organisation for Economic Co-operation and Development
PAN	Permanent Account Number
PEP	Political Expose Persons
PPA	Power Purchase Agreement
PPP	Public Private Partnership
PTC	Power Trading Corporation
RBI	Reserve Bank of India
RPA	Representation of People's Act
RSS	Rashtriya Swayamsevak Sangh
RTE	Right to Education
RTI	Right to Information
SIT	Special Investigation Team
SP	Samajwadi Party
ECD	Exchange Control Department
STRs	Suspicious Transaction Reports

UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UP	Uttar Pradesh
VAT	Value Added Tax
VDS	Voluntary Disclosure scheme
WAN	Wide Area Networks
WWF	World Wildlife Fund
YEIDA	Yamuna Expressway Industrial Development Authority

Chapter 1

Introduction

Chapter I

Introduction

Section I: An Overview

1.1 Central Question and Objective

The fundamental question that this thesis examines is whether, and to what extent the economic reforms in India have resulted in the emergence of complex money laundering mechanisms; including capital flight to overseas tax heavens. More specifically, I examine the role of liberalisation of the Indian economy since 1991 and its impact on money laundering and its associated mechanisms. In examining this fundamental relationship, I delve into whether the aforementioned role is direct, partial or a consequence of factors independent of liberalisation. Examining this relationship is relevant on account of the exponential growth of the 'black money', i.e. illicit funds that may be converted into usable and ostensibly legitimate funds through mechanisms of money laundering. As the 'black money' in the economy has grown by leaps and bounds post-liberalisation[1] and since this growth is sustained by mechanisms of money laundering, the intuitive conclusion which one may jump to is that liberalisation had a direct and substantial role in facilitating the mechanisms of money laundering (Menon, 2019). This

[1] As per some academic estimates, the black economy, as a percentage of GDP has increased from 5 per cent in 1955-56 to nearly 50 per cent in 2011 (to nearly the size of the GDP in recent times as per some popular media stories) (Kumar, 2016). However on the official front, despite various commissions and expert teams constituted by the Indian government for the estimation of unaccounted or black income in India, the Indian government stands firm on the claim that a reliable estimation of unaccounted income in India was not possible. In an official report titled, *Status of unaccounted income/wealth both inside and outside the country-A critical analysis (2012)*, senior finance ministry officials said that a reliable estimation of black money is extremely difficult, since three independent studies commissioned by the Indian government gave starkly varied estimates, showing that it could be anything between 7 per cent and 120 per cent of the gross domestic product (GDP).

otherwise intuitive conclusion constitutes my fundamental hypothesis.

The objective of this study is not only to analyse the mechanisms of money laundering in isolation. This study aims to explore whether mechanisms of money laundering have evolved as a direct consequence of the policy initiatives of the 1990s. The puzzle here is whether money-laundering mechanisms are, in fact, facilitated or a necessary by-product of economic liberalisation in India.

The puzzle is best understood through Aristotelian logic. Suppose "A" is the market reform in India in 1991 or liberalisation; "B" is the growth of the black economy, and "C" are the mechanisms of money laundering.[2] It is safe to state that "A" has led to an exponential rise in "B" as there is credible literature on liberalisation leading to rampant rise in 'black money'[3] (Kumar and Chattopadhyay, 2013; Kar, 2010). A review of literature in the public domain leads to the inescapable conclusion that "B" is facilitated through "C" i.e. the generation of black money is enabled and legitimised through mechanisms of money laundering.[4] Therefore, "A" equals "B" and "B" equals "C". The question that then falls for consideration is whether "A" equals "C"; this is what I examine in this thesis. In other words just because there is sufficient evidence to link 'black money' and its growth to both liberalisation on one hand and mechanisms of money laundering on the other, does it necessarily then follow that liberalisation led to the

[2] According to Aristotelian or traditional logic,"... if A is predicated of every B, and B of every C, then necessarily A is predicated of every C .... In the same way, if A is predicated of no B, and B of every C, then A will belong to no C"

[3] As per many studies, since the introduction of open market policies under economic liberalisation of the Indian economy in 1991, trade restrictions have been relaxed, leading to higher black income generation as well as flight of capital to the offshore (Kumar, 2012). In the international sphere, this period witnessed a rise in number of tax havens in the world (Palan et al 2010; Tax Haven Team, 2014). These offshore tax havens function by aiding capital flight through "layering"' and facilitate its return to the country through round tripping. In Treasure Islands: Tax Havens and the Men Who Stole the World (2011), Nicholas Shaxson points out that Mauritius has become a major hub for the mechanism of "round-tripping". Writing in context of India he says, "A wealthy Indian, say, will send his money to Mauritius, where it is dressed up in a secrecy structure, then disguised as foreign investment, before being returned to India. The sender of the money can avoid Indian tax on local earnings." A recent study by the US-based think tank Global Financial Integrity (GFI) said an estimated $770 billion in black money entered India during 2005-2014. Nearly $165 billion in illicit money exited the country during the same period, the global financial watchdog had said (Kar, 2013).

[4] The Ministry of Finance in India, published *A white paper on black money* in 2012 which claimed that money generated through tax havens offshore was returning to India through complex mechanisms of money laundering. These included the indigenous system of *hawala* as well as other newer complex mechanisms such as foreign direct investment through beneficial tax jurisdictions, trade mispricing and investing in Indian stock markets through participatory notes. Thus, the generation of black money has become more yielding with the easing of the regulations and increase in trade flows post liberalisation in India. This can be attributed to the availability of foreign trade as a mechanism to launder black money to white money (Ministry of Finance, 2012).

growth of money laundering mechanisms as well or is it not that simple. Alternatively, is the relationship more complex?

1.2 Hypothesis

H1: - The liberalisation of the economy in India has resulted in the emergence of complex money laundering mechanisms; including capital flight to overseas tax heavens. H1 is derived from critical political economy, which suggests that neoliberalism was a smokescreen for advancing the cause of the elite in India.[5]

H2: - There is a partial correlation between economic liberalisation and the emergence of complex money laundering mechanisms. The neoliberal ideology has been a general policy prescription which like liberalism, operated differently due to different pre-existing institutional structures, such as *hundi* and *hawala* in India.

H3:- The emergence of complex money laundering mechanisms was part of a larger shift that included changes in technology, shifts in the international political environment and globalisation. H3 is formulated on the basis that the emergence of money laundering mechanisms was significantly influenced by factors other than liberalisation.

1.3 Contribution to Literature

In the past decade, there have been various government commissioned studies as well as consistent media attention and debate in the public sphere on the issue of rampant growth of money laundering in India (Ministry of Finance, 2012). More recently, these debates have focussed on the issue of capital flight to offshore tax havens to launder black money. Connected to the issue of black money, is the underground/parallel or 'black' economy in India which has

[5] As per this view, market liberalisation is not *per se* a problem but the manner in which it was left unchecked and seen as a messiah of change and development led to its 'side effects' remaining unchecked.

become a burning issue in India since 2014.[6] All of this has brought money laundering into sharp focus and generated considerable public debate on its origins. Some commentators and analysts have speculated that the same is a consequence of liberalisation (Bidwai, 2006). Many critics of neoliberalism in India (Ahluwalia, 2002; Kumar, 2002; Bardhan, 2005, 2007) claim that economic reforms brought forth massive corruption and illegality in the Indian economy (Das, 2015). It is widely accepted that prior to 1991, bribes were needed for industrial licenses, import licenses, foreign exchange allotments and credit allotments. However, while the New Economic Policy (NEP) ended industrial and import licensing, it raised the value of all natural resources and the telecommunication spectrum, thus raising kickbacks for their allotments. Furthermore, the economic boom as well as free availability of foreign exchange made it easier to siphon off funds to the offshore by the Indian elite who gained from the economic reforms (Kumar, 2002; Aiyar, 2016).

Since there has been considerable public discourse linking liberalisation to money laundering and its mechanisms – the same requires academic scrutiny. There is a popular view that has gone both unchallenged and largely unresearched to the effect that liberalisation is the root cause of the drain of national wealth through money laundering and its mechanisms. This study is needed in order to either rebut or affirm this view. Thus, there is a need to look at this assertion through an academic lens, and to put this development in the proper historical perspective. This study would therefore help serve and assist policymakers and academicians alike, to view both the mechanisms of money laundering and market reform along with their interplay and put their impact on the economy in the right perspective. The exponential growth of 'black economy' post-liberalisation, makes my study even more relevant. In 2011, the government of India commissioned three expert teams to estimate the size of the black economy in India post-liberalisation.[7] While these reports are not available in the public domain, the media statements issued by their respective research teams have highlighted the prevalence of black money in

[6] The Narendra Modi-led BJP government came to power in the 2014 Lok Sabha elections on an anti- corruption development narrative; promising Indians to bring back the black money parked abroad. During his election campaign in 2014; he famously said, "I will bring back every rupee stored away in foreign banks and ensure it is used for the rehabilitation of the poor". (Chaturvedi, 2014).

[7] In 2011, the UPA government decided to commission these studies to three major think tanks in North India; National Institute of Public Finance and Policy (NIPFP), the National Council of Applied Economic Research (NCAER) and the National Institute of Financial Management (NIFM). These reports by NIPFP, NCAER and NIFM were received by the government on December 30, 2013, July 18, 2014, and August 21, 2014, respectively but not published (Live Mint, 2017). In 2019, the report by NIFM was made available in the public domain; five years after it was submitted to the government of India.

major sectors of the Indian economy such as real estate, mining education, gold and electoral finance.[8] Given the fact that the black economy is an integral part of the functioning of the Indian economy, it follows that money laundering mechanisms too have become an essential part of Indian economic activity (Datta, 2011). This study attempts to examine when and how these mechanisms became institutionalised with respect to the Indian economic framework.

The purpose of this thesis is to analyse money laundering as a subset of IIPE literature. The illicit aspect of the international economy has not been one of the core subjects in the international political economy (IPE) literature. This area of study; also called Illicit International Political Economy (IIPE) lies in the intersection between political economy, security, and criminology (Andreas, 2004). For the purpose of this thesis, I am primarily concerned with the phenomenon of money laundering and the complex structures and variables associated with it. According to Naylor (2002), scholars of political economy have largely ignored the study of money laundering, just as they have ignored the study of IIPE, largely relinquishing this research strand to criminologists, trade theorists, criminal justice specialists, economists, and investigative journalists (Naylor, 2002). Despite extensive research about money laundering, as a part of these domains individually; money laundering has fallen through the cracks of divisions between these social sciences disciplines.[9] Following the 9/11 terror attacks, there was a peak in academic interest in combating money laundering and counter financing of terrorism within the security studies domain. While this enriched the legislative strand of literature on money laundering, it created a sharper divide between security studies and political economy literature (Andreas, 2004). In fact, legal literature has retained its narrow focus on the effectiveness of the Anti-money laundering framework and regulations to control illicit activities which includes money laundering and associated crimes such as drug smuggling and terrorism (Quirk, 1997; Masciandaro, 1999, 2007). I discovered that legal literature tended to focus on the legislative framework to control

[8] As per a statement issued by the Ministry of Finance in India, "The issue of black money has attracted a lot of public and media attention in the recent past. So far, there are no reliable estimates of black money generated and held within and outside the country." The terms of reference of these reports included profiling the nature of activities engendering money laundering as well as identifying the major sectors where money laundering activities thrive in India (Business Today, 2019).

[9] Some exceptions to this lack of literature are Ethan Nadelmann (1990) 'Global Prohibition Regimes: The Evolution of Norms in International Society', International Organisation, 44(4): 479–526; H. Richard Friman and Peter Andreas (eds) (1999). The Illicit Global Economy and State Power, Lanham, MD: Rowman & Littlefield; and Phil Williams (2003), 'Transnational Organised Crime and the State', in Rodney Bruce Hall and Thomas J. Biersteker (eds) The Emergence of Private Authority in Global Governance, Cambridge: Cambridge University Press (Nadelmann, 1990; Andreas, 2004).

money laundering (Harvey, 2008; Pellegrina and Masciandaro, 2008; Barone and Masciandaro, 2010; Brzoska, 2014; Unger *et al.*, 2014). Economic literature addresses the subject of money laundering in an oblique manner i.e. through studies on capital flight (Tiwari, Gepp and Kumar, 2020). Juxtaposed against these strands of literature, investigative journalists view money laundering from the lens of crime and focus on exposing specific crimes and lack of prosecution of those crimes (Hinterseer, 2002).

This thesis aims to fill a gap through a cross-disciplinary framework where the phenomenon of money laundering is examined from an economic, political, legal, sociological and historical perspective. Additionally, this thesis highlights the need to understand the informal economy in India. Economists and political scientists have paid little attention to money laundering per se in the past. Instead, they have focussed on measuring the size and operation of the informal economy often used synonymously with the underground, illicit or illegal economy. According to the ILO (1993), the informal sector is defined as "a group of production units comprised of unincorporated enterprises owned by households, including informal own-account enterprises and enterprises of informal employers (typically small and non-registered enterprises"(ILO, 1993). This definition limits the informal economy to enterprise (ILO, 2013). In a large part of the english-language International Political Economy (IPE) literature the black economy is synonymous with the informal economy, while in the criminology literature the black economy is simply the criminal economy (Hinterseer, 2002).This is not the case in India where it is the law which legitimises the activities of the informal economy as a subset of the unorganised sector in the economy. In fact, the terms unorganised sector and informal sector are used inter changeably in the Indian context (Kulshreshtha, 2011). According to Kulshreshtha (2011),

"The informal sector according to the ILO and the unorganised segment are conceptually different in that the ILO concept focuses on a particular group of production units for socioeconomic reasons, while the unorganised segment is defined according to whether or not the units involved provide information to the statistics office in an "organised" manner. In the Indian context, the unorganised segment of the economy includes, in addition to the two kinds of household enterprises defined by the ILO as constituting the informal sector: (i) own account production of goods; (ii) imputed services of owner occupied dwellings;(iii) services of domestic servants consumed by the household that employs them; (iv) enterprises which do not provide regular accounts to the statistical services; and (v) private non-profit institutions serving households. To get information for India on the ILO's informal sector one would have to subtract the contribution of the above-mentioned activities/enterprises from the unorganised segment" (Kulshreshtha, 2011, p.125).

The Indian law divides economic activities of certain categories (such as agriculture) as legitimate informal activity forming a significant segment of the Indian economy. Through this study, I draw clear distinctions between the formal, informal and black economy in India, which collectively form the Indian ecosystem. I develop this idea and the interplay of these segments in chapter III. This study strives to provide a strategic analysis of the interplay between these three segments by focussing on money laundering as the process that enables the flow of money from one segment of the economy to another. The common denominator between the financial flows moving in and out of the formal, informal and black economies is the process of money laundering and money de-laundering, an idea unique to this study which I develop in chapter VI.

Furthermore, in the context of my case study i.e., India, there is a gap in any original academic research on money laundering mechanisms being facilitated by or being a consequence of market liberalisation in India. In the context of Anti-Money Laundering literature (AML), the term 'typologies' is attributed to the varied mechanisms or techniques employed to launder money or finance terrorism (Nance, 2018). In the 1990s, financial institutions and multilateral organisations such as the FATF and the Asia Pacific Group (APG), started carrying out regular 'typologies' research to generate up-to-date empirical data The typology exercises are structured around bringing together money laundering experts from around the world to discuss the latest issues in money laundering (Passas, 2003). The construction of the India specific typologies is expected to be a useful contribution of this study to country specific typologies research.

This study makes two novel contributions to the literature on money laundering. Firstly, a unique finding of my thesis is the mechanism of 'parking', where money is neither laundered nor delaundered. Secondly, this study discovered an atypical feature of the Indian economy wherein the money from the formal economy i.e. 'white money' is often converted into funds for the unaccounted economy known as 'black money'. As I have explained in this study, this system also makes it possible to change black money to white money reversing the process. This cycle continues so on and so forth. I find this process unique to India and a departure from international practices of money laundering. I have termed this process as de-laundering. It is my hope that this study will be of considerable value in providing a better understanding of the role of money laundering in India and will prove to be of substantial help in developing intervention strategies, by way of legislative policies to overcome the ills of black money and money laundering. At the same time, I think this thesis will serve as a warning to anyone who tries to use "a one size fit all" approach to the problem of money laundering.

1.4 The Argument

The Indian economy can be segmented based on both wealth distribution in different segments of the population as well as the rural-urban divide. The Indian economy is layered along economic lines and with every layer, there is a simultaneous interplay of the black informal and formal economies. Within the three economies at play, all sections of the Indian population interact to create a complex Indian ecosystem. I examine this interplay through various mini case studies in this thesis. I argue that that the entire population has been integrated as small cogs into the large machinery of this ecosystem, acting both as a beneficiary as well as a functionary. This ecosystem benefits from the rampant impoverishment of the masses along with the control of wealth in the hands of few privileged Indians. According to World Inequality Database (2019), inequality has been on the rise in the last two decades and there has been an even greater concentration of wealth with the top 10 per cent of the Indian population further increasing the gap between the rich and poor (The Wire, 2020). The rural poor serve as important functionaries in the Indian ecosystem that I examine. On one hand, they unknowingly serve as entities in the book-entry mechanism. On the other hand, they serve as end beneficiaries of the money that is generated for election spending. I argue that the Indian electoral process has become the political agency that sustains and further entrenches the long sustaining relationships within this ecosystem. A prime example of this relationship that has emerged between 'the triad' of the Indian economy i.e. the businessman, the politician and the bureaucrat. This relationship has been nurtured and further strengthened with the influx of money into the economy post liberalisation. This factor highlights the structural power of specific groups in this ecosystem i.e. the politicians, businessmen and bureaucrats. Another important player in this ecosystem is the voting population of the country. The electorate's demand for side payments during voting is also one of the key drivers of this ecosystem. This sustains and nurtures a river of black money within the ecosystem.

Thus, this study provides empirical evidence and details to show the complexity of the Indian economy as an 'ecosystem' in which formal, informal and black i.e. illegal intertwine in complex ways in different regions and different levels of incomes and wealth. I argue that liberalisation did not create the ecosystem but rather infused it with a greater volume of cash that leads to elaboration and development of existing financial mechanisms. To substantiate this claim, I use the FATF backed typologies research evaluation of money laundering mechanisms. According to Nance (2018), typologies research is both diagnostic and generative and helps to identify and describe current trends in money laundering (Nance, 2018).

For this purpose, I will consider the most oft used techniques or typologies of money laundering in India. While some of these techniques have been identified in the literature on typologies of money laundering, most have been chosen for analysis as a result of my empirical findings. My unique contribution lies in my analysis of each mechanism separately against the matrix of my hypothesis, which I have enumerated in section 1.2.

1.5 Main Findings

The findings presented in this thesis evolved as a consequence of gathering information from empirical research, received from interviewing actual players and beneficiaries of the complex money laundering systems. I began my study and research with a slight bias in favour of the argument that the IMF mandated neoliberal policies have forced the Indian state to act in the interest of big capital. As a result, it was my conclusion that there was growth in black money and money laundering mechanisms as an unintended consequence of following IMF mandated neoliberal policies, depriving the Indian economy of capital and furthering poverty and inequalities among the impoverished masses.

However, further study of literature on the subject, including the writings of political economy scholars like Atul Kohli (1980), Rodrik and Subramanian (2004), Harris-White (2003), Rob Jenkins (1999), Bardhan (1998), and Mushtaq Khan (2011) and more importantly the fieldwork in India, suggested a more complex reality. I found that there is a somewhat limited correlation between economic policies, capital controls and illicit financial flows from Indian to foreign jurisdictions, which could be attributed to economic liberalisation. This analysis suggests that the umbrella concept of liberalisation is too broad and indeterminate to capture the more complex process of layering that has occurred in the evolution of mechanisms of money laundering. I use the concept of layering as opposed to displacement; to examine the emergence of new and changing typologies of money laundering mechanisms with reference to the incremental economic liberalisation process in India (Streeck and Thelen, 2005). In order to analyse this emergence, the subsequent chapters employ concepts developed in historical institutional analysis of gradual institutional change. Further, analysis of each mechanism against the hypothesis displayed divergent results. While some mechanisms of money laundering have become more important post-liberalisation – for example, round-tripping and a new version of hawala which I have coined as *hawala 2.0*, may have become more significant than *hawala 1.0*.

I argue that the view that the Indian liberalisation era political economy can be studied through the prism of its formal segment alone is a fallacy. We cannot understand India's liberalisation-era political economy by looking at its liberalised or formal segments alone: their characteristics and evolution are inseparable from the informal 'sediment' upon which they are layered. Furthermore, I argue that the institutions of money laundering are like a social organism, that develops layers with each structural shift which includes both policy as well as legislation. Its organisational matrix integrates the new layer without compromising its original function. Liberalisation, no doubt, added further layering, but could not alter the basic character of money laundering which is embedded in informal indigenous institutions. Another critical aspect of this research emerged from my interviews with policy specialists, bureaucrats and politicians which indicated that the generation and demand for black money in the Indian economy, was not primarily emanating from the world of crime (alone), but resulted from the demand-pull of the world of electoral politics. India's appetite for black money to run its political institutions; particularly political parties and conduct elections has been humongous (Kapur and Vaishnav, 2003). In fact, the largest players in the field of money laundering and black money are not criminals and businessmen, but politicians and bureaucrats. Thus, the big elephant in the battle against corruption and black money in the political economy of India is the business model of politics or the nexus between politicians, big business and bureaucracy.

To examine the impact of liberalisation on money laundering in light of the proposed hypothesis, I have categorised my analysis under three broad aspects: -

Firstly, Evolutionary; my central research question is essentially the relationship between mechanisms of money laundering in India operating within the black/informal economy and a major structural shift in the Indian economy i.e. liberalisation. In Chapter IV, I have established the pre-existence of money laundering mechanisms in the Indian subcontinent, prior to the onset of not just liberalisation in the 1990s, but even independence in 1947. Many of these mechanisms such as *hundi* and *hawala* have survived through time and continue to be in use in small and medium businesses in India. This depicts both the robustness of these informal mechanisms in the face of modern banking, as well as the position of trust they enjoy among age-old businesses in India; often considered more legitimate and reliable than formal banking instruments. Traditional mechanisms of *hawala, hundi* and *fei chien* are ingrained in the culture of many ethnic groups. They also serve many legitimate needs. This makes it unrealistic to try to stop or eliminate them. Some countries have tried but achieved nothing but the criminalisation of otherwise law-abiding members of society. This is particularly true in India. More importantly, the role of the parallel economy cannot be rejected as an appendage, as it has a critical role in supporting and stabilizing the economy. The taxation in India has had too many exemptions, too many levels and multiple authorities resulting in competitive advantage by merely tax planning which when taken to its zenith results in tax avoidance. The nature of banking in India contributes to deploying, employing and generating black money. Thus, there are primarily four main reasons for the presence of a large black economy working in tandem and at times more effectively, than the formal economy:

i) element of trust ii) culture & evolution iii) cost-effectiveness and efficiency and lastly iv) lack of political will: needs of election funding. The first two aspects are analysed in Chapter IV, the third and fourth aspect are the subject of chapter VI & VI respectively. The following chapter (II) offers a literature review on the concept of money laundering.

Secondly, the *Institutional-Structural* aspect, where I analyse the institutionalisation of mechanisms of money laundering operating within the overall contours of the Indian economy; including all its segments- the formal, informal and black. During the research, it became apparent that there existed overlaps and mutually symbiotic relationships between all three segments (black, informal and formal) of the economy. All three segments are evolving with overall growth impetus in the economy and supporting and supplementing each other, in a structured yet organic manner. My interviews have revealed clear patterns of evolution in mechanisms of money laundering, and how these mechanisms have adapted themselves to new technologies and changes in the Indian legal framework, as well as the international competitive environment, resulting in the rapid growth of businesses in India. In turn, this growth has fuelled the rise of money laundering; as I demonstrate through examples. The strength of my finding lies in the authenticity of real-world examples, that I was able to gather from senior players in the field of politics, business, law and financial professionals.

And *Thirdly,* I explore the *political agency* and lack of political will, where I examine election funding and socio-political acceptance of mechanisms of money laundering for business activities and electoral practices. I find that the nexus of businessmen, politicians and bureaucrats has evolved into a complex reality, despite economic liberalisation in the 1990s and has allowed a few corporate entities and rich individuals to reach the top of the global wealth lists, even as the bulk of the population suffers from poverty and insecurity. An important component of political activity i.e., elections are perforce associated with circulation of unaccounted monies. These factors are also analysed in this study. The largely informal cash-based expenditure in the funding of elections makes for an abundant pool within which unaccounted funds may be transferred and withdrawn at convenience (Rao, 2009). The large gap between the disclosed expenditures on elections and the estimated expenditures demonstrates that the funding is most likely from unaccounted sources (Core Committee on electoral reforms, 2010).

Lastly, there is a limited causal relationship between economic liberalisation in 1991 and mechanisms of money laundering, as they exist today. In fact, the propensity to launder black money as well as the demand for black money is much higher in sectors where the regulatory framework is complex and need for due diligence is onerous. It is well documented that the real estate sector is a safe havens of black money. Numerous interviewees described how they/their clients interactions with government officials were characterised by a layer of suspicion and contempt born out of the constant demand for speed money and convenience payments to these corrupt officials. I explore these concepts in chapter VI in detail. Due to such experiences, these individuals have little or no trust in government and rule of law.

Furthermore, the economic liberalisation of the economy in 1991 had provided opportunities for capital flight of illicit incomes, primarily through the round tripping mechanism. I find limited evidence through interviews carried out that imprudent macroeconomic policies drove illicit financial flows out from the country. This finding finds support in the findings of IMF, Panagariya (2008)~~,~~ and others who observe that macroeconomic policies in India have been prudently managed and played a stabilizing role. According to Dev Kar (2010), "The reason that changes in the deficit and inflation do not adequately explain illicit flows is probably because macroeconomic drivers have a far stronger influence on *licit* capital movements (involving private portfolios) than on flows that are illicit" (Kar, 2010, p.8).

Section II Methodology

1.6 Methods and Materials

This thesis is supported by two bodies of evidence. Firstly, the evidence is mostly derived from secondary sources. This consists of legislation, books, articles, websites, documents of different cases and statistics. Secondly, and more importantly, empirical evidence gathered from interviews and correspondence with eminent lawyers, senior accountants, builders, political advisors, politicians, hawala operators and other protagonists who were involved with, or have knowledge of the development of mechanisms of money laundering in the pre-reform era.

It was the availability of scant evidence on the creation and early development of traditional mechanisms of money laundering such as *hundi* and *hawala*; which surprised me during my initial reading of the subject, and that helped define the direction of my research. The inductive approach, with some exceptions, became mostly associated with the production of a traditional history of events, with its emphasis on historical facts. This methodology has been, I believe, best suited to my first task, which was to write a detailed description of the origins and evolution of the traditional methods of *hundi* and *hawala* used for value transfer, which predate modern retail banking, using empirical data and observation.

I follow two distinct sets of methodology. *Firstly*, a methodology that is inductive and essentially Braudelian in that it follows *la longue durée*, 'the quasi immobile time of structures and traditions' (Holmes, 2003); which in history goes back not just to pre 1991 reform era or pre-1947 independence era but all the way back to ancient and medieval India. Here, I argue that the *hawala/hundi* mechanism of banking also acted as a contraband currency and not just a system of banking; not only held and used outside the country, where it has the status of a 'legal' tender (Martin, 2009), but traded in a market which exists and operates outside the system of state sovereignty. I believe that the history of indigenous domestic institutions can help formulate a dynamic theory of how informal institutions evolve or in the particularly unique case of India, adapt and show resilience to the advent of major structural shifts (such as the introduction of formal banking), especially when reduced to an illegality.

Secondly, in order to explore the relationship between mechanisms of money laundering and economic liberalisation of the 1990s, I use the qualitative, interpretive approach that consisted of interviewing 42 relevant participants in the economy. In the interpretive approach, I have used loosely structured questions around certain relevant thematic areas that I wanted to touch upon. These questions were unstructured so as to not appear too rigid which allowed for a free and flexible interaction and gave time for rapport building with the participants. Later for analysing the data collected during these interviews, I employ the documentary method devised by Ralf Bohnsack (1983). Within this method, both the explicit and implicit meanings are extracted from the data which is part of the participant's interpretation of their world and the structure surrounding them (Trautrims, 2012). I focus not on getting quantitative-based rankings but on trying to elicit experiential insights from the respondent.

The next section presents the trajectory of my research process and fieldwork progression in India.

1.7 Fieldwork and Research Progression

The trajectory of my fieldwork research did not follow the planned linear path that I had initially contemplated. After a false start, I proceeded smoothly albeit in several stages. My approach had to be multidimensional. I realised that I had to incorporate the sector, the mechanism, the participant and most importantly the agency. For this purpose, I approached eminent politicians, economists, businessmen and major players across relevant sectors in the economy. These included lawyers, chartered accountants, hawala operators, book-entry operators, entrepreneurs and businessmen in SME's (small and medium enterprises) in the formal, as well as informal sector in India. Initially, I used the same approach for all the participants. This approach did not yield many results and I faced many issues such as lack of response, refusal to engage in the research, requests for interview schedule to be seen beforehand, as well as the willingness to be interviewed but citing lack of time due to workload. Therefore, out of the 75 people that I originally approached, 42 were finally interviewed.

While no single interviewee could capture the contours of money laundering mechanisms in India and its evolution —necessitating the use of plural methods—the interviews were useful in revealing diverging sectoral perceptions of the contours of the Indian economy. There was much resistance to very structured interactions which I attempted initially. My final interviews were open-ended, flexible, and 'semi-structured' by virtue of my communicating a loose agenda for discussion at the outset of the meetings. The majority of the interviews were carried out in Delhi and Mumbai, supplemented with some interviews in Guwahati and Bangalore. The informal discussions were off-the-record; I do not quote directly from this material.

Ethical considerations are a critical and necessary part of the interview process. Interviewees gave informed consent, having been clearly informed about the purpose of the research and subsequently inviting me to meet them. Barring a few exceptions, the interviewees were of comparatively elite status in their domain, astute and perspicacious, and palpably understood the research subject matter at hand. Their elite status, compounded by the fact that most of the interviewees could be classified as elderly gentlemen, presented its own challenges. The close study of elites is an 'exercise in political reflexivity' (Holmes, 2003). The interviews were characterised by varied asymmetries of power~~,~~ and quality and depth. Some were forthcoming, since I would have been perceived as a non-threatening entity: young, female, and most importantly, not a member of law enforcement or any other intrusive government agency. They became rather candid and relaxed around me once they were informed of my status as a PhD candidate at a foreign university, rather than an Indian organisation.

I began my fieldwork in New Delhi in July, 2017. I started by interviewing the petitioners, as well as the legal experts and lawyers associated with a special task force i.e. the SIT (Special Investigation Team) on black money in India; that reported directly to the Supreme Court of India. This task force had been working to bring black money (stashed in tax havens abroad), back to India for the last two years. One of the major recommendations of this team in the fight against black money and corruption was to demonetise high-value currency notes. Under an anti-corruption drive against black money in India, on November 8th, 2016, Indian Prime Minister

Narendra Modi, announced the demonetisation of high-value currency notes. This historic move stripped the Rs 500 and Rs 1000 notes of their status as legal tender, effective almost immediately (Negi, 2017). [10] This move caused an unprecedented frenzy among the Indian population, as the most common medium of exchange in the country is cash (Chattoraj). The two forms of currency that were invalidated, accounted for nearly 86 per cent of cash circulation in the economy (Muralidharan, 2016; Rowlatt, 2016). It is thus not surprising that while the legal experts were extremely forthcoming during the interviews, I was unable to secure any meaningful information or even consent for interviews from entrepreneurs operating in prominent sectors (such as real estate) that generate black money, at this stage. Most Indian businessmen, their financial intermediaries and their primary and secondary operators, which included *hawala* operators, accountants and entry operators were still reeling from the shocks of the demonetisation drive and consolidating their businesses, even after almost a year since the sudden move by the government (Rowlatt, 2016). This, compounded by the fact, that I approached them without any prior introduction or through any subsidiary, made matters worse resulting in my inability to secure these interviews in my initial attempt.

At this initial stage, I was closely associated with *South Asia Politics*, a renowned monthly magazine covering various issues of regional importance. The magazine had a programme of conducting regular closed door round table sessions with senior-most policymakers in India, where I was responsible to assist and monitor. It was during these sessions that I was introduced to Dr B.B. Dutta, who was one of the petitioners in Writ Petition (civil)176 in the Supreme Court of India. As a result of this petition, the Supreme Court set up the SIT, which I mentioned earlier. Thanks to these sessions, I met many businessmen and policymakers, who had a wide range of economic exposure in both; the formal as well as informal sectors of the economy. Through this association, my research graduated to interviews with a cross-section of persons. At the outset, I approached economists and policymakers of leading think tanks of the country. They helped me understand the contours of the Indian economy, pointing out that the single biggest reason for black money and its laundering was the continued need for huge amounts of black money for election funding. They further encouraged me to meet chartered accountants (CA), lawyers, academicians, and High Net worth Individuals (HNI) to better understand the intricacies of money laundering in India. As per them, real estate agents/builders, chartered accountants and lawyers, played a key role in the operation and management of money

[10] Demonetisation refers to the legal act of invalidating a currency from its status as being a legal tender (Negi, 2017)

laundering functions in India. The real breakthroughs came when some of the people; impressed or encouraged by my enthusiasm and sincerity, decided to put their weight behind me and introduced me to actual players of the businesses that were generating and absorbing large amounts of black money.

In the next stage of my fieldwork, I was introduced to real estate agents and prominent builders in Mumbai, who together constituted a significant part of the entire spectrum of the building and land development projects of cities in South India, the Middle East and Maharashtra (headquartered mostly in the Navi Mumbai region). These were very eminent individuals with powerful connections. Once these people decided they were going to help me, they were extremely forthcoming. They explained to me how their business was, perhaps besides election funding, the largest player in the field I was studying. They took pride in how despite tremendous odds, they were major contributors to the Indian society. They did not think of their activities as socially harmful and the parts that were illegal were perceived by them as minor deviations made necessary due to government policy. They revealed to me, that although the infrastructure sector is the largest employer in India (informally), it doesn't have the status of an industry. Thus, it is not recognised by banks for giving loans and financial support. Often, land and building are used by them as collateral to raise funds from different sources including banks. Officially, not being a priority sector, it is difficult to get loans from banks at reasonable interest rates. As the entire lifecycle of a building project is fraught with government interference and control; involving a multiplicity of permissions and licenses, large amounts of cash are needed to facilitate the projects by way of 'speed money'. There is a broad spectrum within the buyers also. Some buyers want to pay the minimum amount of money as accountable tax-paid amount. Thus, there is a need for making offerings or providing provisions to buyers, where the builder is willing to take 40-60 per cent of the payment in cash. This also becomes necessary because costs need to be kept down to reduce the annual property tax (which is proportional to the cost of the unit), to meet the demands of speed money, to generate a surplus to invest in a new project (which also involves 40-60 per cent investment in cash). Subsequently, I spoke to chartered accountants and lawyers in Mumbai who seconded and confirmed the information provided by the builders.

The last stage of my fieldwork was extremely challenging. My research strategy was to cover the more prominent centres of *hawala* operations in India. This included New Delhi, Guwahati, Mumbai, Surat, Kolkata, and Ahmedabad. While I was unable to visit the latter three cities in person, I was able to gather useful information from the principal *hawala* operators at their corresponding offices in the former three cities (that I was able to visit). Prior to gaining access to primary players of *hawala*, I interviewed many chartered accountants, financial consultants, and lawyers in Delhi, Mumbai, and Guwahati. These professionals gave me useful information regarding the modus operandi of *hawala*, given that *hawala* was a useful component and integral part of transaction planning and execution for their clients. Persons who were operating in the field of hawala and 'book-entry' building/keeping opened up to me as they felt their role in the economy was highly misunderstood. As per them, their emphasis on reliability, relationship and reach gave them a comparative advantage over modern banking.

Some interviewees were more forthcoming than others. Some interviewees requested our conversations be treated as informal or anonymous. I, therefore, identify speakers only by affiliation in the text, unless they have given me written consent to publish their names. The narrative below uses interview data parsimoniously when it is not substantiated by alternative and more transparent sources. In any case, most such interviews helped in informing my overall analysis, rather than definitively shaping any single aspect of it. Thus, persons forming links in the human chain performing any of the functions of interest to me enabled me to conduct my field work in an environment of trust and credibility; which was essential for me to get into the inside of the workings of the systems, their motivations, compulsions and structural ramifications.

In the next section, I discuss the limitations of this field research in some detail. Additionally, this section will enumerate what this thesis is not trying to cover and what falls outside the purview of the research objectives.

1.8. Limitations of the Case Study

The Indian economic entity is too complex and multifaceted for any single study to capture the entirety of interrelationships. The phenomenon of money laundering presents challenges of complexity. The Indian economy and multiplicities of shades of grey, in which it manifests itself, make it impossible for any study to be exhaustive and comprehensive. Additionally, for reasons of confidentiality and security, the real mechanisms and motivations in the economy are layered with legally and socially acceptable appearances. Hence, this makes it extremely challenging to penetrate the wheel of misinformation to arrive at the right conclusions. This section clarifies the boundaries of the thesis and the limited claims that it puts forth. The following are the possible methodological limitations associated with this field research:

1.8.1. Unconscious Bias

The following analysis owes a great debt to the thoughtful analysis offered so generously by my interviewees. There is a possibility to be considered that one's response during the interview may be affected by certain cultural, gender or any other kind of biases and pre-conceived notions on the subject. The respondent may or may not be aware of their biases. Furthermore, he/she may have been a seasoned political commentator and may be well versed with the art of giving insincere 'proper' responses to formal interviews. I had to patiently listen to their 'proper' answers before they opened up to express their real opinions. They had in-depth knowledge about the unique characteristics of the Indian ecosystem and seemed to be well versed with political debates surrounding the same. The information they provided reflected their perceptions and experiences. I, therefore, attempt wherever possible to triangulate interview data with other interviews as well as with other data sources. I preferred data sources that were available in the public domain.

1.8.2. Nature of Research Topic

A very significant challenge around interviewing people about the subject of black money, money laundering and hawala is the very sensitive and almost taboo nature of the subject. Many interviewees become very guarded when the topic of money laundering or hawala is initiated in the conversation. It was especially difficult to talk about this subject with government officials, as they became very defensive and uncomfortable and mostly refused to give interviews. Initially, the responses of the private practitioners (lawyers, accountants) as well as entrepreneurs ranged from tentative to hesitant and sometimes extremely dismissive of the issue. They opened up after some gentle persuasion and assurance of confidentiality.

The interviewer must create a comfortable and relaxed environment for the interviewee. Furthermore, it is critical to build a somewhat friendly rapport with the participant to put them at ease while answering questions, whose responses may contain sensitive information. There is always a possibility that during such questions, the interviewee becomes distant and stops giving honest answers. Some interviewees may entirely refuse to answer further questions. Thus, it is important that the interview process mirrors a discussion or conversation between two acquaintances rather than a question and answer session between two complete strangers. While asking sensitive questions, the interviewer should proceed with caution and use his/her intuition and observational skills. Observing the body language, tone and tenor of the participant to document implicit clues is critical to such studies (Dempsey et al, 2016). It is equally important to conduct proper data assessment to evaluate the responses in context of the research. Thus, I employ the documentary method as a methodological device in this thesis, which for the reasons discussed above, proves to be most suitable for this study.

1.8.3. Access

To conduct empirical research on mechanisms of money laundering in India, I needed access to key players; had hands-on in-depth knowledge about the grey areas of the economy. This was challenging; particularly in the initial stages of my fieldwork, as key players within any sector in India were almost impossible to access without any prior introduction. While I was finally able to secure interviews with various operators and beneficiaries of hawala, I had to face refusal from nearly all the players I approached without a prior introduction through their clients, consultants or subsidiaries (chartered accountants and lawyers).

Also, I would have ideally preferred to have a higher number of participants from the law enforcement agencies including the Income Tax Department and Central Board of Direct Taxation (CBDT) in India. Despite multiple requests for meetings and multiple emails, I was unable to secure any meaningful information from any official in this regard. I faced the same situation in my attempts to secure meaningful information from bureaucrats in New Delhi. However, I was able to overcome this limitation through my association with South Asia Politics (SAP), as I have mentioned elsewhere and was able to secure some interviews with senior-level bureaucrats in New Delhi. I gathered that their association with the government however large or small makes them more cautious. Besides this, I had been warned about the attitude of bureaucrats in India who are known to be 'naysayers', because they are in the habit of saying "no" to everything.

1.8.4. Time Constraints

The duration of this study happens to be a very active time for the subject of black money and money laundering in India. The civil society in India started an 'anti-black money movement' in 2014 and even the current Modi led BJP Government came to power largely based on its electoral promises of bringing back 'black money' stashed in tax havens offshore. Therefore, it is a burning political issue with the Parliament in India debating this regularly. While this makes the research study significantly more relevant, it also adds constantly changing and increasing dimensions to the study, that can be difficult to keep track of, compounded by the timeline of the study itself. For instance, the Modi government enacted the Black Money and Imposition of Tax Act, 2015 during the course of this study. Another major development during this time was the historical move of demonetisation of high-value currency in November 2016. This move made 86 per cent of existing money in circulation redundant, which was targeted at bringing unaccounted black money into banking channels (Dutta, 2018).

Given the contemporary nature of this research, it was challenging to capture the ramifications and consequences of recent changes in legislation and continuous framing of rules under the same. Also, there were many complexities that were still evolving, but as their impact is not yet apparent, I had to leave these out of purview.

1.9 Objectives

The thesis is guided by the following objectives

1. Defining money laundering. How has money laundering been characterised in various strands of literature?
2. To analyse the operational characteristics of the indigenous remittance mechanisms (*hundi, hawala*) that pre-date colonial rule in India~~,~~ and have survived over the centuries

and managed to remain relevant in the face of modern banking.

3. To provide an empirical analysis of the characteristics of *hawala* mechanisms in contemporary India. This analysis will focus on the mapping of *hawala* operations in India through a hub and spoke structure.
4. To create a typology of mechanisms through which the money laundering operations take place in India.
5. Examine the role of 'neoliberal' policies in facilitating the process of money laundering within this topology.
6. Examine and introduce an atypical feature of the Indian economy wherein 'white money' is often converted back into 'black money' and once it changes hands, yet again back to 'white money'. I have termed this laundering and de-laundering.
7. An in-depth analysis of whether policies of economic liberalisation enabled unethical business practices through laundering and de-laundering in important sectors of the Indian economy, such as real estate.
8. To analyse the affinity of the electoral politics in India to absorb, circulate and invest large amounts of black money periodically.

Section III The Case Study: India and Economic Liberalisation

1.10 Approach

This thesis examines the fundamental institutional changes and continuities in one of the largest and fastest-growing countries of the global south - India. These changes are examined from an institutional-structural lens~~,~~ i.e., of India's economic reforms of 1991,~~-~~which signaled a paradigm shift in Indian economic policy, in order to implement major changes in monetary, fiscal, trade and industrial policies. I use one of the oldest institutions of Indian financial architecture, *informal/alternative* or underground remittance mechanisms and the 'black' economy within which they often operate, as my primary case study to suggest a revised account of India's piecemeal economic reform process.

Two terms mentioned above warrant further explanation. *Firstly*, the informal/alternative or underground remittance mechanisms of *hundi* and *hawala* that are indigenous to the Indian subcontinent (Martin, 2009) [11] and *secondly*; the 'black' economy in India within which, these informal banking structures have evolved. In the aftermath of the 9/11 terrorist attacks, hawala has consistently appeared on the typologies of money laundering list, which is periodically brought out by the Financial Action Task Force (FATF) and the Asia Pacific Group (Wilson, 2002). The most credible studies on indigenous transfer mechanisms have classified the *hawala* and *hundi* systems; either as IVTS (Informal Value Transfer System) (Passas, 2005), HOSSPs (Hawala and Other Similar Service Providers) (FATF, 2013) or IFT (Informal Funds Transfer system) (Qorchi *et al.*, 2003; Martin, 2009). Additionally, some scholars have held *hundi* and *hawala* as underground, parallel or hidden banking mechanisms (Trehan, 2003; Daudi, 2005; Mahmud, 2012; Lambert, 2016).

Secondly, the term 'parallel economy' indicates the presence of an unsanctioned sector whose motives are inimical to the goals of the legitimate sanctioned economy (Sarkar, 2012). This parallel economy has collected countless labels and has been referred to as 'unaccounted economy', 'illegal economy', 'subterranean economy', 'unsanctioned economy' and is most popularly known as 'black economy' in India. As per Prof. J.C. Sandesara, "in popular parlance, the unofficial economy goes by the name of black money and the official, as white money. Black and white are also variously substituted by number two and number one, unaccounted and accounted, unreported and reported, unrecorded and recorded and so on." (Sarkar, 2012, p.124) For the purpose of this thesis, I employ the terms 'black' to denote the parallel or unaccounted economy and 'white' to denote the legitimate economy throughout this study in order to further my arguments in the context of my case study i.e. India.

1.11 Background

The economic liberalisation of 1991; coupled with structural adjustment of the economy, the Indian state moved away from a state-led welfare-oriented planned economic system, to a more market-driven capitalistic system. This structural shift characterised a drastic dismissal of the

[11] See chapter IV for definition, evolution, and operational characteristics of *hundi* and *hawala* mechanisms in India

Nehru-Mahalanobis[12] strategy of leading India on the paradigm of a closed economy with the public sector at the forefront (Aiyar, 2016). The policymakers at the helm of the economic reforms of 1991 presented the neoliberal capitalist growth model as the panacea of all the problems and challenges facing the Indian economy. Thus, the reforms were promoted as the solution to the alarming fiscal imbalances that had grown over the 1980s.

The reforms were expected to result in higher efficiency and competitiveness in the Indian market, increase in productivity of the manufacturing sector and generation of additional employment, eventually leading to a reduction in poverty and pauperism in weaker sections of the Indian economy (Green, 2009).

When the then Finance Minister, Manmohan Singh presented the Budget in February 1992, he felt it was imperative to say, "Our nation will remain eternally grateful to Jawaharlal Nehru for his vision…". He concluded the speech with "Tonight I feel like I am going to the theatre. Let the assassins be informed, I am prepared for the onslaught". [13] After nearly three decades, when one analyses these words in retrospect, the glaring political risks underpinning this major structural shift in policy become obvious. The then Prime Minister Narasimha Rao was not just abolishing the 'license permit' system but a quasi-feudal oligarchy that had entrenched every aspect of civil and political life in India (Sayal, 2016).

Soon after this declaration, India opened its market to foreign capital and invited multi-national companies, reduced its import tariffs, and actively sought foreign investment in various sectors. According to several scholars (Acharya, 2014), these measures pushed the Indian economy forward to overcome the so-called 'Hindu Rate of Growth'[14] (2-3.5 per cent annual growth rate) and demolished the stiff regulations of allocating industrial and commercial permits

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[12] "At the time of the formulation of the Second Five Year Plan, Prof.P.C. Mahalanobis who was friend and adviser to Late Prime Minister Jawaharlal Nehru and who was a one-time member of the Planning Commission, prepared a growth model with which he showed that to achieve a rapid long- term rate of growth it would be essential to devote a major part of the investment outlay to building of basic heavy industries. The Mahalanobis strategy of development emphasizing basic heavy industries which was adopted, first of all, in the Second Plan also continued to hold the stage in Indian planning right up to the Fifth Plan which was terminated by the Janata Government in March 1978, a year before its full term of five yea*rs"*. Source http://www.yourarticlelibrary.com/economics/mahalanobis-growth-model-and-heavy-industry-strategy-of-development/38376

[13] Finance Minister Speech. Budget 1992-1993. Manmohan Singh [Minister of Finance]. 29th February, 1992.

[14] In 1978, Prof. Rajkrishna, a noted Indian Economist coined the term 'Hindu' rate of growth to denote the low growth rate that had characterised the Indian economy for more than 3 decades, i.e. for the period spanning 1950-1980 (Rowlatt, 2016).

or the *License Permit Quota Raj* (Klein, 2000). Thus, the industrial policies based on self-reliance slowly gave way to export-oriented policies. In the immediate aftermath of the reforms, the Indian economy grew at 5-6 per cent per annum, and in the first ten years of the reforms, India's GDP grew at a rate of 8-9 per cent (Panagariya, 2004a). Witnessing this high and somewhat unprecedented growth rate, some scholars touted India as the next economic super-power (Klein, 2000). Such forecasting was completely different from realities on the ground as the policymakers and politicians were only interested in the rate of economic growth rather than achieving financial inclusion for the impoverished masses.

The Alternative Economic Survey (AES), India: 2012-13 is a very good reference point to understanding the outcome of economic liberalisation in India. The major questions that the survey tackles are: *Who have been the main beneficiaries of the post-reform high growth rate and economic prosperity in India*? *How have these reforms affected the poor and backward sections of the Indian society*? Taking an inclusive view, based on tenets of equal opportunity, distributive justice and rights, the AES (2012-13) compiled a collection of 24 articles, which provides a fundamental critique of the Indian liberalisation growth story (Sahoo, 2014). In this process, the survey analyses the institutions of change brought about by the economic reforms. The survey concludes that while economic growth has served the interests of big capital, it has failed to trickle down to the common man who has no guaranteed welfare rights. Thus, it has failed to fulfil the promises of making growth equitable and distributive in India (Sahoo, 2014).

The economic reforms of 1991 granted widespread concessions to the private sector, discouraging public sector monopoly in Indian markets. The formation of the World Trade Organisation (WTO) in 1995, led to the further opening of the economy to foreign trade and capital (Darkov *et al.*, 2020). These reforms allowed the private sector to freely produce luxury and formerly restricted goods Also, the option to import the products that could not be manufactured locally, was available due to the relaxation of rules pertaining to imports from foreign markets. On one hand, the demand for imported goods such as luxury cars, radio sets, televisions and telephones could now be met legally. For this reason, the black markets of smuggled imported goods, that had evolved for the fulfilment of these demands almost disappeared. On the other hand, with the dismantling of the *license permit raj*, the stranglehold of the Indian government on the business sector diminished. With the retreat of the public sector, many prominent businesses adopted corrupt practices on a wider scale. Furthermore, individuals, as well as businesses could exercise their ability to legally siphon off their illicit income abroad, through tax havens. This ability was enhanced due to the relaxation of exchange controls. (Kumar, 2017) . Take the case of gold inflow in India. Till 1992, the import and export of gold was banned under the Foreign Exchange Regulation Act (FERA), 1947, due to which the smuggling of gold was widely prevalent. From 1968 through 1995, about 10-217 tons of gold were smuggled into the country per year.[15] This figure escalated to 900 tones by 1998. Thus, the legal imports increased but so did the illegal inflow (Gupta, 1980). Many instances of seizures of illegal imports of gold, by agencies such as the Directorate of Revenue Intelligence (DRI) in India, have been extensively chronicled in media reports (Moneylife, 2013). This could be attributed to the profit that could be made on smuggled gold as it was a beneficiary of *hawala* transactions (Kuttapan, 2020) and the smuggling of goods that was prevalent. Due to this, the loss of savings to the country increased many times.[16] Moreover, since the demand for gold cannot be met domestically, it must be imported. The higher incidence of import of gold, the larger would be the resultant loss of productive capital to the economy. Further, owing to its connection with other forms of illegality, its flows lead to the generation of more black money.

Since economic liberalisation, a nexus of corrupt politicians, businessmen and bureaucrats- *the triad* that had been active since before, has evolved to a state of being institutionalised into the structure of the Indian economy across its three formal, informal, and black segments. The establishment of public-private partnerships (PPP), provided new routes for the generation and absorption of black incomes by monopolising national resources like land, forests, and mines and furthering the cycle of "rent-seeking" (Khan, 2000) behaviour. For instance, the rise of the private sector, since 1991 in the education and health sectors has generated massive opportunities to partake in corrupt and illegal practices (Quah, 2008). Furthermore, the amplitude and severity of scams, as well as the number of stakeholders involved per scam, has been significantly rising through the decades since then (The Economic Times, 2003).

Although the pre-reform era of controls and regulations created "rent-seeking" (Khan, 2000) opportunities that were exploited by *the triad* of politicians, businessman and bureaucrats, the era of deregulation saw an increase in illegality and crime due to systematic violation of rules and laws. Consequently, it can be observed, that corruption and black money has grown over time,

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[15] The exception was the year 1980 when 9 metric tons were reported to have been smuggled out of the country to take advantage of the soaring gold prices in the international market.

[16] Gold is an unproductive investment since it does not lead to further production as happens when one sets up a plant or a business.

as is evident through the rapid unearthing of more and bigger scams such as the 2G Spectrum Scam, Food Grain Scam, Commonwealth Games Scam or the *Wakf* Board Land Scam (Joel). Research suggests that systemic and systematic illegality and corruption in the country can be traced to big businesses that developed during the pre-reform period (Datta, 2011) (particularly in real estate) and the triad it helped create so that it could manipulate policy. The thrust of my effort in this study is to illustrate and analyse the topology of the Indian economy and its relationship to the mechanisms of money laundering that have emerged since independence and have become more sophisticated with the use of technology and involvement of professionals, since liberalisation.

As per many political observers and economists, the black economy has continued to grow in India (Kumar, 2017). However, what remains to be analysed, is whether this increase is a consequence of a rise in overall wealth in the economy, or indicative of a macroeconomic policy failure which has led to unintended consequences in the form of growth of money laundering mechanisms, leading to a reduction in productivity in the real economy.

1.12 Analysis

I argue that the Indian economic entity and its impact on policy-making in India have been constrained by deeply embedded informal institutions, through a process of institutional layering, some of which was unintended. The result of this piecemeal process is, surprisingly, a functional formal- informal hybrid layered financial system that constitutes both, regulated and unregulated aspects in all economic sectors. While the formal economy is clearly the child of the state, the informal economy too depends heavily on the state for its survival, persistence, and existence. Besides taking advantage of the infrastructure of communication, security and transportation provided by the state, the informal economy in India structures its existence on pre-existing primaeval loyalties and trust.

So, what went wrong with the implementation of the economic reforms of 1991? To what extent did these reforms generate illicit financial flows; and unintendedly facilitate mechanisms of money laundering? Interviews with financial experts and lawyers revealed that the growth of the formal economy post liberalisation followed the requirement for large-scale funding for new projects allowed by economic liberalisation. This resulted in the large-scale requirement of unaccounted funds or black money due to the structural flaws in the Indian economy.

Those who had accounted money as the only stream of income required black money for convenience expenses; as well as getting sanctions and permission from various government departments. These entities turned to their consultants and chartered accountants to meet this requirement of black money. A network of chartered accountants and financial operators in the grey areas of the economy was born and has since transformed into an effective infrastructural instrument for constant conversion of money from black to white and white to black. I have termed the latter mechanism as 'de-laundering' which is a unique finding of this study.

The mechanism was explained to me by several leading chartered accountants, during my fieldwork in India and is one of the main findings of this thesis. Another source of funds, which was deployed was monies, which had been kept abroad due to high taxation (as high as 97.75 per cent. in the year 1973–74) during the *license permit raj* in India, prior to liberalisation. [17] Along with the liberalisation of industrial policies, the import-export tax regime was also relaxed. Technological advances (Sukhtankar and Vaishnav, 2015), opening of the economy, the entry of international banking and the growth of the service sector (Noland, Park and Estrada, 2012), inadvertently gave rise to innovative mechanisms to bring such money to India for funding the projects. Exploring this causality is the central theme of this thesis.

I argue that a complex ecosystem has emerged, which, both generates black money and has developed sophisticated mechanisms for absorbing it only to apply it towards funding the formal economy simultaneously and later generating black money for the formal economy by de-laundering it. A comprehensive study of this involves examining discontinuity within a complex set of interlocking and interacting institutions, i.e. the Indian financial structure, the traditional institutions of credit and finance, the systems of production and the rules of coordination within these institutions. However, I chose to limit my investigation to the evolution of the domestic institutions during the pre and post-reform era of 1991. It believe that understanding changes in these domestic traditional structures of finance and credit was central to understanding changes

[17] India had 11 income tax slabs with rates of 10 to 85 per cent. The top marginal rate was an effective 97 per cent (National Institute of Financial Management, 2012)

in formal banking structures, whatever the direction of causation. Thus, a different analysis of the evolution of mechanisms of money laundering is required; one that transcends the simple state vs. market, public vs. private division. My thesis, therefore, seeks to do this and challenges this debate.

1.13 Structure of the Thesis

My thesis is structured in the following way:

In this chapter, I define the coordinates within which my research for the thesis takes place. Furthermore, I define the objectives of my study along with my unique contribution to the existing literature. Furthermore, I develop the hypothesis (H1, H2, H3) on which I test different developments related to money as they evolved post liberalisation. Additionally, I provide an overview of the limitations and unique opportunities that I experienced to develop an understanding regarding the focus of my study.

In chapter II, I carry out a comprehensive literature review. The issue of money laundering is complicated, whether it is analysed from the policy perspective or an economic viewpoint. In literature, many authors have tried to capture the process of money laundering. Since the literature on money laundering draws from various strands of social sciences, it would benefit us to look at money laundering literature from an evolutionary perspective. I find that the traditional literature on money laundering draws primarily from criminology and international trade theories. This forms the bedrock of the 'estimative' strand of literature on money laundering, which we will discuss in Chapter II in detail.

The entire body of literature on money laundering falls under three lines of research: (i) Conceptual – concerns the definition of money laundering as a phenomenon, the stages of money laundering operations, typologies, and instruments of the laundering of illegally obtained funds. (ii)Estimative – This line of research is aimed at measuring/quantifying the size of the underground economy in India and money laundering operations in India. (iii)Preventive – This line of literature mainly aims at emphasizing the need to prevent and fight against the ramifications of money laundering activities.

Chapter III provides a conceptual understanding of the formal, informal and black economy in India. The mechanisms of money laundering in India need to be analysed in the context of the three types of overlapping economies: namely, the formal, the informal and the black economy. These together, with their interplay, constitute the Indian financial ecosystem; within which money laundering and its supporting mechanisms have evolved and persist. I argue that is imperative to incorporate the interplay of these three segments into the macro analysis of the typologies or mechanisms of money laundering; within which they operate. The need to incorporate the analysis of the informal economy is not just an empirical matter, but a theoretical necessity as both the circular flow of money that is laundered, as well as its velocity changes as it moves between the formal, informal and black economy in India

Chapter IV expands upon contemporary understandings of indigenous money laundering mechanisms in India, with a specific focus on mechanisms of *hundi* and *hawala in* South Asia, in order to present a more comprehensive understanding of the genesis and growth of money laundering mechanisms in India, within the sphere of the evolving architecture of Indian financial sector. Thus, there are three aspects to carry out this analysis- conceptual, chronological and an empirical on-ground research of hawala operations in India. First, I expand upon the conceptual understanding of indigenous banking and its contemporary relevance in India.

Secondly, to understand the basic thrust of the growth of social, financial and legal structures that are used today to support the black economy and carry out money laundering, one may chronologically divide the Indian story of the growth of institutions, supporting business and evolution of taxation. I examine the changing business practices under changing systems of governance and taxation in India, particularly during periods of economic or political uncertainty. These have shaped the contours of business activity in India today; rising from the shadows of time and crystallizing into modern-day institutions and practices that form the bulwark of money laundering mechanisms. This is important since mechanisms of money laundering existed much before the advent of liberalisation or even independence and colonial rule.

Thirdly, to provide an empirical analysis of the operational characteristics of *hawala* in its contemporary avatar which I have termed as *hawala* 2.0. This analysis will focus on the mapping of hawala operations in India and the key players and beneficiaries of hawala in India, which is based upon the data I collected during my fieldwork in India. I believe this part is the most important part of this chapter, as it provides original on-ground research from centres of hawala activity in India through its actual key players, which is a unique contribution of this study.

Chapter V incorporates many major findings of my thesis. This chapter provides India-specific typologies of money laundering and analyses each mechanism on the matrix of my hypothesis (H1, H2 and H3). Thus, this chapter examines the mechanisms of money laundering and their relationship to the processes of economic liberalisation. Specifically, it analyses whether the processes of liberalisation were causal to the emergence of money laundering practices or whether the relationship between liberalisation and money laundering is more complex. Furthermore, black money is a significant problem for the Indian economy, which transcends its domestic borders and has now become a global predicament. It has been highlighted as a key obstacle in the growth and development of a largely rural and underdeveloped nation and has been a central theme throughout this thesis. Taking a historical view of the growth of the black economy in India, I take the view that the origins of black money and subsequent money laundering cannot be traced to any single structural break or policy shift in the Indian economy such as economic liberalisation in 1991. This chapter suggests that it was neither the pre-liberalisation years nor the 'license-permit raj' of yesteryears, nor its dismantling post-economic liberalisation-1991 that is the root cause of the growth of black money in the country. [18] Nor were other single factors such as high tax rates or high rates of inflation and speculation. Research suggests that a common feature to both periods (1947-1991) and (1991-2017) has been the nexus of politicians-businessmen-bureaucrats ('the triad') that has only become more powerful over time with structural shifts in the Indian economy. The need for huge amounts of black money to maintain political parties and run for elections has remained a constant structural feature with its rapidly increasing appetite since liberalisation. Thus, the phenomena of black money must be analysed in the context of the evolution of the Indian economy. It is a phenomenon closely related to the needs of the parallel or informal/unreported component of the Indian economy, compounded by needs of election funding and squirrelling away of funds to foreign jurisdictions due to needs of doing business under a highly structured, regulated planned economy.

Chapter VI analyses how the demand for black money and its colouration and de-colouration is met through established mechanisms, which are institutions but are not part of the formal

[18] The License Raj or Permit Raj (raj, meaning "rule" in Hindi) was the elaborate system of licenses, regulations and accompanying red tape that were required to set up and run businesses in India between 1947 and 1990. There is a great deal of literature that documents the License Raj and the subsequent reforms in detail. Some of these references include Montek S. Ahluwalia (1999), Ahluwalia (2002), Basu (2004), Organisation for Economic Co-operation and Development (2007), Vijay Joshi and I. M. D. Little (1996), Panagariya (2008), Kirit S. Parikh (2006), and Virmani (2007).

economy. For this purpose, I analyse five sectoral case studies in terms of their lifecycle. These case studies are representative of that sector and have been developed by way of examples after interviewing respective sectoral experts. Also, I describe how institutions in India have evolved to meet the necessities peculiar to the realities of financial by-lanes that need to be traversed to complete economic transactions. This chapter examines the demand or necessity for unaccounted or black income in the Indian entrepreneurial process after economic liberalisation through an institutional lens. This task is accomplished by analysing the determinants of enterprise growth and performance in India through an analysis of five sectorial case studies. In previous chapters, I have explained the evolutionary aspect of the informal economy that provided the historical antecedent to contemporary money laundering, as it exists in India today.

Chapter VII explores a major conduit of money laundering in India, i.e. election finance, by characterising the demand, deployment and circulation of black money in financing electoral campaigns in India. Money is needed regularly for managing and running political parties and for funding specific elections. This incessant need for funding is the foremost cause as identified in this study, for the continued resilience of indigenous as well as contemporary money laundering mechanisms. In order to analyse this lack of political will, as well as establish the causal relationship between election finance and money laundering mechanisms, I examine the role of money in election finance in India. Additionally, I examine the sources of electoral finance as well as players that facilitate the generation and absorption as well as the further investment of these funds.

In chapter VIII, I provide a summary of my findings. Further, I discuss some concluding observations of this study.

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Chapter 2

An Introduction to Money Laundering: Concepts and Theories in Literature

Chapter II

An Introduction to Money Laundering: Concepts and Theories in Literature

"There has been no worthwhile investigation or analysis (at least from within the country) of money laundering, which is focused on India. This absence is all the more glaring not only because India has a long history of hawala transactions, "double book-keeping", misreporting of exports and imports and of remittances from the diaspora, all facilitating capital flight, but because India has opened up its economy over the past one-and-a-half decades to an unprecedented extent. This has vastly expanded the scope for spiriting funds out of the country".

~ Bidwai (2016)

2.0 Introduction

The illicit aspect of the international economy is largely overlooked in the international political economy (IPE) literature (Andreas, 2004). IPE is traditionally defined as the relationship between states and international markets. Similarly, Illicit International Political Economy (IIPE) can be defined as the relationship between states and illegal international markets. The state defines the boundaries of illegal market activities through its monopoly on the power to criminalise certain economic sectors (Keesoony, 2016; Teichmann, 2019). For the purpose of this thesis, we are primarily concerned with the phenomenon of 'money laundering', which lies within the boundary of these illegal activities. In simple terms, money laundering is any activity that aims to convert the proceeds of crime into legitimate money. It is no wonder that scholars of political economy have largely ignored the study of money laundering, just as they have ignored the study of IIPE, largely relinquishing this research strand to criminologists, trade theorists, criminal justice specialists, economists, and investigative journalists. Despite extensive research on the subject of money laundering as a part of these domains individually, money laundering has fallen through the cracks of these social sciences disciplines (Andreas, 2004).

There is a catena of theories around the origin and evolution of money laundering and almost every aspect of this phenomenon has been extensively researched; particularly by governments and international organisations/NGOs from the standpoint of setting up a robust Anti- Money Laundering (AML) regime. These studies, which cover broadly the entire body of literature on money laundering fall under three lines of research: (i) Conceptual – which concerns the definition of money laundering as a phenomenon, the stages of money laundering operations, typologies, and instruments of the laundering of illegally obtained funds. (ii)Estimative – this line of research is aimed at measuring/quantifying the size of the underground economy in India and money laundering operations in India. (iii)Preventive – this line of literature mainly aims at emphasizing the need to prevent and fight against the ramifications of money laundering activities.

The purpose of this chapter is *firstly*, to define the concept of money laundering and explain the debate surrounding the same from the perspective of the present thesis; *secondly* to chronologically trace the evolution and retrace what is known of the concept of money laundering, its stages and current theories; *thirdly,* while doing so critically examine the first and the second from the perspective of its value to the present thesis and critically examine the theories surrounding money laundering. And *fourth* and last, is that after an appraisal and examination of the above-mentioned, delineate the gaps in the same and thus explain how the present thesis bridges that gap in the current literature.

2.1. Genesis of the term 'Money Laundering'

Money laundering is not a modern phenomenon (Passas, 2006; Tiwari, Gepp and Kumar, 2020). According to Uribe (2003), money-laundering practices date back to at least the middle ages when moneylenders invented various mechanisms to cover up their evasion of laws which criminalised usury i.e., lending at exorbitant rates of interest. Uribe (2003), goes on to trace the phenomenon of money laundering back to the concealment of loot by the pirates of the Mediterranean who deprived the Roman empire of its resources but were defeated by Pompeii in 67 BC. He further describes the pirates who targeted European commercial vessels during the 16th-18th centuries as "pioneers in the practice of laundering gold" (Uribe, 2003, p. 131). The historian Sterling Seagrave, author of 'Lords of the Rim', describes how, over 2000 years ago, Chinese merchants used various means, including purchasing movable assets and sending money abroad, to protect their wealth from the government (Morris-Cotterill, 2001).

However, what comes closest to laundering in the absolute sense of the term, in the decades before the official recognition of the phenomenon, was the attempt of Hitler's intelligence forces, not only to hide their loot; but also, to protect it, as if it had been legitimately obtained. During the Second World War, Hitler's officers plundered gold from Jewish families to finance their need for much needed war supplies (Chesnoff, 2011). However, the plundered gold was easily identifiable and could not be used till its source was concealed. For this reason, *Reichenbach* officers decided to re-melt the gold. This gold was then shipped to neutral countries such as Switzerland with fake receipts that showed it had been legally obtained, to be absorbed in the market as collateral for credits (Chesnoff, 2011).

While money laundering is as old as money itself, so are the predicate offences associated with it, specifically the phenomenon of tax evasion. While no clear link has yet been established between tax evasion and money laundering, the perception of tax evasion being associated with money laundering has existed for a substantial period of time (Joshi, Vyas and Joshi, 2012; Storm, 2013). Due to this, the origins of money laundering can be traced back to the historical origins of tax evasion (Storm, 2013). Tax evasion techniques, involving the use of tax havens and offshore bank accounts, began to develop many years ago. Secret banking in Switzerland, for instance, dates back to at least the time of the French Revolution and by the end of the 19th century, Switzerland had begun to offer numbered accounts. In 1932, a political scandal in France exposed an incident of large-scale of tax evasion and the use of Swiss banking for its secrecy by the elite in France. This incident was famously coined the 'Paris affair' or the 'Basler Handelsbank affair', after the name of the Swiss bank involved in the scandal (Guex, 2007). The French police discovered a list with about 2000 names of French citizens, including politicians, judges, bishops, generals and wealthy industrialists, who were hiding their money in Swiss Banks (Vogler, 2006).

The origins of the contemporary mechanisms of money laundering can be traced to the 'Prohibition Era' of the 1920s in the USA when organised crime evolved into big business (Woodiwiss and Hobbs, 2009). Saltmarsh (1990) notes that the term 'money laundering' seems to have its linguistic origins in the ownership and use of launderettes by gangsters like Al Capone and Bugsy Moran in Chicago to clean their 'dirty money'. The gangsters could legitimise their ill-gotten wealth as profits from legally owned launderettes and hence the term 'laundering' was said to have been coined. The notorious gangster, Al Capone, is said to have set the stage for contemporary mechanisms of money laundering (Unger, 2009). He reportedly never opened a bank account or acquired property assets in his own name, used fake names, paid only in cash and tried not to sign anything (Levi and Reuter, 2006). He was indicted with evading taxes of over $250,000 on unreported income for the period from 1924 to 1929 (Crumbley and Apostolou, 2007). The indictment of Capone served as a bitter lesson to his successors, who wished to avoid his fate and tried to develop more innovative ways to launder their illicit wealth. One among these was Lansky who is commonly believed to be the "patron saint of money launderers" (Blunden, 2001, p. 58), who took "capital flight to the next level (. . . and) laid the groundwork" for money laundering (Robinson, 2003, p. 24), including organised money laundering. Thus, the events involving Al Capone and criminals in the prohibition era prepared the stage for the emergence of legendary tax evaders and pioneers in money laundering such as Lansky and Sindona (Blunden, 2001; Suendorf and Stübert, 2001) However, it was not until the 1970s, at the time of the Watergate scandal, that money laundering was recognised as a phenomenon (Gelemerova, 2011).

The first public use of the expression 'money laundering' can be traced back to 1972-73, when it surfaced in print media during the Watergate scandal, which was a turning point in the history of money laundering. It exposed corruption in the highest political circles and implicated the Central Intelligence Agency (CIA) in highly questionable dealings (Gelemerova, 2011). In the 1980s, the illicit drug trade was at its peak and came under heavy scrutiny of law enforcement agencies in the United States of America. Owing to the growing demand to curb illicit drug trade and as a part of the Anti-Drug Abuse Act,[19] the Money Laundering Control Act (MLCA) came into force in 1986 (Public Law 99-570), which made money laundering a federal crime for the first time in the US. The US administration began to prepare the international community, through the United Nations, to adopt a more severe attitude to drugs and related money laundering. The resolution of the seventh United Nations Congress on the Prevention of Crime and the Treatment of Offenders in 1985 introduced the fight against drug trafficking and drug abuse as 'imperative'. Also, a section on money laundering was introduced, containing the basic outlines of the later anti-money laundering regime (UNODC, 2017). In 1998, the IMF estimated that the aggregate size of money laundering in the world could be somewhere between 2-5 per cent of the World G.D.P. If I were to use 1998 global statistics, this percentage would roughly

[19] The Money Laundering Control Act of 1986 was enacted as Title I of the Anti-Drug Abuse Act.

range between USD 590 billion and USD 1.5 trillion. This value (lower value) is equivalent to the total output of a nation the size of Spain. Thus, by the late 1990s, governments world over, began to realise the possible economic and political ramifications of money laundering, if left unchecked.

However, it was only after the 9/11 terrorist attacks in the US that the international community woke up to the imminent risks posed by mechanisms of money laundering and terrorist financing as a major security threat and resolved to make the fight against these threats a priority under an Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime (Clunan, 2006). International organisations such as the IMF, became active in the AML/CFT controls arena, encouraging countries to enact legislation under an effective AML/CFT regime in order to mitigate the risks associated with money laundering and promote integrity and stability in financial markets (Clunan, 2006).

2.2 Conceptual Literature on Money Laundering

In this section, I review the developments that have placed money laundering on the international political agenda. I trace the evolution of the term money laundering; and when and why did policymakers and legislators start paying attention to the phenomenon of money laundering.

2.2.1 Definition

According to Genzman (1997), money laundering can be defined as "... to knowingly engage in a financial transaction with the proceeds of some unlawful activity with the intent of promoting or carrying on that unlawful activity or to conceal or disguise the nature, location, source, ownership, or control of these proceeds" (Genzman, 1997, p.342). According to the World Bank (2003), money laundering is the process by which any type of illegal proceeds are disguised to conceal their illicit origins (Schneider, 2010). The phenomenon of money laundering thus appears difficult to assess, as it depends on other crimes or illicit activities. It is a consequential crime that only exists in the context of another, predicate crime (Watkins *et al.*, 2003). However, the phenomenon in its strictest sense is not difficult to understand and define. It is the range of its broader definitions that complicates its understanding and makes it difficult to research the 'phenomenon' of money laundering. To address the 'phenomenon' of money laundering and measure it, I first need to have a working empirical definition as a basis.

Researchers at the Utrecht School of Economics have identified 18 existing definitions of money laundering. The majority of existing definitions, however, do not necessarily reflect the essence of the laundering phenomenon (Ferwerda *et al.*, 2013). As per Mathers (2004), when money is generated through criminal activities, it is useless till its origins can be untraceable (Uribe, 2003). Thus, money laundering is the process that obfuscates the proceeds of the crime from its source. According to Robinson (1998), "money laundering is called what it is because that perfectly describes what takes place - illegal or dirty money is put through a cycle of transactions or washed so that it comes out the other end as legal or clean money. In other words, the source of illegally obtained funds is obscured through a succession of transfers and deals so that those same funds can eventually be made to reappear as legitimate income" (Robinson, 1998, p. 3).

During the 1980s, money laundering was associated with illicit drug proceeds and its ancillary crimes. However, this perception changed in the 1990s; as policymakers broadened the scope and definition of money laundering, by recognizing that the origin of laundered funds could be a range of predicate crimes, and not just proceeds of drug trade (Levi and Reuter, 2006). Similarly, for the purpose of this thesis, the relevant money laundering definition lies around the concept of 'predicate' offences. In common parlance 'predicate' refers to a crime that is a component of a more serious criminal offence (Chaikin and Sharman, 2007; Chohan, 2019). For example, producing unlawful funds is the main offence and money laundering is the predicate offence. A better instance from the perspective of this thesis would be the case of tax evasion. Tax evasion is not included in the legal definition of money laundering in many countries like Australia where tax evasion is not a crime (Masciandaro, Takáts and Unger, 2007). Similarly, the Germans do not consider tax evasion from individuals, but only from business and criminal organisations, as a predicate crime for laundering. The Dutch do not consider tax evasion as an offence, but only as a misdemeanour and it is only when connected to serious fraud that an offence related to money laundering is acknowledged . As per the European Union, fraud is a predicate crime for money laundering, while tax evasion is not. Thus, there is a lack of conceptual clarity about what is illegal or criminal. This confusion exists within and between individual persons, organisations, and even countries (Masciandaro, Takáts and Unger, 2007).

As per Section 3 of the Prevention of Money Laundering Act 2002 (PMLA), money laundering is defined as "direct or indirect attempt to indulge in, knowingly assist or knowingly become a party to, or having actual involvement in, the process or activity connected with the proceeds of crime (including its concealment, possession, acquisition or use) and projecting or claiming such property as untainted property" (Dalmia, 2013). The PMLA defines 'proceeds of crime' to mean any property (or the value of any property) derived or obtained, directly or indirectly, by any person as a result of any offence under the Indian penal statutes set out in the Schedule to the PML Act (scheduled offences); or where such property is taken or held outside the country, the property equivalent in value held within the country or abroad (Sharma, 2020). The Finance Act 2018 (Part XIV) amended the definition of 'proceeds of crime' such that the right of attachment also extends to property (equivalent to the proceeds of crime) held outside India (Viritha, Mariappan and Haq, 2015). During the course of my fieldwork, I started most of my interviews with the opening question, '*What do you understand by the term money laundering*?'. Barring few exceptions, almost all the interviewees responded with the answer, "*Money laundering is the conversion of black money to white money*". Thus, in the Indian perception, across the political, business as well as academic spectrum, the concept of money laundering is inextricably linked to the concept of black money as opposed to the tax-paid white money or tax-exempt money of the informal economy. Due to this, I have made considerable effort in examining the concept of black money and its relationship to mechanisms of money laundering. The Financial Action Task Force (FATF) on money laundering (2011) defines money laundering as "the processes where criminal proceeds are disguised from their illegal origin with the purpose of legitimizing the illegal proceeds" (FATF, 2011). This definition allows me the flexibility of specifying what is considered criminal or a predicate offence, and/or illegal activity, as well as mechanisms of legitimising illegal proceeds. Thus, for the purpose of this thesis, I adhere to this definition by the Financial Action Task Force (FATF).

2.2.2 Stages of Money Laundering

Money Laundering is not a singular act, but rather a process that is accomplished in three identifiable stages. These stages traditionally called *Placement, Layering* and *Integration* can be taking place at the same time; in the course of a single transaction, or they can appear in separate forms at different points of time (Watkins *et al.*, 2003). The section below outlines all three of these stages in detail.

1. Placement (including Smurfing)

In the placement stage, criminals holding large amounts of cash place the same in the financial system using some pretext or the other. At this stage, the risk of being caught is large. Typically, launderers break the huge volumes of cash in small deposits to different financial institutions in order to make them less conspicuous, an operation called smurfing. Often small deposits are used to buy financial instruments where some legitimate funds are mixed to hide them from departments of compliance and tax authorities (Unger and Linde, 2013). Very often the launderers use the practice of 'smurfing' to defeat the reporting threshold limits and avoid suspicion. In banking jargon, the act of structuring deposits into small amounts carefully calculated to avoid detection is known as smurfing. The term smurfing was coined by a Miami-based lawyer Gregory Baldwin who was inspired by the popular comic book series, the Smurfs. According to the APG (2020), structuring can be defined as "a method involving numerous transactions (deposits, withdrawals, transfers), often various people, high volumes of small transactions and sometimes numerous accounts to avoid detection threshold reporting obligations".

2. Layering

Layering helps hide the origin of money behind several layers of legitimate transaction preferably across jurisdictions to obfuscate the money trail. The purpose of layering is to distance the illegal monies from the source of the crime by creating a complex web of transactions and entities aimed at obliterating any trail. Layers are created by moving money in and out and integration of offshore bank accounts of shell companies through electronic fund transfers (Watkins *et al.*, 2003; Cassella, 2018).

3. Integration

This is the final stage where the money is integrated into the legitimate economic and financial system and is mixed with other assets. The objective at this stage is to reunite the money with the launderer in such a manner that it does not arouse suspicion. Once this happens, it becomes very difficult to distinguish between legal and illegal wealth (Watkins *et al.*, 2003).

The variation in the Indian system of these three stages depends on three factors. Firstly, the source of money that needs to be laundered. The source could be proceeds of crime, illegally obtained money or simply money on which taxes have not been paid. In the classic example, the generation of black money is through proceeds of crime such as drug peddling and smuggling. Traditionally in India, black money is generated through illegal activities such as over-invoicing/, under-invoicing in trade, kickbacks from contracts, illegal mining particularly of coal sand and iron ore. Secondly, variation in these three stages of money laundering will depend on the sector of the Indian economy where the money needs to be deployed. For instance, Indian industrialists and businessmen regularly indulge in over and under invoicing to create personal financial security, in a system that taxes heavily and gives loans at prohibitive interest rates.

Thirdly, any variation in the three stages of money laundering will be dependent on the final intended utilisation of that money. My research has revealed a very substantive amount of this money needs to be utilised for party funding and election financing; in which case, the final step of integration is replaced by an Indian practice called 'Parking'. I develop this concept in chapter V. Alternatively, the final objective may be to set up a project in India by procuring technology and equipment from abroad. In that case, all three layers i.e., placement, layering integration as well as round-tripping would be involved. Alternatively, if the end objective was to invest black money ultimately in the financial markets, then all three stages of money laundering will be deployed, along with the usage of participatory or P-notes (see chapter V).

2.3 Estimative Literature on Money Laundering

In the following section, I review the existing literature on money laundering from an interdisciplinary perspective. Since the literature on money laundering draws from various strands of social sciences, it is beneficial to look at money laundering literature from an interdisciplinary perspective. It can be observed that the traditional literature on money laundering draws primarily from criminology and international trade theories (Andreas, 2004; Hinterseer, 2002). This forms the bedrock of the 'estimative' strand of literature on money laundering, which I discuss in the next section in detail. Firstly, I begin with official estimates of attempts at quantifying global money laundering. Secondly, I examine the empirical estimates of theories and models of money laundering with emphasis on *Gravity models* of money laundering. Additionally, I also look at theorizing money laundering as a subset of shadow economy estimates. This proves to be most relevant to this thesis. It is important to note that measuring the amount and scale of money laundering also legitimises the effectiveness of the Anti-Money Laundering (AML) regime, which forms the latter half or 'preventive' literature on money laundering in the subsequent section.

2.3.1 Measuring and Modelling Money Laundering

Measuring the scale and impact of money laundering more accurately has become progressively pertinent for political as well as economic reasons. The typical methods employed are case studies, proxy variables or models for measuring the shadow economy, which tend to under or overestimate money laundering amounts. However, in the political sphere, anti-money laundering policies involve certain costs both in the public, as well as private sphere. This necessitates a cost-benefit analysis of the effects of regulation and law enforcement on the underground economy and money laundering. Thus, knowing how much money is being laundered is a necessary precondition for legitimizing anti-money laundering policy (Walker and Unger, 2009).

The earliest accounts of transnational crime and subsequent money laundering came from criminology, which were notoriously case-oriented. Until 1970, police data collection and crime reporting, a prerequisite to analyse crime trends, was poor and electronic data was unavailable (Westfelt, Estrada and Estrada, 2012). There was little or no use of statistics to develop problem-oriented policies, improve crime data and crime prevention in subsequent decades. By the 1980s, the U.N. began to collate international crime and justice statistics, on a standard set of definitions. This process was carried out through a standardised questionnaire for justice agencies in member countries. The initial response to this analysis was quite tepid, as there was a lack of consistency between the individual responses of member states (Harrendorf, Heiskanen and Malby, 2010). The UN undertook, in addition, a number of research projects around the time which included analysis of transnational crime, but these were mostly country-specific, offence-specific or confined to studies of specific mafia, yakuza or drug gangs, etc. The 1980s also saw many international organisations like Transparency International develop indices to measure and analyse corruption, which had become a prominent global concern. The United Nations introduced its convention against illicit traffic in narcotic drugs and psychotropic substances in 1988. This led to the first International Crime Victims Survey by the European Union (EU) which was conducted and included direct questions like "*did you report the crime to the police*?" and "*how much did the crime cost you*?" and were focused primarily at personal and household crimes (Unger, 2009).

By the advent of the 1990s, these surveys adopted a more global approach such as the 'United Nations International Survey of Crime Against Business' (Shaw, Dijk and Rhomberg, 2003). Australia, UK, Netherlands, and South Africa were the founding members of this survey. The data from these surveys formed the basis of estimates of the 'Costs of Crime in Australia' in 1992 (Walker, 1992), which was promoted by the U.N. as a model for other countries to follow (Harrendorf, Heiskanen and Malby, 2010). The period following the year 1995, saw many advances in developing new sources of data on crime. This enabled cross-country comparisons of levels of crime incidence and made it easier to classify risk factors in different types of crimes. Between the periods of 1996-2000, the UN Office on Drugs and Crime made sustained efforts at conducting various surveys to analyse and assess transnational crime and survey patterns of organised crime groups in different countries (Shaw, Dijk and Rhomberg, 2003). These efforts in the form of surveys and reports included: *International Crime and Justice Surveys*, *International Crime Victims Surveys,* and the *International Business Crime Surveys*. One of the earliest estimates of global money laundering came from the IMF when the Managing Director of the IMF, Michel Camdessus, stated in an address to the FATF that money laundering constituted about 2-5 per cent of global GDP at the time i.e., 1998 or 1.5 trillion US$. However, despite various attempts at the FATF, the method of arriving at these estimates could not be retraced by academics. Nonetheless, Camdessus's figures are among the most quoted in the context of money laundering (Barone and Schneider, 2017).

I observe that the traditional criminology literature is focused on the criminal and predicate offence, rather than the cost of crime. Progressively, with the increase in the scale of money laundering operations, governments are seeking to improve measurement and the exact scale and extent of illicit financial flows, to estimate its relative cost to national income (Shaw, Dijk and Rhomberg, 2003; Teichmann, 2019). The demand for data on unaccounted income led to a shift in approach from criminology to developing theories on international trade to measure money laundering (Soudijn, 2016). The next sub-section reviews this shift in the money laundering literature in detail.

2.3.2 Gravity Model of measuring Money Laundering

The literature on the economics of money laundering which explores the scale and impact of unaccounted incomes is still in its infancy (Walker and Unger, 2009). However, the demand for reliable information and the data on scale and impact of illicit financial flows has seen unprecedented growth. Moreover, post the terrorist attacks of September 9/11 in the US, many intergovernmental organisations such as the FATF, the Commonwealth Secretariat, the IMF, G7 have politically supported the efforts to measure the size and impact of money laundering and illicit incomes in the domestic, as well as the global economy. However, prior to this development, some advancement in international trade theory added to the money laundering literature significantly (Gilmour, 2016). In this context, the works of Dutch Nobel prizewinner Jan Tinbergen (1962) are particularly noteworthy. His work on cross border trade transformed the understanding of the newly established economics of international trade (Chaney, 2011). He developed his formula on international trade by applying Newton's formula to bilateral trade flows - where the trade from country I to country II depends on the economic mass of the two countries (measured by GDP) and the distance between the two locations. It was observed that this formula could also be applied to a variety of social interactions such as migration, trade, and foreign direct investment. While this formula was criticised extensively on account of being theoretical and ad hoc, it predicted international trade very well. Thus, "Measurement without theory" turned out to perform better than measuring from existing trade theories. More importantly, though, this formula went on to provide the theoretical foundation for the economics of money laundering (Chaney, 2011; Ferwerda *et al.*, 2012).

In 1995, Walker (1995) adapted the gravity model of trade to measure the money laundered between countries at the request of AUSTRAC - the Australian Financial Intelligence Unit, which commissioned estimates of the extent of money laundering in Australia. This gave birth to the "Walker Model" (Walker, 1995, 1999, 2002, 2003a,b) which was the first known model of estimating money laundering from country A to B. Walker's model relies on an "attractiveness index" which was developed based on the specific risks and opportunities for financial crime present in different countries. Walker's 'input-output' model based on standard economic theory is one of the most well-known economic models of global money laundering. He concluded that global money laundering could be estimated to the tune of US$ 3 trillion per annum since the year 2000. He further observes that the size of the shadow economy of a country is inversely proportional to its economic strength or how rich it is, ceteris paribus (Gilligan, 2001; Ferwerda *et al.*, 2012, 2013). Peter Reuter (2006) is critical of Walker's method and finds these estimates weak owing to the fact that the figures are being derived without any conclusive agreement on how to conceptualise money laundering (Levi and Reuter, 2006). Another author who has criticised the currently available sources of quantification of financial crime and money laundering is Van Duyne (2003). He observes that there is a lack of scientific insight, as well as empirical knowledge of the phenomenon of money laundering by most national and international agencies such as the FATF or the World Bank, the IMF or the US administration, the FIU (Financial Intelligence Unit). For this purpose, he is sceptical of methods enumerated by international organisations such as FATF and authors such as Walker to estimate the size and development of money laundering operations globally (Van Duyne, 2003).

Post this development, many authors (including Walker) such as Masciandaro (1999), Argentiero (2008), Walker (1999), Schneider and Windischauber (2008), Unger and Bagella (2009) provide models and methods of estimation to quantify money laundering operations (Walker, 1999; Masciandaro, Takáts and Unger, 2007; Schneider, 2011). Brigitte Unger (2007, 2006) builds upon the work of Walker by combining it with the gravity model of Tinbergen, thus providing a first theoretical basis of the input-output model of Walker (Walker and Unger, 2013). Her estimates include quantifying money laundering in the Netherlands to approx. $18-25 billion, as well as effects of money laundering on society. She concludes that most literature on money laundering lacks an empirical basis and relies more on speculation than solid evidence (Walker and Unger, 2013). For this, the behaviour of launderers has to be observed, studied and analysed. Cooperation with criminologists and their findings can shed a light on how money launderers (at least convicted ones) behave, by studying police dossiers, their income, their expenditures and their wealth. And, likely, tax evaders behave differently from smugglers (Unger, 2009). This behavioural analysis is an important starting point for my study of India. The core of my thesis lies in tracing the evolution of mechanisms of money laundering to decipher patterns of individual behaviour and its motivations; as well as establish causality between these patterns and economic policies of 1991.

As per Unger (2009), out of all the models, the Walker Model is the most reliable and promising. Mainly, because it can be used for all countries and jurisdictions in the world and because it can be given a theoretical underpinning that is much stronger and more promising than all of the other global money laundering measuring approaches identified, so far. Furthermore, comparing the results of the Walker model with other studies on the shadow economy and the underground economy, have shown that the outcomes are compatible with them (Unger, 2009). To give an example: In 2006, the Austrian economist Friedrich Schneider published some interesting estimates of the shadow economy of 145 different countries (Schneider, 2010). Besides, the gravity model is most compatible with other empirical studies on unobservable parts of the economy, such as the studies of Baker (2005) on capital flight, or the findings of Savona´s Law Based Index showing a country's willingness to combat money laundering. According to Unger (2009), measuring money laundering needs a combination of criminology, economics and finance, which are all included in the Walker Model (Unger, 2009).

Argentiero, Bagella and Busato (2008) derive equilibrium conditions for the money laundered in Italy. The authors find a negative correlation between money laundering and GDP. The paper concludes counter cyclicity between money laundering and the state of affairs in the economy (Argentiero, Bagella and Busato, 2008, 2011). During periods of depression, money laundering activities are likely to go up. They explicitly introduce the criminal sector in the model and find that as anticipated, the larger relative volatility of money laundering is a direct consequence of the explicit introduction of the criminal sector combined with the money laundering mechanism. The propagation mechanism operating in this model is a distinctive characteristic of a two-sector model with an illegal economy. Indeed, its introduction into a stochastic growth model does not affect either the slope of labour demand and supply schedule or the elasticity of output to shocks but introduces a propagation mechanism triggered by the re-allocation of labour services between the two sectors. When a shock hits one of the two sectors, it is transmitted to the other, which returns an additional, smoothed, impulse to the former sector" (Argentiero et al., 2008, p.14). Thus, this mechanism suggests that the two sectors move in tandem.

Masciandro (2008) sets up demand and supply models to explain money laundering. The attempt was to formalise individual agent behaviour and that of the economy as a whole. He finds that an individual will launder more money with an increase in proceeds of criminal activities and with an increase in profitability of the laundered cash, as compared to that of direct income (Pellegrina and Masciandaro, 2008). The laundered money tends to decline with a rise in the probability of detection, the severity of sanctions in the money laundering phase and cost of money laundering operations. He further elaborates by showing that if unlaundered proceeds are more likely to be detected then all sorts of criminal activities will generate demand for money laundering. As a consequence of this, the volume of money laundering activity would be directly proportional to the dimensions of the illegal economy. His macro model suggests that the polluting effects of money laundering on society would be higher: if the cost of money laundering operations is lower, if the share of re-investment in illegal activities, especially those where investment needs to be financed out of clean money, if the differential expected in the rate of return is higher and if the associated risk of illegal activities is lower (Masciandaro, 2007). These models emphasise the close association between the legal and illegal parts of the economy. The close association between the formal and informal sectors is quite evident for my case study i.e. India. In chapter III, I will examine the relationship between the formal, informal and black economy in India.

2.3.3 Money Laundering as a Subset of Estimates of Shadow Economy

In many countries, the shadow economy consists mostly of legal activities that are kept hidden for tax avoidance purposes, but logically, since criminals do not report their illegal incomes to the tax authorities, the proceeds of crime should be a subset of the shadow economy. Thus, another way to measure money laundering is to use approaches from measuring the shadow economy to measuring money laundering, such as the DYMIMIC (dynamic multiple-indicators multiple-causes) model (Masciandaro, Takáts and Unger, 2007). This model uses two sets of observable variables and links them as a proxy to the unobservable variable. One set of observable variables is the cause (for the shadow economy or money laundering) such as regulations, taxation, and prosecutions. The other set is called indicators. These observable variables parallel money laundering and include the growing demand for money, less official growth and/or increases in crime rates. So, if for example money laundering prosecution increases by 'x' per cent, and if parallel to this the crime rate goes down by 'y' percent, the model would conclude that money laundering has declined by 'z' per cent. Schneider's (2004) estimate of the shadow economy is about twice as high as the estimates on money laundering from the gravity model for the Netherlands and Australia. The DYMIMIC model uses factor analysis to determine how well the different cause variables explain the unobservable variable and those that can be grouped together. The same is then done for the indicator variables (Schneider, 2011; Ferwerda *et al.*, 2013). This means statistics decide which indicators form the relevant bundle of causes of the shadow economy (or money laundering) and which are relevant for the parallel indicators of a shadow economy (or money laundering). Indicators are classified into sub-groups that are supposed to represent parts of the unobservable variable. But, again, statistics cannot replace theory. Nevertheless, the method identifies the variables that are highly correlated and measure the same part of the proxy variable and reduces redundancies in the choice of proxy variables (Adrian and Ashcraft, 2012).

In the next section, I introduce the concept of 'black money', which is a typical Indian name for what appears to have an explicitly universal presence, and that is money primarily produced by tax evasion and proceeds of other criminal offences(National Institute of Financial Management, 2012). It is important to understand that black money is money deployed in the black economy, which is analogous to the concept of shadow economy, except that it also includes that component of the economy which thrives on crime such as smuggling, human trafficking, drugs, corruption and land grabbing

2.3.4 Defining 'Black Money' in India

Black money is currently one of the most discussed political and economic issues in India. During the tenure of the last government, the issue of corruption galvanised a popular civil movement. When the BJP government (led by Prime Minister Narendra Modi) came to power in 2014, among its promises was the recovery of black money from tax havens abroad and the promise to deposit Rs. 15 lakhs in every Indian's bank account.[20] In November 2016, when

[20] 2014 Lok Sabha election manifestos: BJP, Congress and AAP's stand on key issues, IBN Live, April 07, 2014, (http://ibnlive.in.com/news/2014-lok-sabha-election-manifestos-bjp-congress-and-aaps-stand-on-key-issues/463263-

Prime Minister Narendra Modi announced the demonetisation of high currency notes, he said he had taken the step primarily to fight the ill effects of black money. Black money in normal parlance means income illegally obtained or not declared for tax purposes (Chaudhuri, 2006). There is no uniform definition of black money in economic literature or economic theory (National Institute of Financial Management, 2012). In fact, several terms with similar connotations have been in vogue, including 'unaccounted income', 'black income', 'dirty money', 'black wealth', 'underground wealth', 'black economy', 'parallel economy', 'shadow economy', and 'underground' or 'unofficial' economy. All these terms usually refer to any income on which the taxes imposed by government or public authorities have not been paid (Menon, 2019). The definition ascribed by the Indian government in the 'White Paper on Black Money', includes money generated through illegal activities (terrorism, drug trade, corruption, etc. or generated through unaccounted or undisclosed permissible economic activities under the garb of black money (Ministry of Finance, 2012).

In its 1985 report on *Aspects of Black Economy*, the NIPFP defined 'black income' as 'the aggregates of incomes which are taxable but not reported to the tax authorities' (NIPFP, 1985). Further, black incomes or unaccounted incomes are 'the extent to which estimates of national income and output are biased downwards because of deliberate, false reporting of incomes, output and transactions for reasons of tax evasion, flouting of other economic controls and relative motives'. Thus, in addition to wealth earned through illegal means, the term black money would also include legal income that is concealed from public authorities (Kumar, 2002).

2.3.5 Estimates of Shadow/Black Economy in India

There has been a growing interest globally in understanding and measuring the size of unaccounted incomes in economies (Frey and Pommerehne, 1984; Thomas, 1986; Bagachwa *et al.*, 1995; Bajada, 1999; Caridi and Passerini, 2001; Eilat *et al.*, 2002; Bajada and Schneider, 2005; Capasso and Jappelli, 2013). The approaches to measuring unaccounted incomes can be

81.html) Election Commission of India (http://eci.nic.in/eci/eci.html) divided into three categories: the "monetary method" (or "currency demand approach"), the "latent variable method", and the "global indicator method" (Mukherjee and Rao, 2019). The monetary method operates on the premise that the hidden part of the economy operates mostly through cash and the velocity of money in the accounted segment of the economy equals the unaccounted segment of the economy (Gutmann, 1977; Feige, 1979; Gupta and Gupta, 1982; Ahumada, Alvaredo and Canavese, 2008; Ardizzi *et al.*, 2014). This method is replete with difficulties primarily due to the assumptions under which it operates i.e. it's over-reliance on cash as a variable. The latent variable method predicts the value of the latent variable based on observable variables (Frey and Pommerehne, 1984; Chaudhuri, Schneider and Chattopadhyay, 2006). Lastly, the Global Indicator Method measures unaccounted incomes against a single variable (usually a physical indicator) with which it is perceived to be related, electricity consumption being the most prevalent (Gutmann, 1977; Feige, 1979; Gupta and Gupta, 1982; Ahumada, Alvaredo and Canavese, 2008; Schneider, 2011).

By its very definition, unaccounted income is not directly measurable (Bhattacharyya, 1999). Any method used to measure the size of unaccounted incomes has to utilise proxy variables and deduce an estimate based on assumptions. Since there are intrinsic issues in calculating the size of the underground economy, it would be prudent to look for alternatives and new proxies for measuring unaccounted incomes. According to Acharya (1983), the literature on unaccounted income can be divided into two broad categories: (i) those dealing with incomes which should have been reported to tax authorities but were not and (ii) extent of under-reporting. While there are several established methods in the literature, each of these has faced some criticism. The first estimate of Black money in India was made in the 1950s and amounted to Rs. 4.4 to 5 billion, which was roughly about four per cent of the GDP. Over the years, this share of black money to GDP has been escalating and by the mid-1990s touched nearly twenty per cent of the GDP (Sharma, 2016).

In 1950, the first estimate of black money in India was attempted which amounted to Rs. 4.4 to 5 billion, roughly amounting to approximately four per cent of the GDP. This percentage of black money to GDP has been rising gradually since then. By the mid-1990s the black money to GDP amounted to about twenty per cent of the GDP (Datta and Sundharam, 2004; Panagariya, 2004a). In 1971, as per the Wanchoo Committee report, "the estimated income on which tax would probably be Rs. 700 crores and Rs. 1000 crores for the years 1961-62 and 1965-66 respectively. Projecting this estimate further to 1968-69 on the basis of percentage increase in national income from 1961-62 to 1968-69, the income on which tax was evaded for 1968-69, can be estimated at a figure of Rs. 1800 crores" (Datta and Sundharam, 2004, 378). Thus, in 1961-62, black money amounted to Rs. 700 crores which escalated to Rs. 1000 crores in 1965-66 and then rose to Rs. 1400 or Rs 1800 crores in 1969-70 (Ministry of Finance, 2012). In 1982, D.K. Rangnakar who was a member of the Wanchoo Committee submitted his report on Black money in India. As per his estimates, tax evaded income for 1961-62 amounted to nearly Rs. 1,150 crores, for 1965-66 it amounted to Rs. 2,300 crores and for 1968-69 and 1969-70 the figures amounted to Rs. 2,833 crores and Rs. 3,080 crores respectively (Datta and Sundharam, 2004, 378).

In 1981, the Indian government constituted another committee to measure the size of the underground economy in India. The study employed Feige's method of transaction income ratio to estimate unaccounted incomes in India. They chose three years viz. 1949-50, 1950-51 and 1951-52 as the focal points to calculate unaccounted money for the year 1967-68 to 1978-79. According to this study, the black money increased from Rs. 3034 crores in 1967-68 to Rs. 46867 crores in 1978-79 and black money was pegged at 19.8 per cent of GDP (Sarkar, 2012). The study made some pertinent and useful observations. These were: "(a) A buoyant economy offers more opportunities for unaccounted income (b) The ratio of unaccounted income to assessable non-salary income has gone up after 1973-74 (c) Increase in prices leads to an increase in black money (d) Funds are diverted to agriculture to convert black money into white money, and (e) One per cent increase in overall taxes leads to more than 3 per cent increase in the black economy related to the official economy" (Sarkar, 2012, p. 128). These assertions hold true today as well.

In 1982, the noted economist O.P.Chopra came up with a series of observations and estimates for black income in India. His tests indicated that black incomes increased from Rs. 916 crores (6.1 per cent of GDP) in 1961-62 to Rs 8098 crores (10.5 per cent of GDP) in 1976-77. Chopra (1982) observed the tax-exempt agricultural sector to be a major conduit for the absorption of unaccounted incomes (Chopra, 1982). He also observed that an increase in taxes, as well as prices, led to an increase in unaccounted incomes (Ministry of Finance, 2012).

In 1985, under the Ministry of Finance, the National Institute of Public Finance and Policy estimated the amount of black money (for the year 1980-81) in India to be approximately Rs. 1,00,000 crores, which amounted to nearly 20 per cent of the GDP. This report gathered a lot of criticism from noted economists such as Suraj B. Gupta who estimated the unaccounted income in India for the same year to be pegged at about 50 per cent of GDP. Arun Kumar (1999) further criticised both the Gupta and NIPFP studies and estimated unaccounted or black money at 42 per cent of GDP for the year 1980-81. More recently, Kumar (2012) a noted economist at the Jawaharlal Nehru University (JNU) has estimated the black economy to be nearly fifty percent of the GDP in 2012 (Sarkar, 2012).

Most recently, Rao and Mukherjee (2015) developed an alternative methodology for the estimation of unaccounted GDP based on road freight transport as a universal input. The methodology captures economic activities which are not fully accounted for in the official estimate of GDP. The paper estimates the size of the unaccounted GDP (as a percentage of total GDP: unaccounted and accounted) in India. However, activities like bribe-taking and kickbacks are transfers and not accounted, either in the official estimate of GDP or in our estimation of unaccounted GDP. To capture the dynamics of the relationship between inputs and outputs and structural changes of the economy, the methodology is tested by using two different I–O tables (2003–04 and 2007–08) and estimating the results for three consecutive years (2009–10 to 2011–12). The results show that for reasonable assumptions, fairly consistent estimates of unaccounted GDP can be derived. The actual level of unaccounted incomes in the country can be calibrated by incorporating estimates of the adulteration in diesel and estimates of overloading in trucks (Mukherjee and Rao, 2017).

It should be noted here that the estimate of unaccounted incomes derived here can be interpreted as an estimate of the extent to which GDP estimates of economic activity are under-reported. According to Rao (2017), "This interpretation has two limitations: Firstly, these estimates by themselves cannot be related to incomes not reported for purposes of taxes. Second, any incomes which are generated for illegal activities and/or from activities that are not part of value addition in the economy will not be reflected in this approach. For instance, suppression of incomes from capital gains from the sale of real estate property will not be reflected in this estimate, since this is considered a transfer in the methodology for measurement of GDP" (Mukherjee and Rao, 2017, p. 113).

The various reports and papers enumerated above for measuring the size of the unaccounted/black economy in India have been guided by divergent methodologies and have gathered criticism over their many underlying assumptions and approximations. Moreover, it can be observed that the estimates for the same year have been divergent in different studies (Ministry of Finance, 2012). Indian media has constantly been flooded with articles and news reports with various estimates of the black economy in India, ranging from as low as 7 per cent to as high as

120 per cent (The Financial Express, 2019b). More recently, various accounts of Indian money held abroad by Indians in tax havens have gained traction in news reports and daily news headlines (Ministry of Finance, 2012). As per the reports on unaccounted income in India, submitted by three think tanks (NIFM, NIPFP and NCAER) to the government of India, the black money that had been siphoned off abroad by Indians; for the period 1980-2010, was estimated to be in the range of $216.48 billion to $490 billion. Nevertheless, in an official report titled, *Status of unaccounted income/wealth both inside and outside the country-A critical analysis (2012)*, senior finance ministry officials said that a reliable estimation of black money is extremely difficult since three independent studies commissioned by the Indian government gave starkly varied estimates of black money, both inside and outside the country.

As per some recent studies (Schneider et al, 2003; 2010; NIFM, 2012; NCAER, 2012), the size of the black economy in India has been declining in the post-1991 reform period. Sharma (2016) uses a variant of the currency model to estimate the size of the black economy in India for the period 1971-2013. He argues that calculating the size of the black economy poses many difficulties, especially for a country like India that has a sizeable informal economy. His findings indicate that India had a sizable black economy till the 1970s, which peaked at 50 per cent of GDP, owing to the high tax rate at the time. However, this number has seen a declining trend since the implementation of a plethora of reforms in taxation, industrial licensing and the financial sector. This decline has been attributed to the ameliorative effects of fiscal reforms and the resultant improved economic environment (Sharma, 2016). The report of the National Institute of Financial Management (NIFM) commissioned by the Indian government in 2011 also concludes that the share of the black economy has declined since the economic reforms due to the structural reforms of 1991. These studies have been contested by the T.Sinha (2015) who argues that these observations are misleading. His study observes that the black income in India, as a percentage of GDP, has actually increased in the post-reform period.

The contradictory findings among these studies are indicative of the lack of a uniform, accurate and widely- accepted methodology to make such estimates. Moreover, most data available to measure the black economy is unreliable as any determination of the size of the economy requires not only the quantum of money deployed in it but also the velocity of that money, the quantum of credits and valuation of relationships which can be converted to productive business transactions (National Institute of Financial Management, 2012). Such data in a formalised economy is available by way of corporate financial figures, banking data and government data. Except for the amount of money in the black economy, which too, is at best a guesstimate, all other data cannot be covered by a formal system or matrix due to its very nature. For this reason, measuring the size of the black economy seems like a redundant exercise.

In the next section, I examine the literature forming the 'preventive' strand of literature on money laundering.

2.4 Preventive Literature on Money Laundering

Latest developments in the global financial arena are indicative of a growing realization among policymakers that the twin problems of money laundering and tax evasion can no longer be compartmentalised (Chaikin and Sharman, 2009). As per the *Commonwealth Model of Best Practice* for combating money laundering in the financial sector, there are four primary reasons for tackling money laundering (Moshi, 2007). Firstly, money laundering facilitates the criminal and criminal organisations to benefit from their criminal or illicit activities, which further allows them to finance illegal operations creating a vicious cycle and increase in the level of crime. Secondly, the unchecked use of the financial system for the purpose of money laundering could potentially compromise the integrity of the entire financial system and not just individual financial firms. Moreover, this could have adverse macroeconomic implications such as distorted resource allocation and unstable exchange rates. Thirdly, if left unchecked these activities could lead to contempt of law among law-abiding citizens and undermine public confidence in the law of the land, particularly the fiscal apparatus. Lastly, this could create a national culture that encourages economic crime such as tax evasion, corruption and exchange control violations (Nance, 2018). In collaboration with other international stakeholders, the Financial Action Task Force (FATF) works to identify national-level vulnerabilities with the aim of protecting the international financial system from misuse. The FATF is an inter-governmental body established at the G7 summit in Paris in 1989. The objective was to set standards and promote effective implementation of legal, regulatory and operational measures to combat money laundering and terrorist financing and other related threats to the integrity of the international financial system. The FATF has developed a series of recommendations that are recognised as the international standards for combating money laundering and the financing of terrorism. They form a basis for a coordinated response to these threats to the integrity of the financial system and help ensure a level playing field. In April 1990, it issued a report containing a set of *forty recommendations*, which were intended to be part of a comprehensive plan of action in the fight against money laundering. In addition to this, in October 2001, the FATF issued *Eight Special Recommendations* to deal with the issue of terrorist financing. In October 2004, it published a *Ninth Special Recommendation*, further strengthening the agreed international standards for combating money laundering and terrorist financing.

Unlike most international inter-government bodies that have come to be humongous bureaucracies with huge infrastructure, FATF is a lean organisation based on the principle of networking the capacities of its constituent member nations and building on a small core group to develop task-based committees open to taking experts from the private sector where required. FATF concentrates on helping its constituent nations develop policy and mechanisms to implement the same thru legislation and administrative apparatus available with constituent members for law enforcement (Nance, 2018). The State delegation that comes to constitute FATF meetings and committees range from all kinds of domestic agencies dealing with legislation, treasury function and law enforcement. International bodies such as World Bank and IMF are invited to make their contribution as observers. Often, for consultative work, FATF takes recourse to inviting a wide range of people and institutions including bankers, lawyers, NGO's that are concerned with FATF's sphere of activities (Nance, 2018).

FATF does not write laws or policy for states but provides a consultative environment recommending what may be needed and encourages the states to write and implement their own laws based on the recommendation of FATF. Taking an example, Recommendation 9 (formerly Rec. 4) reads: 'Countries should ensure that financial institution secrecy laws do not inhibit implementation of the FATF Recommendations.' This is nothing but a principle to guide legislation, not sample legislation which must be adopted verbatim to pass legislation by member states. Members themselves are tasked to annually review the recommendations. Where a recommendation is found to be onerous to implement, members resort to issuing notes for interpretation. These may then be integrated, subject to a trial period, into the official recommendations. Members are on record to have revised the recommendations as much as three times, in 1996, 2003/4, and 2012. There is no agreement on a set procedure for decision making. Plenary meetings are held about three times annually. At least one of those meetings is held in Paris, where FATF's small secretariat shares the roof with OECD. The secretariat has only 17 people, an increase from 12 when FATF was founded in 1989. FATF's monitoring powers extensive. The two key monitoring mechanisms are - a. mutual evaluation and b. typology exercises.

a) Mutual evaluation: Originally such an exercise applied only to members however these invasive evaluations now apply to any state that wishes to be FATF compliant on a rotation basis. The evaluation consists of an on-site visit by a monitoring team of experts. This team consists of representatives of member states or representatives of international organizations. Typically it spends about one-week interviewing relevant players on on-site visits. The team fills out documentation following a common methodology to essentially gauge how well the State's AML system is aligned with the FATF's 40 Recommendations. This is then discussed by way of a peer review during the Plenary session. An unsatisfactory score results in a recommendation for continued and closer monitoring. A fresh report must be prepared for discussion at the following plenary on progress. These evaluations were originally conducted by FATF staff and member representatives however now the established common methodology allows other international organizations, such as regional iterations of FATF or the World Bank, to conduct these evaluations. The peer review of such evaluation must still be held at FATF plenary among FATF members (Chohan, 2019).

b) Typologies exercise: Secondly, the typology exercises are both diagnostic and generative. The typology exercises are structured around bringing together money laundering experts from around the world to discuss the latest issues in money laundering. They have three tasks: a. exchange information ongoing cases and related operation, b. to identify current trends in money laundering, and c. to identify and describe effective (and failed) counter-measures. There is a common understanding in academia that the FATF blacklists are the primary diffusion mechanism used by FATF. (APG, 2012). The current system of enforcement in the FATF regime is the International Cooperation Review Group (ICRG). This took shape in 2007. In 2009, G20 called upon the FATF to strengthen the ICRG procedures by publicly declaring the names of countries with deficient AML regimes (Chohan, 2019). In February 2012, the special recommendations on terrorist financing were merged with the main recommendations in the review process of the Forty (plus nine) Recommendations by the FATF. The FATF also adopted the mandate for the period 2012-2020 in the same review.

As per Brent (2002), transnational money laundering activities impede growth in underdeveloped and poor countries such as India, as they drain the scarce resources of the country by diverting these resources to less productive activities (Bartlett, 2002). These activities further nurture and enable domestic corruption and crime, which in turn hinders economic growth. He further states that unfettered money laundering in developing countries adversely affects their economy through trade and international capital flows. As per a study conducted by World Bank (2003), money launderers use "front companies" which are business ventures that appear legitimate but are a smokescreen to create a façade that facilitates the proceeds of crime to appear as earnings of legitimate business activity (Chohan, 2019).

An Anti-Money Laundering Framework (AML), essentially is the structure that each country has to combat money laundering activities and associated crimes. It is primarily aimed at prevention, detection and repression of money laundering activities (Ahiauzu and Inko-Tariah, 2016; Mekpor, Aboagye and Welbeck, 2018; Friedrich and Quick, 2019). Most frameworks on AML rest on two pillars of prevention and enforcement; the former falling within the ambit of supervision agencies and the latter within the law enforcement authority of the country. Since money laundering activities are linked to an associated crime: firstly, the AML framework investigates in order to increase the likelihood of criminal detection. They also regularly develop judicial strategies to extract illicit or black money from criminals, thus ensuring that the fruits of crime do not pay. Thus, the economic efficiency of crime is inversely related to the efficiency of the AML framework (Lyman and Noor, 2014; Chohan, 2019).

For this reason, the AML framework design is a major step in the fight against money laundering. There are two approaches that authorities can or could/ choose from; rule-based and risk-based. While the rule-based approach stipulates norms and laws for every social actor within the financial system, the risk-based approach "*makes the obligation of public authorities passive: in this model they await reports from bank managers, accountants, lawyers and other professionals, rather than taking active steps to deploy crime-fighters to identify, pursue and indict criminals*" (Unger and Waarden, 2009). While the rule-based approach seems to be more effective in theory, in countries where the financial system relies purely on rules and norms, the efficiency of the AML regime is low (Naheem, 2020). As per Takas (2007), the notion of "suspicious" becomes vague, as the rules are ambiguous; it is difficult to separate money-laundering activities from normal activities. For instance, in the United States, the rule-based approach has resulted in massive reporting of unnecessary information to all financial institutions of nearly every mildly suspicious activity (Aiolfi and Pieth, 2003). Also, the rule-based approach often makes the corporation a passive body merely concerned with rules and norms. This makes it easier for non-cooperative bodies to find loopholes in order to go unreported and mislead supervisory bodies (Masciandaro, Takáts and Unger, 2007). Besides, over-reporting also benefits money laundering activities, as all the illegal transactions and activities are diluted by normal transactions thus making reporting redundant (Unger and Waarden, 2009). As per Naylor (2002), this idea has contributed to the notion that AML frameworks are not efficient in fighting the launderers as reporting everything causes associated crimes. On the other hand, the risk-based approach relies on the premise that regulations should be stringent in high-risk sectors or jurisdictions (Hutter, 2005). This approach became prominent with the EU (European Union) Third Directive on money laundering and made it mandatory for financial institutions to strengthen their risk management departments. Financial institutions were also expected to create internal departments of compliance and report in order to create the capacity to deliberate on suspicious transactions (Chaikin and Sharman, 2007).

The inherent flexibility in a risk-based AML framework ensures agility, as well as lower costs due to less administrative costs, as the responsibility of monitoring the system mostly relies upon the corporation rather than the bureaucracy. However, critics of the risk-based approach note that banks may be unable to monitor every transaction and a conflict of interest may arise between the commercial interests of the bank and the enforcement authorities (Unger, 2009). Thus, in both approaches, the phenomenon of 'crying wolf' exists as banks and auditors tend to conceal important information about their customers, which generates asymmetry of information or crying wolf behaviour) (Masciandaro, Takáts and Unger, 2007).

In 2015, the EU introduced the Fourth Anti-Money Laundering Directive which was aimed at preventing illicit financial flows, strengthening the risk assessment obligation on the financial sector, and preventing terrorist financing operations. In 2018, it was followed by the Fifth Anti-Money Laundering Directive (Savia, 2019). Currently, both these directives are in force. The 4th AML has been touted as the most comprehensive and useful anti-money laundering directive with its wide application and stringent measures against financial crimes (Savia, 2019).

Besides the debate on the most suitable AML design, there has been significant criticism of AML regimes in totality on account of being inefficient economically. Many authors have pointed out various weaknesses of AML frameworks particularly with respect to risk management and compliance departments (Nijsen et al., 2008). More importantly, keeping in mind the end goal i.e. to assess the AML framework in financial terms, the expenses of these strategies must be contrasted with the effectiveness of the framework. Considering that national resources are constantly constrained, governments should carry out a cost-benefit analysis of the AML framework, in place, to make the best conceivable use of the resources available (Mitchell, 2005). According to Mitchel (2005), AML structures, specifically when concentrated on the procedure, instead of the outcomes, are not cost-efficient. Many authors have focused on some critical expenses connected with AML Frameworks, which lead to incidental losses to the real economy (Aiolfi and Pieth, 2003).

There have been some recent advances in the literature on law and economics to explore and measure the relationship between policy effort and transnational organised crime. The theoretical framework presented by Kugler, Verdier and Zenou (2003) indicates that oligopoly-driven market structures in the hands of criminal organisations engage in competition by corrupting bureaucracy in order to avoid punishment and acquire market power over illicit markets. Buscaglia (2008) points out that in such situations the traditional Becker (1968) and Levitt (1998) hypothesis holds true, where expected higher sanctions and higher probabilities of prosecution work on having an inverse effect for crime, does not hold. Higher policing and increasing expected sanctions can produce higher crime rates by making organised crime extend the corruption rings aimed at controlling their territories and feudalizing the state domain in order to gain greater impunity and a reduction in actual expected punishment (Kugler, Verdier and Zenou, 2003). Herein lies the paradox of criminal sanctions, where more frequent and stiffer punishments lead to higher levels of organised crime and higher levels of corruption. The situation is somewhat similar in the Indian case. The criminal implications of the Income Tax Act 1961 and Prevention of Money Laundering Act (PMLA) 2002, have had a detrimental effect on the entities that are in the informal economy, from stepping into the formal economy. Being in the informal economy, they continue to rely on structures of the informal economy, including mechanisms of money laundering and hawala. Thus, there is a huge disincentive to move to the formal economy.

I have identified (see chapter VI) sectors of economic activity in the Indian economy (such as real estate, education and electoral finance) that require a large amount of funds. Often, this may include large amounts of black money. The financial structuring of the corporate identities in these areas of economic activity is so structured that they can absorb and convert large amounts of black money and when needed, reverse the process. The demand for black and white money continuously is met through money laundering and money de-laundering, an idea that I develop in chapter VI. Politicians in positions of power, who have the necessary control on taxation and punishment for evasion of the same take a lenient view of violation of tax laws as they have a vested interest, in as much as that they need humongous amounts of black money for conducting elections. Thus, with their active blessing and participation, an entire ecosystem has been created for the optimisation of black money by deploying it partly in the informal and black economy; and partly by laundering it to be deployed in the formal economy. As the need for election funds is cyclical, huge amounts need to be delaundered from the formal economy. Thus, owing to this cyclical spike in demand for black money during elections, it was only logical that a system that relies primarily on laundered white money, could not fulfil this requirement adequately. For this reason, I surmised that the money laundering system had integrated, within its institutions, a mechanism for de-laundering. My research demonstrates this view to be accurate.

The core problem of the Indian economy vis-à-vis AML literature is that the AML regime does not acknowledge all three core aspects of laundering identified in this thesis. AML literature just addresses one arm of the total ecosystem of laundering which consists of 'parking funds' (i.e. black money parked within the black economy), money laundering and money 'de-laundering'. As mentioned earlier, there is also an aspect of confusing black money and informal economy as being the same in international political economy literature. In jurisdictions such as US, there is taxation in all economic sectors and informal economy is synonymous with roadside economy which is not the case in India. I further develop the distinction between the formal, informal and black economy in chapter III. I examine the demand for money laundering, the source of funds that need to be laundered, the objective of parking the funds in case they are not required to be laundered. Furthermore, I find the need for de-laundering to meet the demand for black money is endemic due to the nature of deployment of the funds being such that white money cannot be used. Thus, through this study, I am adding to the AML literature by introducing the concepts of 'parking' (see Chapter V) and 'de-laundering' (see Chapter VI) and hence, providing the complete cycle, as opposed to just one arm of the financial ecosystem which most global AML literature deals with.

In the following section, I examine the existing AML framework in India and how it has evolved in the country with respect to political developments in the domestic as well as the international sphere.

2.4.1 The Anti-Money Laundering (AML) Framework in India

Money laundering has been criminalised under both the Prevention of Money Laundering Act, 2002 (PMLA), and the Narcotic Drugs and Psychotropic Substances Act, 1985 (NDPS Act), as amended in 2001. Prior to the enactment of the Prevention of Money Laundering Act 2002 and rules framed under it which came into force in 2005, a plethora of laws scantily addressed the problem of money laundering. These statutes were *The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974; The Income Tax Act, 1961; The Benami Transactions (Prohibition) Act, 1988; The Indian Penal Code and Code of Criminal Procedure, 1973; The Narcotic Drugs and Psychotropic Substances Act, 1985; The Prevention of Illicit Traffic in Narcotic Drugs and Psychotropic Substances Act, 1988* (Rohit and Patel, 2015). The most salient legislative instrument in India's AML regime is the Prevention of Money Laundering Act (PMLA), 2002. The PMLA entered into force in 2005 and has been considerably amended in recent years. The first evaluation of the Indian AML framework was carried out in 2005 by the FATF. The outcome of the evaluation revealed that India had failed to incorporate 20 serious predicate offences which were part of the FATF forty (plus nine) recommendations list (Viritha, Mariappan and Haq, 2015). As a response to this shortcoming, it was duly amended to include more predicate offences and passed as the Prevention of Money Laundering Act, 2009. Another round of evaluation was carried out by the FATF to monitor and report India's anti-money laundering efforts. This evaluation report suggested further changes by pointing out certain inadequacies in the India AML regime. The government further amended the act and announced PMLA, 2011 which was more compliant with the FATF recommendations. Further, the definition of money laundering was widened in scope to include cheating, concealment, acquisition, possession and use of proceeds of crime.

The United States Department of State (DOS) does an evaluation of the money laundering regimes in various countries. In the Indian context, the main points of evaluation (reported in International Narcotics Strategy Report, 2012) can be summarised as follows: "*India is a regional financial centre, with a rapidly growing economy and well developed formal and informal financial systems. India's extensive informal economy and remittance systems, porous borders, persistent corruption, and onerous tax administration and currency controls contribute to its* *vulnerability to economic crimes (including fraud, cybercrime, and identity theft), money laundering and terrorist financing).* Further, on account of various amendments made in PMLA, 2011, the report remarks, "*Despite these important steps, deficiencies remain…Despite increased law enforcement resources, as of April 2011, there was still no money laundering convictions or confiscations*". This study endorses this opinion based on empirical analysis. During my interviews with lawyers associated with cases on money laundering, I consistently asked one question related to the stringency and conviction rate of the PMLA i.e. '*Would it be correct to say that money laundering cases are on the rise in India*?' to which I nearly always got a resounding 'No' for an answer. I will quote one such comprehensive answer by a practicing advocate in Delhi high court, who said*: "No this doesn't appear to be the case in my knowledge. The conviction rate appears to be low as per the information I have been privy to. The rate of conviction has been extremely low despite an increase in the filing of FIRs* " (personal communication, May 12, 2018).

India's principal AML agency, the Enforcement Directorate (ED) reserves the authority to confiscate "tainted assets" i.e. those assets which could be proceeds of listed offences as per the PMLA in 2011 (Viritha, Mariappan and Haq, 2015).

As part of the regular review cycle, FATF was scheduled to hold a review of India's compliance with the AML regime in 2020 after 10 years from the first review held in January, 2010. After the last review in 2013 FATF said "India had made significant progress in addressing deficiencies identified in its mutual evaluation report and the FATF decided that the country should be removed from the regular follow-up process"(Financial Action Task Force, 2013). For the purpose of pending review, India has set up a working group involving 22 of its agencies including those concerned with regulating and investigation. Just before the Covid-19 pandemic outbreak, preparations were complete for various presentations to be submitted to the FATF Review team as per a senior Indian Finance Ministry Official who said "We have been informed by the FATF that it has postponed the mutual evaluation of many jurisdictions scheduled this year, including that of India, due to the ongoing Covid-19 restrictions. It is expected that the new dates will be for early next year"(The Print, 2020). The official also said that India was not on the FATF list of countries having strategic AML deficiencies. As per a senior retired official working on economic policy, in the government of India, I was told that it is important to note that the focus of FATF is on the AML regime targeting money laundering and counter financing of terrorism. He said "*FATF has continuously ignored global money laundering, tax evasion using offshore* *accounts used primarily for business purposes that are legitimate in the regime where the money is invested. Offshore accounts in many jurisdictions such as in some states of the US like Nevada, Switzerland, Cayman Island, etc. have not been targeted by FATF. Its main concern is with terror financing*" (personal communication, August 19, 2018). It is for this reason that he felt that FATF has ignored the round-tripping and money laundering by Indian HNI's corporates, politicians and bureaucrats using a sophisticated network of shell companies and tax-exempt regimes.

The next section has been compiled with the information and insights gathered during interviews with two practicing advocates in the Supreme Court of India. Their association with the issue of black money in India, in their capacity as the advocate for the SIT – Special Investigation Team for black money, has provided the insights mentioned.

2.4.2 Special Investigation Team on Black Money: Leading Case in India

In 2009, a Special Investigation Team (SIT) was set up by the Supreme Court of India to facilitate the return of black money into India and prosecute those responsible for the same on one hand and make a suitable policy framework to stem the flight of black money in the future on the other hand.

Dr. B.B. Dutta, Former Member of Parliament, Professor of economics and Executive Chairman of *Rashtriya Jagrati Sansthan* (RJS), told me during an interview that this PIL was an offshoot of a discussion initiated at a conference held by RJS that centered on corruption. Dr. B.B. Dutta, along with Dr. Subhash C. Kashyap, Ms. Jalabala Vaidya, Mr. Gopal Sharman and senior advocate Ram Jethmalani got together to file the PIL as Writ Petition 176 in the Supreme Court of India. The petition sought the Supreme Court's intervention in bringing black money stashed abroad in tax havens into the country and bringing those responsible for tax evasion to justice. The case initially concentrated on a particular individual Hasan Ali, to make an example of him and thereafter widen the net. Hassan Ali was arrested by the Income Tax Department on charges of stashing over 360 billion black money in foreign banks. Thereafter, the Supreme

Court realised that it cannot monitor each case comprehensively, and a dedicated team needs to be set up which receives support and personnel from various government agencies. This team was designated Special Investigation Team (SIT). This team was headed by a retired Supreme Court Judge and was required to report to the Supreme Court to maintain complete transparency.

As per an advocate appearing on behalf of the government in the matter, I was told, " *We are prosecuting several individuals based on inputs from various sources. We are also taking steps to amend policy and bring about consensus to prevail on the government to take substantive legislative steps*" (Member, SIT, personal communication, December 17, 2017). At all times the SIT has kept the Supreme Court updated by filing status reports. In terms of those prosecuted (largely from the HSBC leaked list) it is possibly useful for me to quote from the 2nd Report filed by the SIT before the Supreme Court:

"*As per the information received from France, there are in all 628 persons/entities (except in 2 cases where the same names have appeared twice). Out of these 628 persons/entities, amounts/balances are shown against 339 persons and no amounts/ balances are shown against 289 persons/entities. In respect of the latter category also, further investigations and assessments are being taken to a logical end.*

Out of the said 628 persons, 201 are either non-residents or non-traceable, leaving 427 persons' cases as actionable. The amount involved in these cases as per details available in the information received is about Rs 4,479 crores approximately ($ converted @ Rs 45). Out of these, Department has finalised an assessment of 79 assesses (involving more than 300 assessments). An amount of Rs 2,926 crores has been brought to tax towards the undisclosed balances in the accounts relating to these persons. For the said amount, these assessees have been levied tax and interest at the appropriate rates. Penalty proceedings under Section 271 (1)(c) of the Income Tax Act, 1961 (IT. Act) have been initiated in 46 cases. Such penalties have been levied in 3 cases so far. With regard to the other assessees, proceedings are pending.

Further, prosecutions have been initiated in 6 cases u/s. 276C (1) of the Income Tax (IT.) Act for willful attempt to evade taxes and in 5 cases, proceedings have been initiated u/s. 276D of the IT. Act on account of willful failure to furnish information in response to the notices issued by the Income Tax Department. Show Cause Notices for filing prosecution have been issued in 10 more cases and further action would be taken at the earliest".

The SIT has been pushing very hard for curbing the menace of black money. It is emphasizing curbing the menace of "bogus bills" & over/under invoicing. SIT has attached utmost importance to curb the creation of fake/bogus bills which is a primary way in which income is suppressed and expenditure inflated to evade taxes. The advocate appearing for the SIT shared the list filed before Supreme Court by the SIT, concerning cases being pursued by Enforcement Directorate (ED) as below:

"a) From the details furnished by Directorate of Enforcement in relation to mining cases, on the basis of previous illegal mining of iron ore reports relating to Orissa, Goa and Karnataka, action has been taken. In one case of Orissa, accused persons were taken into custody by the Enforcement Directorate and properties worth more than Rs. 400 crores have already been identified and are under process of attachment. Regarding other cases, the efforts are on to get the data from the Director of Intelligence Bureau and State Government.

b) In respect of Karnataka, three attachment orders have been passed attaching deposits in bank worth Rs 54.84 crores, properties estimated at value of Rs 37 crores and shares valued at Rs 904.13 crores.Further, the orders have been confirmed by the adjudicating authority.

c) Further efforts have been made to ascertain whether any other proceeds of crime exist so that they can be provisionally attached. In respect of Goa and Jharkhand, the preliminary scrutiny and investigation is in progress.

d) It has been pointed out that because of stay order passed by the Hon'ble Kolkata High Court, the Directorate is facing difficulty in taking coercive action in Ponzi/chit fund scheme cases.

e) In respect of certain other cases, prosecution complaints have been filed. In case of one group case in Jharkhand, provisional attachment orders attaching properties worth Rs. 452.43 crores were passed, and adjudicating authority has confirmed attachment of properties worth Rs. 263.73 crores.

f) Five Letters Rogatories (LRs) have been issued by the PMLA Court. Replies to four LRs are pending while one LR has been returned and effort is being made to issue fresh LR.

g) In another mining case in Karnataka, provisional attachment for Rs 884.13 crores have been issued and confirmed by the adjudicating authority. Appeals are pending.

h) In respect of another group of cases of Andhra Pradesh, provisional attachment orders for Rs

1093.10 crores have been confirmed by the adjudicating authority. It is directed that necessary steps be taken immediately for realization of the amounts involved".

Furthermore, he said, "*This is not just a case. It is an ongoing investigation. The SIT and the Supreme Court are providing the framework and acting as the watchdog to ensure prosecution in 1000's of cases and provide the policy framework to ensure India moves towards a regime of laws that check the flight of black money effectively*" (personal communication, July 5, 2017).

The advocate for the state gave me inputs that I have reproduced above, in short, regarding the stand taken by the state and recommendations made as a result of this PIL. I was particularly fortunate in being able to meet all the petitioners and interact with advocates appearing for the state in this PIL. My interview with another petitioner on the subject was very comprehensive.[21] In fact, it is the insights provided by him that I feel are more relevant and pertinent for my study. He said that, though this PIL has made a lot of noise, the hard fact remains that it is only relatively smaller fish that have been issued notices as larger tax evaders have moved funds out of their accounts (of which details have been obtained). Thus, limited actionable information is available from the respective banks. This is also due to Swiss banking secrecy laws. As per him, the biggest players are beyond the clutches of the law. He told me that the single biggest case of which Supreme court took cognizance was one that amounted to nearly $60 billion which was allegedly connected to Hassan Ali. This value is ten times more than the worth of the richest individual on earth as per him. He personally knew Hassan Ali to be a relatively small player who dealt in a stud farm and horse racing.. He told me that he was a frontman to a politician of the same city, who was a close confidant and adviser to the most powerful leader in India and to the best of his knowledge, this money actually belonged to that leader. He felt that due to the sheer amount of money involved nothing much would come of the case. Since then, Hassan Ali has got bail and the matter is one of the pending cases in the Indian judicial system (personal communication, July 5, 2017).

2.4.3 Terrorism and Money Laundering

International organisations began to pay more attention to migrant remittance networks, also known as Informal Value Transfer Systems (IVTS) after the 2001 terrorist attacks. There had

[21] Name has intentionally been anonymised to conceal identity of petitioner

been earlier typology reports by the FATF that mentioned money laundering and the use of 'remittance services' in this context in Asia (Passas, 2003). The reports that followed gave out more details and mentioned hawala as an 'underground banking' system that was 'almost always associated with ethnic groups from Africa and Asia'. In addition to financing terrorism, these informal methods were presented as unregulated practices that could be misemployed towards money laundering. The turning point in the discussion that highlighted the use of hawala was the claim that hawala was used to finance the USA terrorist attacks by the *Al Qaida*. (Vlcek, 2018).

In general, terrorists may raise funds through legitimate sources including through the use of charitable entities or legitimate businesses and self-financing or through criminal activity including state sponsors and activities in failed states and offshore tax havens. India has been at the receiving end of terrorism for a long time, which includes Islamic terrorism, separatist terrorism as well as left-wing terrorism (Subramaniam, 2012; Khan, Ruiz Estrada and Yusof, 2016; Loan and Shah, 2018). However, it was only after the 9/11 attack in the United States, that the United Nations was prompted to adopt a convention on terrorism. At the outset, there are many differences between money laundering and terrorist financing. While money laundering requires huge sums of readily available cash flows usually made illegitimately; terrorism can operate on a shoestring budget. In terrorism, funds are processed from any source, including legitimate ones to finance the terrorist activities. Consequently, terrorist financing is more difficult to identify. In pure money laundering, it is possible to identify the criminal money from past antecedents. However, terrorist financing is aimed at the attacks planned for the future. Nevertheless, there are certain similarities between both phenomena. The techniques used to launder money are essentially the same, as those used to conceal the sources of and uses in terrorist financing. Funds used to support terrorism may originate from legitimate sources, criminal activities, or both. Nonetheless, disguising the source of terrorist financing, regardless of whether the source is of legitimate or illicit origin is important. If the source can be concealed, it remains available for future terrorist financing activities. Similarly, it is important for terrorists to conceal the use of funds so that financing activity goes undetected (Krieger and Meierrieks, 2011).

As per the FATF (2008), the direct cost of terrorist attacks in well-known cases is indicative of the actual costs being rather low, despite having vastly damaging consequences. According to the National Commission on Terrorist Attacks upon the United States on terrorist financing, the 9/11 plot cost the *Al Qaeda* somewhere in the range of $4000,000-500,000, of which approximately $300,000 passed through the hijackers' bank accounts in the US. These observations were noted in the National Commission on Terrorist Attacks upon the United States. The hijackers returned approximately $26000 to a facilitator in the UAE in the days prior to the attack. This signified the importance of money to terrorist organisations (FATF, 2008).

Vijay Kumar Singh (2009) mentions how money transferred via hawala accounts forms about 30-40 per cent of transactions in the formal economy. There are a large number of expatriate Indians residing in North America and the Middle East, and thus Indians lead as recipients of remittances in the world. As per the Reserve Bank of India (RBI), through formal channels, $ 28.8 billion remittances were transferred in the year 2006-2007 (Singh, 2017b). However, due to the exponential growth of black money, the need to launder grew as the generation of illegal money increased by the selling of human organs, rare animal flesh, antiques and other illegal items. According to Benson (2016), an individual's occupation, interpersonal and social relationships, etc. have an impact on their decision to launder money. Another view looks at the cost-benefit analysis as the reason behind decisions relating to operating in the black or informal economy (Becker, 1968).

In the next section, I provide an overview of the informal economy and its dominant schools of thought. Furthermore, I examine the position of the informal economy in the context of the evolution of the global governance regime; and how India fits into this narrative of evolution of international governance to combat money laundering and financial crime.

2.5 Global Financial Governance and the Informal Economy

2.5.1 Informal Economy Debates: Dominant Schools of Thought

The concept of informal economy in International literature can be traced back to the early 1970s. The term *informal sector* was coined by Keith Hart in 1973 while discussing unregistered economic activity in Accra, Ghana. In 1971, Keith Hart presented his paper on "Informal Income Opportunities and Urban Employment in Ghana" at a conference and the same was published in 1973. Harts's paper was based on income opportunities in the urban setting and he defined informal economy to simply consist of self-employed persons. It was his finding that informal opportunities of employment were created by persons who were neglected and denied employment by both state and corporate sector. For Hart, informality was merely a way for the poor to seek self-employment for economic gain. As per Hart, there had been studies before that talked about "economy of the street". However, it was after Hart's introduction of the terminology of the informal economy that a very clear dual approach took shape, recognizing the presence of both, a formal and informal economy. This persistent dualism found consensus within the ILO and led to the creation of the first of three perspectives on the relationship between formal and informal economy. These perspectives or schools of thought are namely; the *Dualist* perspective followed by the *Structuralist* and *Legalist* perspectives on Informal Economy (Bangasser, 2000).

In 1972, ILO published what has come to be known as the Kenya report and based on this and further efforts over three decades till 2000, ILO considers itself to have been the principal force behind the recognition and acceptance of the informal sector. ILO recognizes that the roots of the informal economy may be traced back to the 1950s very successful redevelopment of Europe and Japan using the institutionalised planned approach to the economy. It was thought that a similar planned model of development could help the developing nations where institutions could be set up and with an infusion of funds and preferential access to markets in the developed world they could generate employment for all. In practice, institutions had a high cost of operations and the government together with the institutions were unable to provide full employment (Becker, 2004). However, due to the possibility of operating at lower costs and fewer controls individuals were able to engage in what was referred to as informal economic activities.

The Kenya Report significantly changed the definition of the informal economy as provided by Hart and divided the urban economy into formal and informal, laying emphasis on support to the informal sector as a major element of developmental strategy. This could also be considered to effectively renaming W. Arthur Lewis's dualistic model for underdeveloped countries which divided them into modern and traditional sectors . According to the ILO (1972), within the dualist perspective, "the informal economy is a separate marginal economy not directly linked to the formal economy, providing income or a safety net for the poor" (Becker, 2004, p. 10). The 1970s also witnessed the emergence of the *Structuralist School.* According to this school, the informal economy exists as a subordinate entity to all formal activity. Informal workers and enterprises reduce the cost of the formal economy. By doing so, they also increase the competitiveness of formal enterprises. This perspective sees the existence of formal and informal sectors as unavoidably interdependent and interconnected (Castells and Portes, 1989). The Structuralist approach views the relationship between the formal and informal economy as complex and heterogeneous A significant contribution of this approach was the idea that there were deep forward and backward linkages between the formal and informal economy (Castells and Portes, 1989).

Viewed as the polar opposite of the structural approach is the neo-liberal approach which was utilised by Peruvian economist Hernando De Soto in 1989. Through his book titled, 'The Other Path: The Invisible Revolution in the Third World' (1989), De Soto caused a paradigm shift of sorts by examined the informal sector that had emerged in Latin America as a result of excessive state control. De Soto (1989) propounded that the informal sector is the result of excessive state control by 'plucky' individuals who in the face of stifling state policy and regulations found economic opportunities. He felt that it was these individuals who were the 'real revolutionaries'. Furthermore, he held that the prime movers of the informal sector were the real pillars of free-market economic thinking. De Soto gave a new twist to the debate on the informal economy when he said "In developing countries, much of the teeming masses do not consist of oppressed legal proletarians but oppressed extra-legal small entrepreneurs with a sizeable amount of assets" (De Soto, 1989, p.255). He championed an alternative view to Marx's "class struggle into a struggle for popular initiative and entrepreneurship". He proposed that the masses had come together as a front of extra-legal, micro-entrepreneurs against a bureaucratic, restrictive economy that denies them opportunities to accumulate capital. They were denied formal jobs and also formal, legal title to their property. De Soto was in favour of formalizing property holdings to free up capital for free-market development. Unlike his contemporaries who viewed growth in the informal economy as a rare exception, De Soto considered the informal economy as "real economy" of the third world with "real capitalists" brimming with potential for exceptional growth (De Soto, 1988; Bromley, 1990).

Later, in the 1980s and 1990s, with the rise of neoliberal economic policies globally, the *Legalist School* emerged. This school laid emphasis on informal production by micro-entrepreneurs and the likelihood of its continuance due to the costly and cumbersome nature of government procedures. As per this view, unnecessary and unreasonable government regulations stifle the growth of private enterprises . According to Thomas (2001), in order to analyse the informal economy, it is important to fully examine its sectors that are the informal sector, the underground sector, the household sector, and the criminal sector. Within the household sector, production and consumption of goods and services takes place within a home and these are absent in the open market. In the informal sector, legal services and goods are produced in an unregulated environment. Similarly, in the underground sector, legal goods and service are produced but illegally. This would include evading taxes and selling goods without a proper permit. Lastly, in the criminal sector, both the production and distribution of goods is conducted illegally. These sectors may overlap but form a significant framework in categorizing activities in the informal economy (Chen, 2005).

The more recent definitions of informal enterprises are much broader. The newly expanded definition, which was approved in 2002 at the International Labor Conference (ILC), acknowledges the role of the informal worker. It acknowledges that quite often the informal worker does the same kind of work as the formal worker but in an unregulated and unsafe environment. As per the definition of ILO (2002) the informal economy consists of, "*all economic activities by workers and economic units that are- in law or in practice- not covered or insufficiently covered by formal arrangements*" (Petrovici, 2019). This new definition looks beyond sectorial characteristics and takes into account unregulated, employment relationships like day-labourers and home-workers. Therefore, this broadened definition recognises the complex and multi-lateral linkages between formal and informal economies. Despite this recognition, the vast number of informal workers within the informal economy remain invisible (Chen, 2005), making the task of measuring their activities and allied implications, both positive and negative, for urban activities, all the more difficult but all the more important (Topxhiu, 2012).

Though there are a vast number of papers and other descriptions on informal economic activity with variations ranging from developed to developing countries (Ballard, 2005; Kulshreshtha, 2011; Topxhiu, 2012; Petrovici, 2019), there is need for more in-depth analysis of the policy implications of existing meta- definitions. There is very little data present on unregulated economic activity (Alderslade, Talmage and Freeman, 2006). The traditional models of market analysis used by financial institutions do not take into account the major buying power of the informal economy at local levels. This information gap leads to missed opportunities that encourage indigenous economic development and wealth creation due to the influx of predatory lenders offering substandard financial products. In such cases, the opportunity cost of functioning in the informal economy has the propensity to be substantially more expensive than operating in the formal economy. The reason for the growth of the informal economy is not just to evade government regulations and taxes by workers, but also because of the aforementioned barriers that prevail in the process of formalization or the worker's circumstances that prevent them from leaving informal economic structures. Though, in the formal sector, there are many benefits to be gained in the form of good working conditions, good wages and availability of financial assistance like small business loans, which may attract informal actors (Alderslade & Talmage, 2006).

Thus, it is pertinent that more research and investigation be conducted on the operations and functioning of the informal economy as it will be significant in aiding investors and policymakers about informal structures and make accurate information available. There are varied methods available to measure the informal economy and they need to be better aligned to support and adapt at local levels. This is especially true in the Indian context. Efforts need to be made to assess initiatives to quantify the informal economy at micro-market level. The assessment of informal activity needs to be done more intensively with relation to formal activity, as a unified economy and not as a separate entity altogether. Future research must also consider the case of India, where informal economy is not the same as the black or the 'economy of street' but the result of a well thought economic policy built on tax exemption and planned encouragement to small business. As mentioned in chapter I, the informal economy is neither criminal nor black but can be classified as a subset of the unorganized sector. According to Kulshreshtha (2011), "The informal sector according to the ILO and the unorganised segment are conceptually different in that the ILO concept focuses on a particular group of production units for socioeconomic reasons, while the unorganised segment is defined according to whether or not the units involved provide information to the statistics office in an "organised" manner. In the Indian context, the unorganised segment of the economy includes, in addition to the two kinds of household enterprises defined by the ILO as constituting the informal sector: (i) own account production of goods; (ii) imputed services of owner occupied dwellings;(iii) services of domestic servants consumed by the household that employs them; (iv) enterprises which do not provide regular accounts to the statistical services; and (v) private non-profit institutions serving households" (Kulshreshtha, 2011, p.125).

This research acknowledges that there is a vast pool of subsistence and the informal economy in India, which strictly speaking is not black, but exempt from tax as per law. As mentioned by Kulshreshtha (2011), the informal economy also consists of a large number of enterprises who do not provide regular accounts to statistical services as they perceivably fall below certain stipulated thresholds and qualify for tax exemptions. Such enterprises combined with a huge agricultural sector in India has sustained a large informal economy in India. I contend that this large informal economy forms the sea from which the black economy derives strength and sustenance. For example, the entire agricultural economy is effectively tax-free. This consists of at least 60 per cent of the Indian population (World Bank, 2019).[22] A chartered accountant in Delhi explained this further by giving the following example, "*A finance company can be set up to collect the investment from few hundred thousand persons whose name is taken from the electoral rolls. All this money comes from corruption and chartered accountants who are also consultants to bureaucrats and politicians whose money they manage through the finance company. This money is converted to white money and used for investment further, such as during elections for election campaigning*" (personal communication, January 17, 2018).

Thus, the available literature that treats money laundering in statistical terms based on aggregates, fails to capture the peculiar driving forces in India that work towards generating and deploying black money. The literature available does not fully take into account motivation for money laundering in India that arises from the application and objective that the holder of such unlaundered monies has in mind. It is my approach to find the motivation and application of money laundering. The fact that the Indian case is different was illustrated strongly when using classic economic theory, the Indian government banned Rs. 500 and Rs 1000 notes in a move popularly termed as the demonetisation drive, claiming that a large part of it was black money (Tamboli, 2017). What was surprising and particularly noteworthy here is that 99.30 per cent of demonetised money returned to the system, as per a report by the Reserve Bank of India (RBI)

[22] Till 2019, as per World Bank Development Indicators, Rural population (% of total population) in India was reported at 66 per cent

(The Economic Times, 2018).[23] This clearly demonstrates and confirms that due to the structure of the Indian economy, there exist options and mechanisms that allow money; that may be black in the account of XYZ, to be deployed in the economy in white, by ABC. I suspected and confirmed later that there was a two-way pipeline in the economy, which could convert white to black and black to white. I have examined this pipeline under the sections on the mechanism of de-laundering and the 'entry business' in India in Chapter VI.

2.5.2 The FATF and the Informal Economy in Developing Countries

Ever since its inception in 1989, the FATF has been working to help countries implement robust AML/CFT rules with the aim of combating money laundering (Pisa, 2019). Over the last decade, the FATF has provided recommendations to countries to formulate policies that "protect the integrity of the financial system, while at the same time support and facilitate financial inclusion" (Pisa, 2019, p. 2). In the late 2000s, the FATF started paying attention to the issue of financial inclusion as the international community became more attuned to the risks connected to money laundering and terrorism financing. In 2009, during a speech, the FATF President Paul Vlaanderen said, "the pursuit of financial inclusion and the pursuit of an effective AML/CFT regime are complementary; they are by no means conflicting financial sector policy objectives". In 2011, the FATF formally acknowledged its twin objectives of financial inclusion and financial integrity. These complimentary objectives would provide the basis for its future approach towards its guidance on AML/CFT, and influence the formulation of recommendations to countries (Lyman and Noor, 2014). A major challenge anticipated in this endeavour was the implementation of the common template of recommendations designed for both developing and developed high-income countries. While financial access could be assumed as a pervasive feature of the developed world, the situation was starkly different in the low-income developing world.

[23] Post demonetisation, Indians were permitted to deposit old currency notes, called specified bank notes (SBNs), in banks for a specific time period, with suspicious transactions to be brought under income tax scrutiny.

This divergence can be attributed to the presence of a large intrinsic informal economy in many developing countries (Pisa, 2019).

As per the FATF (2011), "*informal, unregulated and undocumented financial services and a pervasive cash economy can generate significant money laundering and terrorist financing risks and negatively affect AML/CFT preventive, detection and investigation/prosecution efforts*" (FATF, 2011). There has been a continued struggle on part of the FATF to adequately implement their anti-money laundering mechanisms in developing economies. William Vleck (2017) highlights the absence of informal economic practices from the narrative on global financial governance. Informal practices go beyond remittance transfers. It is to be understood from their very definitions that anti-money laundering practices cannot target informal practices within informal economies where these operate (Vlcek, 2018). These practices function beyond the purview of governments. Whatever activities are declared to be illegal within the formal domain operate within the domain of the informal economy. Within this context, the demands for goods and services that are declared illegal and are banned as per state laws, is then fulfilled within the informal economy. Given the large size and reach of informal economies, the implementation of anti-money laundering legislation becomes quite difficult. There are other variants within the cash-based informal economy that create obstacles for the effective implementation of anti-money laundering legislation. Referring to the cases of the Andean states of Bolivia, Columbia and Peru, Francisco E. Thoumi and Marcela Anzola (2009) identified three ways in which an 'inadequate environment' was created to implement anti-money laundering laws. What is referred to here is a 'legal transplant' wherein the guidelines set up by the FATF were followed but their implementation did not align with the national political economy of the above-mentioned states (Thoumi and Anzola, 2010; Vlcek, 2018). The way that formal and informal economies interconnected and overlapped in these states made it impossible for existing legislation to target the specific economic transactions used for laundering assets by organised crime syndicates (Vlcek, 2018).

Several issues come to light with the observation of key stages in the evolution of FATF; a global body engaged with dealing with informal economies, money laundering and terrorism financing. One of the key issues associated with the treatment of informal economies by the FATF is that whenever one typology or methodology relating to the way that money launderers operate is identified, alternative means are adopted by money launderers to escape the scrutiny of the FATF and to conduct their operations. There are other prerequisites needed to successfully implement methods used to monitor transactions within the formal sector to the informal economic sector. For instance, in order for agents within the informal economic sector to collect customer data, the customer needs to possess formal legitimate identification which is not often the case. Unless local government agencies maintain proper registries, verification of documents etc. it becomes difficult for the FATF to implement anti-laundering legislation successfully (Vlcek, 2018). The formalisation of informal economic sector agents is one proposed solution but there are some obstacles that stand in the way. These obstacles range from lack of institutional capacity to potential objections by the state governments towards documentation and classification of its citizens. These mechanisms also require technological support and relevant resources which may be absent or are difficult to consistently maintain. To remedy this, India is in the midst of a 12-digit unique identification system to collect biometric data on all citizens, called the *Aadhar* card system. The *Aadhar* has been touted as the world's largest biometric ID system. According to the World Bank Chief Economist Paul Romer, the Aadhar biometric system is "the most sophisticated ID programme in the world" (Daiji World, 2017). To summarise, by tracking the developments in the FATF approach towards anti-money laundering legislations for informal economies, it is evident that the problem lies in the structural approach of the organisation. One of the issues is alternative ways by which new evasive ways of laundering money are constantly discovered by agents operating within informal financial systems. Their structured approach undermines their capacity for dealing with evolving methods and techniques adopted by money launderers. The lack of flexibility in this approach makes it an ineffective one (Vlcek, 2018).

At this point, I would like to reiterate how the Indian case is different from the understanding of the informal economy presented in most literature on informal economies. The informal economy in the case of India cannot be equated with an illegal and unregulated economy. This can be attributed to the fact that, by law, only a small fraction of the Indian population is required to pay direct taxes such as income tax and property tax. This lapse is enabled by a series of tax exemptions provided by law. For example, there is no property tax liability in Delhi for someone staying on a plot measuring less than 25 sq. metres under Section 177 of the Delhi Municipal Corporation Act. Also, there is no property tax on rural housing. Thus, for property tax purposes, a large number of dwelling units which are very much in the system as they are reported by way of land records, are exempt from tax and are a part of the informal but legal economy.

Similar is the case of income tax. In a county of 130 crores, only 1.46 cr. Indian pay Income Tax (IT) as per PM Modi's speech to *Times Now Summit* in February 2020 (The Economic Times, 2018). This is 1 per cent of India's total population and 1.6 per cent of India's population which is above 20 years of age. This is not only because of the unreported or unregulated sector but this is so because IT law provides for several exemptions. The biggest one is that no tax is due and no need to file tax returns if income is below Rs. 2.5 lac p.a. Further the IT law provides that for persons up to Rs. 5 lakhs income per annum tax liability will be zero provided certain savings are made by the income tax assessee and Income Tax Return (ITR) filed. This has resulted in a situation where 99 per cent of the population is not paying Income Taxes, not all of the 99 per cent are having illegal incomes which should have been taxed. Furthermore, agricultural income by law is tax-free. The second types of taxes that the state levies be paid are indirect taxes. These constituted nearly thirty-seven different taxes, levied by the national government and various state governments, which have now been subsumed under the Goods and Services Tax (GST). The main tax amongst these was excise tax which was a tax on production and payable on the removal of goods from the site of production. Here too, there was a complete exemption for units having annual turnover of less than Rs. 1 crores as per the Excise Act (Rao, 2005). As a large number of manufacturers in India fall into the tiny or small scale industry, their activities were legal but part of the informal economy (Bairagya, 2010). Of course, when they produced more than the Rs. 1 crore limit and to avoid paying excise sold some of their produce without billing, they become part of the black economy. Even under the recent Goods and Services Tax (GST) regime, there are generous exemptions for small producers of goods and service provides. As per the decision of the 32nd GST Council Meeting on 10th January 2019, the exemption limit for the supply of goods has been fixed at Rs. 40 lacs and for services it is Rs. 20 lacs. This takes a large number of manufactures, goods and service suppliers out of the GST net (Government of India, 2019).

In India, I discovered that the state; by design, encourages an informal economy by offering a series of tax exemptions. Thus, in India the informal economy cannot be called an entirely unregulated economy; it is not all illegal and consists of, what I define as, legal informal economy and the black economy. I discuss these contours of the Indian economy in the next chapter.

2.6 Conclusion: How this study bridges the gap in the literature

A review of the literature on global money laundering does not yield much empirical evidence regarding the exact volume of laundered funds, but does reveal various perceptions of authors who studied this phenomenon. As is apparent from the discussion in the previous four sections, the literature on money laundering derives from criminology, as its starting point and assumes that money so generated must be laundered, so as to be usable in the legitimate economy. The fundamental assumption of money laundering seems to be that money must be laundered, so that it can come into circulation; as legitimate currency. This is not the case in India. To elaborate further on this distinction of my case study i.e. India, I closely examine the interplay between the informal, formal economy and its demands in India, which are intrinsically linked to mechanisms of money laundering. My primary research aim is to analyse the relationship between drivers of money laundering in India and the economic reforms of 1991. I take the traditional remittance mechanism of *hundi* and *hawala* as a starting point of analysis and examine the role of players, their motivation and contribution to the continued usage of these institutions. Additionally, I explore the various mechanisms employed for money laundering i.e. converting black money to white money by constructing and analysing India-specific typologies of money laundering. The construction of the India specific typologies is expected to be a useful contribution of this study to country-specific typologies research. While there are some sector specific (Passas, 2003; Terry *et al.*, 2018) and some region specific (Chaikin and Sharman, 2007) typologies research available, I discovered that the country specific typologies within these classifications for India were limited to regional trends in South Asia. Thus, this study aims to fill this gap in the 'Preventive' strand of literature on money laundering as effective AML frameworks and better policies can be built on a better understanding of country-specific mechanisms of money laundering.

Furthermore, the literature benefits from classic theories of international trade and expands further into economics; this is particularly true of the Gravity Model on global money laundering. With the increase in size and nature of money laundering mechanisms and increasing awareness about the same, legislative responses added to the body of literature. However, there is a lack of literature on the individual behaviour of money launderers which could help establish a causality link. There is a need to bridge the gap between these disciplines, as well as incorporate policy responses within this body of literature. More importantly, most empirical models on money laundering have limitations due to the nature of the activity studied. They also have a predominantly western orientation based on reliable data streams. This poses two problems for my case study i.e. India. Firstly, such hard data is not available in India. Secondly, post-liberalisation there has been limited study of how traditional indigenous systems used for money laundering have adapted to structural changes in the Indian economy. This will be the focal and starting point of my thesis. This study finds that the economic structure and the vast population of India interplay to give rise to demands and opportunities which can be satisfied by innovative application of traditional mechanisms of money laundering. I will analyse how these indigenous mechanisms; namely *hawala* and *hundi* which are classified as an IVTS (Informal Value Transfer system) (Passas, 2005)*,* have been affected by liberalisation. Through empirical research, I conclude that post economic liberalisation in India, *hawala* has evolved with technological advancements in the financial sector while retaining its functionality in more traditional roles. The economic reforms of 1991 combined with the IT revolution that took shape in the mid 1980s, enabled beneficiaries and operators of *hawala* in improving its functionality by adopting modern technology and involving professionals in its application. I have termed this modern avatar of *hawala* as *hawala* 2.0. While it is still classified as informal, in the Indian case it is now well integrated with the formal banking system, particularly after liberalisation, with the involvement of professionals such as lawyers and accountants. I will examine this in detail in chapter IV.

Predominantly, the literature on money laundering is written with a western lens, where there is a social contract between the people and the state, by way of income tax. This is very weak in India and the formal economy, which pays most of the taxes and sustains development, is actually supported by a very small percentage of the population and in turn supports a very small percentage of the population through employment generation. According to a recent report by the ILO titled 'Men and Women in the Informal Economy- A Statistical Picture', up to 94 per cent of the Indian population is dependent on the informal sector for employment; in the case of the agricultural sector, it as high as 99.3 per cent. In the industrial sector the figure stands at 68.8 per cent and in the service sector at 54.1 per cent (ILO, 2019). The lack of penetration of the formal economy in the lives of Indians can be assessed by the fact that less than 2 per cent of the population pays income tax (Kumar, 2002). The formal economy which generates revenue for the government generates very few jobs for the people.

The available studies fail to go into the differentiation vis-a-vis the motivation for money laundering, motivation for keeping black money as black money; and motivation for de-laundering money i.e. to convert white money to black money. In this thesis, I argue that as the Indian economy has grown since independence, its appetite has also grown for black money. The main causal factor for the growth of black money in India which serves as the feedstock for money laundering, as it has evolved in India, has been traced to various forms of corruption, tax avoidance and kickbacks. Moreover, there is scant literature available on the liberalisation of Indian economy and its relationship to money laundering. There is some literature on black money and liberalisation based on the critical political view that liberalisation leads to an increase in the generation of black money. However, there is considerable literature available on the relationship between growth and liberalisation in India, which I have studied and found relevant to this study (Atul Kohli (1980), Rodrik and Subramanian (2004), Harris-White (2003), Rob Jenkins (1999), Bardhan (1998), and Mushtaq Khan (2011)). I have made an attempt to correlate the fruits of liberalisation as expressed in these papers and views put forward by these economists, combined with primary research through semi-structured interviews with the senior-most players in the field of money laundering (who are normally inaccessible). These players provided me with insights regarding the motivations, uses and mainly the need for hawala and money laundering in India. I have studied the nuances that motivate different players, based on their need for laundered funds in India or abroad. India is a special case in terms of understanding the forces that are at work propelling its economy. Its vast informal economy intertwined with the black economy acts as an anchor, preventing harsh downturns; even in economic slowdowns like the one faced in 2008 globally. Any generalised statistical study, of the kinds which are available, fail to catch the finer nuances of the role of money pertaining to any of the three kinds of economic activity enumerated in this study, i.e. formal, informal or black economy. In order to fill this gap and as a starting point of analysis, it is important to understand the three overlapping, distinct segments of the Indian economy i.e. the formal, informal and black economy. Together, these constitute the Indian ecosystem within which mechanisms of money laundering operate and facilitate the movement of funds from one segment of economy to another. I examine this interplay in the following chapter (III).

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Chapter 3

The Contours of the Indian Economy : The Interplay of the Formal, Informal and Black Economy and Economic Liberalisation of 1991

Chapter III

The Contours of the Indian Economy : The Interplay of the Formal, Informal and Black Economy and Economic Liberalisation of 1991

"At the heart of this business, and what ensured its survival and growth, is the reality that the Indian economy has a kind of dual personality, split as it is, into the 'white' and the 'black' economy, with cash transactions (though not always of an illicit nature) dominating the latter. But these economies don't exist separately from each other. They drive each other, and feed off each other, and money flows from one into the other, depending on the economic cycle and entrepreneurs animal spirits"

~ The Economic Times (2017)

3.0 Introduction

This chapter examines the institutional practices of the formal, informal and black economy in India, as it is imperative to incorporate their interplay into the macro analysis of the typologies or mechanisms of money laundering within which they operate. The need to incorporate the analysis of these three key sectors of the Indian economy is not just an empirical matter but a theoretical necessity. This is because money flows are moving in all directions within these sectors as well as to and fro from these sectors. In this chapter, I present an analysis of the Indian economy and the interplay of its three components: the formal economy, the informal economy and the black economy. To begin with, I have discussed the interplay of the three economies in India i.e. the black, informal and formal economy. Secondly, I have examined the definition and understanding of the three economies in context of India. Furthermore, I discuss the impact of economic liberalisation in India on the formal and informal economy in India. Under this discussion, I discuss the reasons for economic reforms and the scope and content of reforms under liberalisation in context of the formal economy in India. Additionally, I discuss the issue of lack of availability of formal credit in the informal economy as an important factor contributing to reliance on informal credit sources. Furthermore, I examine the concept of the black economy in India. Lastly, to contextualise the empirical research material in succeeding chapters, I summarise my findings in table 3.1.

3.1 Interplay of Formal, Informal and Black Economy in India

In this chapter, I further illustrate the interplay of the black economy with the formal and informal economy in India. The formal-informal dichotomy has been a contentious issue in the development policy discourse for more than the last three decades (Lipton, 1984). Despite the significance of these opposing frameworks in the paradigm for economic development, there is lack of a clear definition of these terms in the economic literature (Cross and Sergio Peña, 2006). In fact, a bewildering range of definitions abound in literature, discussing the formal and the informal economy as a continuum of each other, and not distinct separate wholes with distinctive characteristics (Cross, 1998). A majority of these definitions highlight two important dimensions: First, the notion of reach of official governance and secondly the nature/structure of the organisation (Guha-Khasnobis, Kanbur and Ostrom, 2005). The first dimension highlights the importance of enterprises that are registered and within the tax net as formal enterprises. The second dimension identifies formal enterprises as units whose activities and interactions among its individuals are 'structured', as per a predictable framework or comprising the 'organised' sector. However, the association of the second dimension as a basis for the classification of the formal sector has proven to be problematic (Guha-Khasnobis, Kanbur and Ostrom, 2005). A striking illustration of this is the software sector in India. As per the Indian national accounting records, the output and exports of the software industry were classified as 'miscellaneous' instead of being classified as 'manufacturing' and 'services' (Sahoo and ten Raa, 2009). This is indicative of the extent of the informality of the software sector, which allowed the sector to grow rapidly, without interference from the government, despite being a fairly regulated economy even after economic reforms. Being categorised as an informal sector has helped the software industry of India become one of the fastest export sectors of India. Thus, the propensity to associate informality with the lack of a structure is conceptually unsound and leads to policy paralysis;

where the state superimposes structures on pre-existing ones, assuming the lack of these. This is particularly true of India, where new forms of state intervention have been layered upon the existing sediment of indigenous structures, such as in the case of hawala as discussed in the last chapter. In fact, it is important to note that India considers unincorporated enterprises, that maintain accounts as quasi corporates, as part of the formal sector.

Furthermore, in international economic literature, the term black economy is often used interchangeably with the informal economy, shadow or underground economy (Dilnot and Morris, 1981; Frey and Pommerehne, 1984; Frey and Weck-Hanneman, 1984; Robinson, 1988; McCrohan, Smith and Terry, 1991; McCrohan and Sugrue, 1998). For this reason, it is important to establish and distinguish between the informal and black economy in India, by clearly defining both. During my fieldwork in India, I was informed by chartered accountants and businessmen that it was impossible to conduct a business that was transparent and fully reported. This could be attributed to the large amounts of money needed for feeding corruption, client acquisition, rent-seeking and political patronage, which were characteristic features of the Indian developmental state (Khan, 2000). I was told repeatedly that electoral politics and the need for running large political parties was the single biggest reason for the need for black and unaccounted money, which gave rise to an entire ecosystem of the interplay between formal, informal and black economy. Further, interviewees revealed that no segment of the economy is isolated and separate in terms of its interaction and role vis a vis other segments due to ingrained interdependence. To understand this, I was given several examples in the interviews I conducted with businessmen and CAs. I have analysed these examples for this study and this analysis has coalesced into an examination of the topology of the Indian economy and the interplay of its three overlapping components. Thus, to understand the interplay of these three components of the Indian economy, I have illustrated them in the Venn diagram below. I would like to analyse each of the above components, through examples of economic activity that lie within each of the segments illustrated in Figure 3.1.

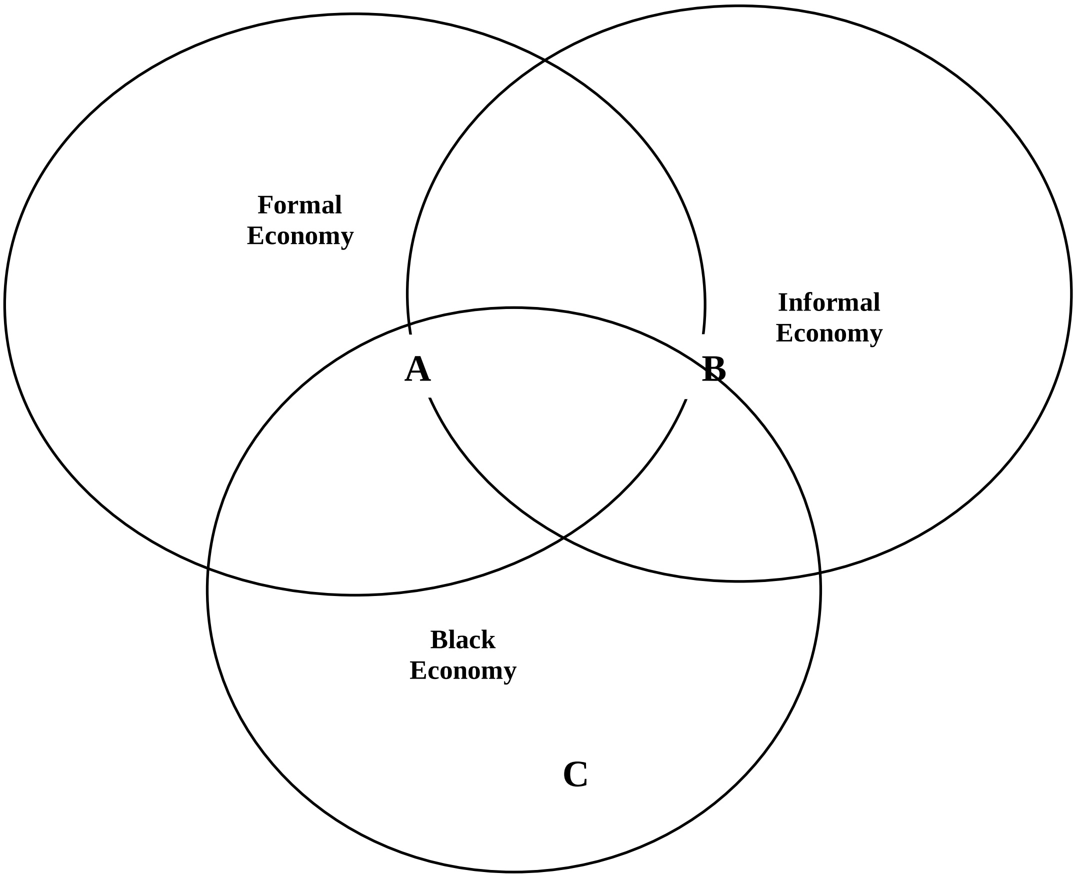
Illustration 1: Activity of a player in the Formal Economy tied to black and informal economy: An NGO establishing a school

The formal economy consists of entities that are maintaining accounts of their activities regularly as per law, filing tax returns and paying due taxes to the state. I consider a representative example of an entity in the formal economy to illustrate the interplay between the three segments. Under normal circumstances, in an uncorrupted economic system, these activities would be run transparently and would have no overlap with the informal or black economy. However, the reality is that there is a considerable overlap as is illustrated below for this representative example.

Initially, the money for setting up the NGO and the school comes from donations that are tax exempt from donor entities. Invariably, these donors are large business corporations. When land is acquired to build the school, even by preferential allotment by a government body, considerable kickback has to be paid. This kickback goes to bureaucrats and politicians. This amount must come from either converting the donated amount into black money or by way of additional investment by the parent donor in black money. Alternatively, if the land is purchased from the open market, typically 40-60 per cent of the value has to be paid in black money while the rest is paid for in white or accounted money.

In such cases where a component of land value is paid in black money then the transaction falls under the intersecting segment $A \cap C$ i.e. activity that lies in both the formal and black economy. It is understood that when operational, the school incurs many of its expenses through small contractual assignments which deploy persons from the informal economy who issue their respective invoices to the school for services rendered. Such activities fall under $A \cap B$ i.e. activities of both formal and informal economy. The school is part of a tax-exempt NGO and thus is also often used by the controlling donor business entities for moving large amounts of cash into its accounts by way of donations, and out of its accounts when needed by the business entity by misinvoicing. Such invoices may be for services or supplies not rendered or only partly rendered. Such activity falls under $A \cap B \cap C$ i.e. activities in formal, informal and black Economy.

Further, when an invoice is raised under which no service is actually performed or no supply is actually made to the school, then that activity falls under $A \cap C$ i.e. activities of the formal and black economy. Further, in the working of the school, it is well known that capitation fees (besides regular fee) play a big role in getting admission to the school. This fee is taken in cash and is thus black money and forms an element of $A \cap C$. There may be some supplies bought by the school management or bought by the school contractor to complete the task assigned to him. If the item so procured is from the black market, then the entire transaction forms an element of B ∩ C i.e. activities of both informal and black economy.



SEGMENTS OF THE INDIAN ECONOMY

A. Formal Economy

B. Informal Economy

C. Black Economy

A∩B. Activities of both Formal and Informal Economy

A∩C. Activities of Formal and Black Economy

B∩C. Activities of both Informal and Black Economy

A∩B∩C. Activities in Formal, Informal and Black Economy

Figure 3. 1 Topology of the Indian Economy

Illustration 2: Activities from the Informal Economy: Farmer and Small Trader

Now, I take an example from the informal economy of a farmer or a small-scale trader. Their own income may not be reported, as it may be tax-exempt; in the case of the farmer and not covered by GST, in the case of the trader who too would claim his income to be either tax-exempt or covered under a very generous presumptive tax regime. They are buying products from the formal economy, like a car or a tractor. Further, they are also buying some or more things that go into their consumption such as fertilizer or items for trade from the formal economy. This constitutes $A \cap B$ i.e. activities of both formal and informal economy when these procurements are done against invoices. When these procurements happen without invoices, then the transaction falls under the informal and black economy i.e. $C \cap B$.

What is noteworthy and was repeatedly emphasised by lawmakers, accountants, lawyers and businesspersons during my interviews is the sheer size of the informal economy. The informal sector provides a huge number of identities of individual and corporate identities which are all available for manipulation and misrepresentation by clever professionals, i.e. accountants and lawyers. This creates a virtual sink for putting in white money and converting it to black or alternatively, this can be treated as a deep well to draw huge amounts of money in the names of these corporate or individual entities as white money (This is an important finding of my research and is discussed in the chapter VI on de-laundering in detail).

This is confusing, and on deeper consideration, I came to the counterintuitive conclusion that the entire system was geared not only to launder money, but also de launder it. It is this that forms the backbone of financial money laundering/de laundering mechanisms that allow the constant interplay between the black and white economy of India; using the vast number of entities in the informal economy which has the capacity to generate black or white money as may be required, on short notice. This was proven graphically to me when high-value currency namely Rs 500 and Rs 1000-rupee notes were demonetised by the Indian government in November 2016.

The bulk of the money in public hands before demonetization found its way back into the banking system, much against the expectations of the policymakers, who had resorted to demonetisation to get rid of black money. As per RBI data, there was a total of Rs 15.41

lakh crore of Rs 500 and Rs 1000 notes in circulation on Nov 8th 2016 when demonetisation was announced. More than 99 (99.3) per cent i.e. Rs 15.31 lakh crore returned to the banking system (PTI, 2018). This was made possible by an elaborate system that was able to work at full throttle to 'launder' this humongous amount of money, defeating the very purpose for which demonetisation was done.

In the following section, I examine the concept of the formal economy, as applicable to India, with a focus on how it evolved with a policy shift towards liberalisation of 1991.

3.2 The Formal Economy in India

According to Rada (2010), India's formal sector comprises of those enterprises that are registered in the official records and comply with legal provisions of the country. During the 1990s, as per data collected by India's Central Statistics Organisation (CSO) and National Sample Survey Organisation (NSSO), the informal sector accounted for 60 per cent of total national output and nearly 93 per cent of total employment in the country (Rada, 2010). While the share of the economy-wide output of the formal sector has been gradually increasing (6 points since the 1990s) due to the expansion of the tertiary sector in India, an ostensibly large proportion of the Indian labour force is still employed in the informal sector. (Sinha and Adam, 2004; Bhattacharya and Sakthivel, 2005). In India, the secondary sector has seen a shift in favour of the informal sector, with the diminishing role of the formal sector to the informal sector (Mehrotra, 2019). The economic literature on classic patterns of growth has regarded the industrial or secondary sector as the engine of growth (Szirmai, 2009). According to classical theories of structural transformation, sustained economic growth is inextricably linked to productivity growth within the industrial sector and hence to structural transformation (Kaldor, 1976; Lewis and Brooks-Gunn, 1979; Thirlwall, 2011). The Indian economy is an exception to these patterns and has been bolstered by the service or tertiary sector, which has been hailed as its engine of growth since economic liberalisation (Chen, 2005).

The terms "structure" and "structural change" are widely used in economic literature (Gabardo, Pereima and Einloft, 2017; Van Neuss, 2019). While structural changes are commonly associated with economic development and changing compositions of productive systems (Ricardo, 1871); the most recent understanding of the term pertains to long term and persistent shifts in the sectoral composition of economic systems (Syrquin, 2010). The term 'Structural Change' is reminiscent of a time in India's economic history when the then Prime Minister, Manmohan Singh announced in a historic address for India, major structural changes in policies from import substitution regime to a free-market regime in the early 1990s (Mukherji, 2009). Post the economic reforms of 1991, the economy has seen a high growth rate and is regarded as one of the fastest-growing economies in the world (Aiyar, 2016). It has been growing at an annual average rate of 6.86 per cent during the two decades of economic reforms (1992-93 to 2009-10) as against 4.07 per cent during the four decades prior to the economic reforms (i.e. 1950-51 to 1991-92). Also, the growth of the economy scaled up particularly after the year 2000, with the growth averaging at an annual rate of 7.32 per cent during 2000-01 to 2009-10 and 8.46 per cent during 2003-04 to 2009-10 (Saikia, 2012). The introduction of economic reforms in 1991 is often regarded as the sole turning point in India's post-independence economic history, providing a break from the low growth trap in which the country's economy had been caught for four decades (Bardhan, 1984). This fixation on growth rate leaves out the issues relating to structural changes and the changes that take place in the development process from a long-term perspective (Papola, 2012). In order to analyse how liberalisation has affected both the formal and informal sectors, it would be useful to analyse the components of the reforms.

In the next section, I discuss the primary political dimensions of the reform process in India. As per Haggard and Kaufman (1992), any discussion on the politics of economic reforms should be focussed on three aspects of the reform process. Firstly, why were the reforms initiated? The second dimension should address the scope and content of the reform process. Thirdly, an analysis of the sustenance and implementation of the reform process is necessary to understand how various interest groups responded to its initiation (Haggard and Kaufman, 1997). To address these three dimensions, I draw upon development economy literature on the politics of economic reform in India.

3.2.1 Reasons for economic liberalisation

The sudden initiation of economic reforms in 1991 was triggered by an acute balance of payments crisis (Pedersen, 2000). The government faced a severe liquidity crisis with fast depleting foreign exchange reserves (Nayyar, 1982). This prompted the government to undertake a major structural shift in development strategy. The reforms have been primarily focused on liberalising the trade and industry sectors. This includes the reduction of tariffs on imports, which has been reduced from a weighted average rate of 87 per cent in 1990–91 to 29 per cent in 2001–02 (Williamson and Zagha, 2002). The abolishment of industrial licensing for all except 18 industries, followed by a reduction in the number of industries that were reserved for the public sector. This number has decreased to 3 in 2000-01 from 17 in 1991-92 (Srinivasan, 2003). Further, the government has taken a conscious policy decision to encourage FDI by relaxation of controls (N Srinivasan, 2003). The policy sanctioning automatic approval of up to 51 per cent (up from 40 per cent) equity holdings of 34 priority industries is indicative of this development (Virmani, 2003). According to Arvind Virmani (2003), noted Indian economist, “The 51 per cent level was chosen as this allowed foreign companies to amalgamate profits and losses from such a company into those of the parent company for tax purposes”. This ‘automatic route’ list was expanded to 48 industries in 1996-97. However, these reforms have been introduced in a gradual, intermittent and incremental fashion, rather than a ‘big bang’ as the image of economic liberalisation policy often evokes (Nayar, 2007).

A crucial component of policy reforms introduced in the 1990s is often not included in the development economy literature of the reform process in India. I believe, the introduction of the 73rd and 74th constitutional amendments which stipulated the decentralisation of powers to the *Panchayat* level i.e. the village level institutions for self-governance, was a critical part of the reform process (DeSouza, 2003). The significance of this amendment lay in the fact that these reforms put developmental funds in the hands of units of local self-governance called ‘*Panchayats*’ at the village level, directly from the federal government bypassing the state government(Johnson, 2003). This empowered the heads of local self-governance to spend money on local projects. This deepened the democracy and also created village level centres of corruption. I have elaborated this in detail in section 5.5.1 on the emergence of democratic decentralisation in India through the 734d and 74th amendment to the constitution of India concerning the *Panchayati* system.

According to some political economists, the role of intergovernmental organisations such as the WTO is central to the adoption of the liberalisation and structural adjustment programme in India (Bhaduri and Nayyar, 1995; Patnaik, 2000). Patnaik (2000). This emphasizes the role of Bretton Woods institutions and their motivations to encourage developing countries to undertake economic liberalisation. He argues that the removal of trade restrictions and opening up of markets in developing countries primarily served the interests of international capital and its main players, such as MNC's who acquire local companies with huge profit margins. According to Bhaduri and Nayyar (1996), while the liquidity crisis of the early 1990s was problematic, it did not warrant the complete abandonment of the Nehruvian socialist doctrine adopted at the time of independence. As a part of the IMF financial assistance package, India was compelled to commit to reform measures that did not cater to Indian indigenous institutions and historical experiences, but on a western policy prescription, having little in common with Indian realities (Corbridge and Harriss, 2013). In contrast, Nayar (2003) disregards the international pressures to open up the economy, furthering the notion of the economic reforms reinforcing state autonomy rather than dismantling it (Nayar, 2003). Thus, international pressures alone cannot explain the scope and content of the continued momentum for reforms in India.

Presently, the widely held view among a notable number of political economists, in line with the views of Atul Kohli suggests that the Indian economic reforms were not market-friendly, but business-friendly (Kohli, 2006).

In the following section, I have made an attempt to discuss the salient features of the reform process, since 1991, undertaken by the Indian economy and the factors that influenced the process.

3.2.2. Scope and content of reforms under liberalisation

Most political economists approach the scope and content of the reform process by relating it to the dominant political and economic interests of the time. As per Pranab Bardhan's (1984) influential study on India in the mid-eighties, the Indian political diaspora was divided into three prominent dominant classes: the industrial capitalists or new business owners, affluent landowners and military and civilian professionals of the state. He argues that that the reforms catered to the interests of new business groups. These interests were protected through international trade agreements, loan constraints and the CII (Confederation Of Indian Industries), an organisation that was created to create and sustain favourable conditions for new businesses (Bardhan, 1984). Besides, the CII was a major proponent of globalisation and supported delicensing measures by the Indian government(Kohli, 2006). Bardhan's interpretation, though plausible, brings to the fore a pertinent question. How did the ruling propriety classes reconcile their own vested interests with the new policy measures and allow the reforms to be carried out in a sustained manner? Furthermore, economic liberalisation as a policy has pervaded every political quarter and the mainstream consensus opines that there is widespread acceptance of the reforms, particularly among elite political factions, with very minimal opposition (Nayar, 2003).

Given that India is a uniquely heterogeneous democracy, both in terms of its political factions, as well as economic stratification, this lack of opposition amidst numerous possibilities of dissent poses a puzzle for political observers of the Indian reform process. The answer to these two intriguing questions can be found in the works of Ashutosh Varshney (1999); among others, who argues that the economic reforms were implemented selectively by political elites. Owing to political considerations, political elites consciously ignored certain sectors; particularly politically sensitive sectors which could potentially hamper the appeal of the political elite to their mass electoral voter base (Varshney, 1998). He argues, "Reforms that touch, directly or primarily, elite politics have gone farthest: a large devaluation of the currency, a restructuring of capital markets, a liberalisation of the trade regime, and a simplification of investment rules" (Varshney, 1998, p.323).

Another explanation comes from Rob Jenkin's, who developed an original interpretation of the forces that made reforms sustainable in India in his book 'Democratic Politics and Economic Reform in India'. According to Jenkins (1999), the political elite in India is sanguine regarding the prospect of economic reforms, as they believe that the reforms will not hamper their existing position of power and instead reinforce new forms of coalition building and patronage, furthering their strength in society (Jenkins, 1999). Thus, there is the political will to take risks and introduce reforms that could potentially provide bigger opportunities to earn illegal incomes and rent.

According to Jos Mooji, "the reforms, it was thought, would only provide new opportunities for corruption and earning illegal incomes" (Mooij, 2005). Further, Jenkins (1999) describes the manner in which the reforms are introduced by the political elite. He employs the notion of 'reform by stealth' to describe the inconspicuous and often underhand ways in which reforms have been introduced in India. Thus, reforms were introduced quietly and political leadership was successful in implementing reforms without major opposition, by masking a change in the guise of continuity.

An argument put forth by Corbridge and Harriss (2013) demonstrates the 'winners and losers' of the liberalisation paradigm. They claim that the economic reforms have only managed to continue, as they have continued to serve the interest of the most powerful interest groups in the country(Corbridge and Harriss, 2013). In a similar vein, Pedersen (2000) contends that Indian businesses went through a silent revolution in the eighties, with technology-driven sectors taking over the business sector (Pedersen, 2000). These sectors led by the software and computers industry were promoted by the CII in the late eighties. Pederson (2000) believes that it was this technology-led growth that sustained the momentum of the reforms in the 1990s. Despite being hailed as a neglected sector, several key reforms were silently implemented in the agricultural sector. These included, among others, the removal of central government restrictions on the movement of agricultural commodities, as well as the removal of quantitative restrictions on agricultural trade (Jenkins, 1999). In fact, the momentum of the reforms was not disturbed, even with the change in government in 1996, when a coalition government headed by the Janata Dal party came to power replacing the Congress government. Reforms in key sectors continues to be a feature of the formal economy, through 1998 and 1999 when the BJP led coalition government came to power (Mooij, 2005).

In the following section, I examine factors in the economy that were responsible for the consolidation of the reform process in India from even before i.e. since the 1980s itself.

3.2.3. Consolidation of the Reform Process

According to Denoon (1998), India has been oscillating between bursts of liberalisation and backtracking, to the closing up of the economy since the early sixties. The eighties were witness to small episodes of liberalisation, one between the period 1980-84 under the leadership of Prime Minister Indira Gandhi and another between the period 1984-89, under her son Rajiv Gandhi, the then Prime Minister (Aiyar, 2016). This intermittent incremental liberalisation of the 1960s, 1970s and 1980s was followed by a structural shift in 1991, with a resolve by the government to initiate 'deeper reforms' (Panagriya, 2004) in major sectors of the economy. In fact, the higher growth rate associated with pro-market reforms can be dated to the eighties and predated to the paradigm shift of 1991 (Rodrik and Subramanian, 2004; Das Gupta, 2007; McCartney, 2009; Khan, 2011). On the opposite side of the political spectrum, some economists contend that the 'big bang' liberalisation was critical to sustain the higher growth witnessed in the early 2000s in India (Panagriya, 2004). According to Panagriya, "It has been argued that reforms in India cannot be credited with higher growth because growth rate had crossed the 5 per cent mark in the 1980s, well before the launch of the July 1991 reforms. This is a wrong reading of the Indian experience for two reasons. First, liberalisation was already underway during the 1980s and it played a crucial role in stimulating growth during that decade. Second, growth in the 1980s was fragile and unsustainable. The more systematic and systemic reforms of the 1990s, discussed in detail, gave rise to more sustainable growth" (Panagriya, 2004, p. 2581).

It is important to acknowledge that the majority of the reform policies were focused on the trade and industrial sectors (Ahluwalia, 2002, 2019). In fact, it has been argued that these reforms were part of a larger design motivated by signing favourable international trade agreements. As part of the reform process, India embarked on policy initiatives to attract FDI and also entered into bilateral agreements for avoiding double taxation. However, these agreements have been exploited extensively through round tripping of funds. These agreements were part of India's conscious decision to attract FDI into the country; and led to unintended consequences such as importing the ills of tax competition and furthering commercialisation of state sovereignty (Palan, 2003). I endorse the views of Jenkins (199) but go a step ahead in crediting the existing structures of informal finance, which allowed the Indian elite to embrace liberalisation, so wholeheartedly. It is surprising that apart from the leftist parties, liberalisation has been embraced by almost every political party, creating and furthering new forms of patronage. These new forms of rent-seeking, clientelism and patronage are not new in their form or function; instead, they carry the veneer of the neoliberal paradigm, with larger volumes of money, transactions and players operating within this ecosystem. This could be one of the reasons attributed to the continued relevance of the black economy in India, since independence.

In the next section, I examine the concept of the informal economy in India which is not only very large but also diverse in nature. Its importance and diversity can be summed up in the words of Barbara Harris-White (2020), "It includes agriculture, despite the fact that land titles are registered, except for plantations, which are regarded as 'organised' despite their unravelling workforces. But it also includes most of the rural non-farm economy and the vast services sector, from high-end to low-end, the manufacturing labour force, workshop industry and trade. While there is no comprehensive data, and we have to extrapolate from surveys and case studies which involve a multitude of inconsistent concepts and terms, we do know it is very large, absolutely and relatively, compared with other low-middle income countries. Its size is distinctively Indian" (Harris-White, 2020).

3.3 Informal Economy

As per Vaidyanath (2004), the informal sector in India is a subset of the unorganised sector, which in turn is a subset of the un-incorporated or non-corporate sector of the economy which consists of partnership/proprietorship firms and self-employed individuals (Srinivasan, 2017). He further argues that the unincorporated sector in India, has the largest share in national income, savings, direct and indirect taxes, employment, manufacturing, services, etc.

The informal sector and unorganised sector are often used interchangeably in economic literature in India. The National Sample Survey Organisation (NSSO) carried out the first national survey on informal non-agricultural enterprises between 1999-2000. This survey defines all un-incorporated propriety and partnership enterprises as informal sector enterprises. The unorganised sector includes cooperative societies, trusts and public and private limited companies, aside from small and medium propriety and partnership enterprises (Srinivasan, 2017). Clearly, the informal sector is a subset of the unorganised sector in India (Harriss, 1978;

Srinivasan, 2017).

According to the Government of India *Report of the Committee on Unorganised Sector Statistics* (2012), "As per statistics available in India so far, it has been seen that GDP from the unorganised sector is almost half of the total GDP. However, the very nature of this sector mostly characterised by the huge proliferation of tiny production units, hardly maintaining any accounts and remaining invisible or non-observable most of the time, does not allow direct measurement"(National Statistical Commission, 2012). This statement highlights two important facets of the informal economy, as a subset of the unorganised sector in India. Firstly, it emphasizes the importance of the sector as an integral segment of the Indian economy. Secondly, it highlights the inability of the Indian accounting system to capture the extent and value of its activities.

It is widely acknowledged that the unorganised sector in India is starved of capital in the form of credit from the organised sector (Dutta and Kar, 2017). Unable to secure access to funds for working capital from the organised sector, players in this sector borrow funds at usurious rates from the informal credit market. As per a report by the National Commission for Enterprises in the Unorganised Sector (NCEUS) in 2007, only 5-6 per cent of the enterprises in the unorganised sector get access to institutional credit. The rest presumably comes from informal credit sources. It can be argued that the government has become proactive in the last two decades to make access to credit at low interests available to manufacturers in the unorganised sector through private commercial banks, cooperative societies etc. (National Statistical Commission, 2012). As per the report by the NCEUS (2007), a comparison of the share of total outstanding loans by institutional sources to the unorganised manufacturing sector reveals an increase, but it is far from adequate (National Commission for Enterprises in the Unorganised Sector, 2007).

Generally, informal financial sources include family money or moneylenders who operate outside the banking framework of the country. In this regard, traditional informal money lending has existed since time immemorial within the informal sector. However, new ingenious mechanisms are emerging which go beyond the credit extended between buyer and seller. A primary and recent example of such activities is the practice of companies accepting deposits from the public in the form of gold loans. According to Gnanasekar Thiagarajan, director at Commtrendz Risk Management Services Pvt. "A professional setup like the gold loan companies, who offer transparency and finer pricing are likely to see huge volumes to move from there." India's market for such lending is set to expand by at least 34 per cent to 4.6 trillion rupees ($61 billion) in two years by March 2022, according to an estimate by KPMG (Bloomberg, 2020). An additional advantage of borrowing from the informal credit market pertains to the lack of lengthy documentation, formalities and substantial collateral, contrary to formal banking mechanisms.

It is important to clarify that while these instruments exist in the informal economy, they can be used for both black as well as white (legitimate) transactions. Often, the widely prevalent opportunities for laundering black money into white and vice versa, albeit at a cost, suggests that these two sets of income in the formal or informal economy need not watertight compartments. Also, since the formal economy faces taxes, while many sectors of the informal economy do not, the difference is expected to induce a difference in the debt-equity element where the tax-free segments would opt more for equity when compared to activities on which taxes are due in the formal economy.

In the next section, I discuss the problem of lack of formal credit sources for the informal economy in India. This factor forces individuals operating in the informal sector of the economy to rely on the traditional sources of finance such as the traditional usurious moneylenders. Since private unlicensed money lending is illegal in India (as per the individual Money Lending Act[24] of the respective state), some persons having large amounts of black money resort to lending it to petty traders and fruit and vegetable sellers on short-term basis at high interest rates. Bank loans or other legal sources of funding are not available to these traders and vendors who are themselves working in the legal informal economy. This is an illustration of black money placing its funds profitably in the informal economy. This is a good example of the interaction of the black and informal economy. In such a case, the black economy is providing much-needed credit to the informal economy.

3.3.1. Informal Economy: Dependence on Informal Credit

[24] See https://moj.gov.jm/sites/default/files/laws/Money%20Lending%20Act.pdf

In 2017, former Finance Minister Arun Jaitley said "It is a fact that people in the unorganised sector are much higher than the organised sector, but the former gets credit with a lot of difficulty" (The Indian Express, 2012). The availability and supply of credit to the unorganised sector from scheduled commercial banks has been consistently low, and the majority of enterprises in the unorganised sector lack access to credit from institutional sources. Nevertheless, there are mainly three sources of credit available to an enterprise in the informal sector of the economy. Firstly, informal credit sources can be used to fund activities that are unreported or unaccounted for such as unlicensed moneylender, as mentioned earlier. Secondly, informal economy benefits from advances on contracts and assignments it receives from entities in the formal economy. This is a good example of the interaction of the formal and informal economy. Thirdly, a small percentage of enterprises have the opportunity to avail of formal credit from commercial banks or limited government schemes (ILO, 2013). In all three cases, there is a continuous interplay between the informal, black and the formal economy, which I have explored in section 3.1.

On 19th July 1969, the Indian government nationalised 14 of the largest commercial banks in the country, which accounted for 85 per cent of bank deposits in the country, under the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance. The years following the nationalization of banks in 1969, leading up to the economic liberalisation of 1991 was marked by the opening of bank branches in states with lower penetration of banking facilities with special emphasis on opening bank branches in rural areas, as well as a resolve to provide priority sector lending in these areas (Krishna, 2015). According to Burgess and Pande (2003), this resolution could not be sustained and this trend was duly reversed post-liberalisation (Young, 2013).

In the next section, I briefly discuss the impact of economic reforms on the availability of credit to the informal economy which includes the rural economy as well as the manufacturing sector.

3.3.2. Informal Credit and Liberalisation of the Indian economy

Post-liberalisation in 1991, the number of branches of scheduled commercial banks in rural areas, as well as the number of loans advanced to priority sectors, declined(RBI, 2008). More specifically, priority sector lending by scheduled commercial banks in proportion to total borrowings saw a rise from 14 per cent in 1969 to 34.4 per cent in 1993. Nevertheless, between 1993 and 2011, this number fell to 33.9 per cent (Dutta and Kar, 2017). In recent years, there has been a decline in the share of formal credit as a source of debt. In fact, the total share of indebtedness in rural, as well as the urban poor households in India, shows a high proportion of dependence on local moneylenders. Dutta and Kar (2017) document the proportion of credit extended to rural households from both institutional, as well as non-institutional sources between the period 1991-2005. They observe that there is a decline in the share of formal credit sources to households, despite a steady increase in the total loan taken by these households since the onset of liberalisation.

According to Basu (2006), the continuous dependence on informal credit markets has been a tenacious feature of rural India, despite major structural changes in the credit institutions and forms of rural credit introduced under the economic reforms of 1991 (Guha-Khasnobis, Kanbur and Ostrom, 2005). This could be attributed to the nature of Indian informal credit markets at the time of economic liberalisation. These informal credit markets were highly fragmented; which was one of the main reasons for the failure of the players operating in the unorganised sector to avail of the benefits extended to them through liberalisation(Vij, Khanna and Srivastava, 2017). These benefits include, in terms of coverage, ease of access and low interest rates (Pradhan, 2013).

3.3.3. Informal economy and Rural Finance

In 2003, the *Rural Finance Access Survey* stated that 70 per cent of landless farmers did not have bank accounts and about 87 per cent did not have access to formal institutional credit (Basu, 2006). According to this study, approximately 48 per cent of marginal and landless farmers had borrowed from informal credit markets at least once in the past year at interest rates averaging as high as 48 per cent per annum. As per the *All India Debt and Investment Survey*, the percentage of moneylenders in the total borrowings of households in rural India saw a steady rise from 17.5

per cent in 1991 to 29.6 per cent in 2002 (National Commission for Enterprises in the Unorganised Sector, 2007).

3.3.4. Informal economy and manufacturing

In this regard, the National Sample Survey Organisation (2006) reported that informal credit sources accounted for nearly 44 per cent of outstanding borrowing by unorganised manufacturing enterprises. Since then, the government has taken many steps to mitigate these unintended adverse effects of the economic reforms of 1991(Murthy, 2015). These measures were aimed at disentangling poor borrowers from the clutches of the unfair practices of informal moneylenders and included expanding the institutional structure of formal lending institutions. Furthermore, there was an initiative to provide subsidised credit. In fact, for the states and union territories such as Bihar, Jharkhand, Meghalaya, Manipur, Dadra and Nagar Haveli, Daman and Diu, fixed assets belonging to informal enterprises are worth much more than the loans that they are able to obtain(Dutta and Kar, 2017). This statement is further corroborated by the *Third Census of SSI* (2001-02) as per which, only 14.26 per cent of the registered units availed of institutional credit. Further, about a mere 3.09 per cent of the unregistered units were provided loans from commercial banks (RBI, 2008). The census clearly establishes that approximately 97 per cent of these tiny and micro-enterprises classified as non-farm unorganised enterprises (NFUEs) lacked access to formal loans. In this situation, these NFUEs are forced to rely upon loans from kin, friends and moneylenders.

In the next section, I discuss the third segment of the Indian economy i.e. the highly contentious black economy of India which interacts with both the informal and formal economy of India, as discussed in this chapter.

3.4. Black Economy

3.4.1. Concept and scope

According to the 'white paper on black money' issued by the Indian Ministry of Finance in 2012, black money is defined, "as assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession" (Ministry of Finance, 2012). Further, the report clarifies, "there is no uniform definition of black money in the literature or economic theory". As per the Cambridge dictionary, black money is "money that is earned illegally, or on which the necessary tax is not paid". This definition reflects the more popular understanding of the notion of black money being unaccounted or undeclared money or income. As mentioned in chapter II, the term unaccounted income has been used interchangeably (and more commonly) with black money.

In economic literature, unaccounted income is often used interchangeably with the terms; informal, unofficial, irregular, underground, unreported, invisible, unrecorded or shadow economy. Also, the definitions of black or unaccounted money reflected in literature are as diverse as the multitude of terms surrounding the concept (National Institute of Financial Management, 2012). Based on these diverse definitions, Feige (1997; 2005) distinguished between four terms: 'illegal economy', 'unrecorded economy', 'unreported economy' and 'informal economy'. According to Feige (1997), these terms are defined as follows:

"*the illegal economy consists in the income generated by economic activities pursued in violation of legal status defining the scope of legitimate forms of commerce. The most notable illegal activities are production and distribution of prohibited substances (drugs; for example) and such services as prostitution, pornography, and black-market currency exchange*".

"The unreported economy consists in economic activities that circumvent or evade fiscal rules as set out in the tax code. A statuary measure of the reported economy is the unreported income

namely, the amount of income that should legally be reported to the tax authorities but is not. Since illegal income is taxable, the unreported economy includes both legal and illegal source income that is not properly reported".

"The unrecorded economy consists in those economic activities circumventing the institutional conventions that define the reporting requirements of government statistical agencies. A summary measure of the unrecorded economy is the amount of unrecorded income-namely, the amount of income that should, under existing rules and conventions, be recorded in national accounting systems such as national income but it is not".

"*The informal economy encompasses economic activity that circumvent the costs and are excluded from the benefits and rights of property relationships, commercial licensing, labour contracts, torts, financial credit and social security systems.*"

Since black money means different things to different people, I must clarify the definition I have used for the purpose of this study.

3.4.2. My definition for this study

For the purpose of this thesis, 'black money' is defined as assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession. This definition would align with the three concepts of 'illegal', 'unreported' and 'unrecorded' economy, specified earlier. Based on these definitions, I present a critical review of the mechanisms of money laundering, employed to convert black money to white money.

Further, this definition of black money aligns with the definition used by the National Institute of Public Finance and Policy (NIPFP). In its 1985 report on *Aspects of Black Economy*, the NIPFP defined 'black income' as "the aggregates of incomes which are taxable, but not reported to the tax authorities". Further, black incomes or unaccounted incomes are 'the extent to which estimates of national income and output are biased downwards because of deliberate, false reporting of incomes, output and transactions for reasons of tax evasion, flouting of other economic controls and relative motives' (Sandesara, 1985). Thus, in addition to wealth earned through illegal means, the term black money would also include legal income that is concealed from public authorities (Kumar, 2012).

3.5 Bringing Together the Formal, Informal and Black Economy in India

To begin with, I have discussed the interplay of the three economies in India i.e. the black, informal and formal economy. Secondly, I have examined the definition and understanding of the three economies in context of India. Furthermore, I have discussed the impact of economic liberalisation in India on the formal and informal economy in India. Under this discussion, I discuss the reasons for economic reforms and the scope and content of reforms under liberalisation in context of the formal economy in India. Additionally, I discuss the issue of lack of availability of formal credit in the informal economy as an important factor contributing to reliance on informal credit sources. Furthermore, I examine the concept of the black economy in India. In this section I summarise my findings (see table 3.1).

To contextualise my research, it is important that the contours of the Indian economy are understood. I am taking the example of transactions based on dealings in similar businesses in all three sets of economies and tabulating how and why they use *hawala and* hundi mechanisms as an integral part of their existent. The examples that I am considering (existing in all three economies) are-

1. Sale of White Goods
2. Sale of Processed Foods
3. Packaged foods

	FORMAL ECONOMY A	INFORMAL ECONOMY B	BLACK ECONOMY C
Example of Entities in Different Types of Economy Doing Business in Similar Products. **For E.g. White goods, Processed foods, Packaged tea.**	Large corporate entity making goods for consumers in large automated factories sold under well-known brand name	Small scale units making white goods by manual assembly of kits or parts sourced from component manufacturers. Sold as local brand or generic goods.	Smuggled goods. Stolen goods while in transit available for sale in the black market. Also, spurious goods i.e. goods sold under a famous brand name but made in mid-sized illegal unregistered factories.
Tax Treatment for Indirect Tax i.e. GST and Income tax i.e. Direct tax.	Tax at applicable GST rate on all sales. Entity responsible for depositing due tax on all transactions with the state. All income is taxed at corporate income tax rate.	No GST till turnover RS. 40 lacs for goods and 20 lacs for services. Sales made beyond the limit are either done through another parallel entity or done in black i.e. without any paper trail in cash. Earlier no excise duty was levied on turnover up to Rs. 1 crore. After deduction of allowed expenses don't have to pay income tax as soften will how little or no profit if accounts are maintained alternatively there is a very attractive presumptive tax scheme if no accounts are maintained.	All transactions in cash. No invoices issued. No tax i.e. GST paid on any transaction. No Income Tax paid
Cost of Labour and its Tax Liability	Employees get good salaries and pay income tax. Entity responsible for deducting income tax at source and depositing it with Government. Employee get medical benefits and also provident fund, regular working hours and	Entity has no liabilities of labour welfare hence cost of labour is minimal but more than minimum wages as prescribed by the Government. No provident fund and no medical treatment support by the business entity. Employees get workable environment with little regard to conditions and safety.	No question of tax on employees income who on minimum wages and under less than acceptable working conditions. The largest slum of Asia in Mumbai in Dharavi houses several factories.

	healthy safe work environment	Most employees have income below taxable limit.	
Sources of Raw Materials and Services Sourced to Produce the Goods	All against invoices. May include false invoices or inflated invoices to generate black money i.e. de-laundering i.e. an example of **A ∩ C**	Some materials and services procured against invoices to meet 40 lakhs sales turnover limit while materials and services needed for production beyond exemption limit is against cash without any invoices. Some inputs are tax-paid (**A** ∩ B). As turnover above exempted limit generates revenue in cash which is black money, there is no need to generate black money by de-laundering (**B** ∩ C).	All transactions are in cash i.e. in black. Smuggling packaging material as input to informal economy (**B** ∩ C). Smuggled packaging material as input to the formal economy (**A** ∩ C). Smuggled material for packaging as input to informal economy to be sold to formal economy against tax-exempt billing (**A** ∩ **B** ∩ C).
Mechanism of Transfer of Funds by Use of Formal Banking or hawala	Funds are transferred using formal banking channels for all business related transactions.	For part of the business which is within exemption limit for GST, formal banking channels are used for transfer of funds For cash part of business hawala is used i.e. **B ∩ C**	*Hawala* is used as all business in cash. *Hawala* when used for informal economy for unbilled dues (**B** ∩ C). *Hawala* used for delaundered money (**A ∩ C**).

Table 3. 1 *Black, Informal and Formal Economy: Showing differences using example of businesses dealing in similar products*

Consider table 3.1. In the formal economy, these goods are sold by large corporate entities by both direct (income tax) and indirect taxes (GST) paid. Transactions in the formal economy generate accounted for white and fully tax-paid money. In the case of the informal economy, similar products are sold, either directly in the market to consumers or as subcontract suppliers to the businesses in the formal economy. Transactions in the informal economy up to 40 lakhs generate accounted money i.e. on which tax is not paid as it is not due. If the company in the informal economy has turnover beyond 40 lakhs, it is done without generation formal bills and thus generates black money. When they are sold up to Rs 40 lakhs turnover, there is no GST to be paid under the law. Also, informal units hire management and labour at low cost and thus little or no income tax is paid on that account. According to Harriss-White (2020), "These days, most firms engage selectively with regulatory laws. They are selectively informal. You may need to have a licence and a bank account, but the laws surrounding building construction, the environment and working conditions aren't enforced, and while you may pay local taxes, you do not pay income and business taxes. For several decades, corporate India has shifted the costs and risks of labour onto private subcontractors whose relations with workers range from incomplete verbal contracts, or scraps of paper with discretionary perks for loyalty, to bondage…"(Harriss-White, 2020). In case of black economy, the goods may be smuggled or stolen in transit from stocks of formal or informal economy. These transactions are completely illegal and generate black money. It is important to note that business entities operating in the formal economy generating accounted for or white money have a need for black money for meet demands of political favours, convenience payments and speed money. For this purpose, they constantly need to 'de-launder' money to generate black money. Additionally, sometimes to save tax they under invoice imports and need black money to be sent via hawala to foreign suppliers to meet the difference.

3.6 Conclusion:

My research has led me to believe that there is no iron curtain separating the different entities in the economy as all entities that constitute economic activity need to have interaction with all three segments of the economy through the layered existence of the Indian economy. Its complex ecosystem rarely reveals itself in totality to any single player or observer. Every actor in the economy sees only those layers in the economy that are relevant to him. Larger corporate entities have layers of service providers, suppliers and consultants catering to their needs insulating them from the realities of the totality of the economy they operate in. This has evolved into layers of corporatised entities in control of individual members of the political spectrum. The line between black and white money has dimmed over the life cycle of any packet of money as sophisticated mechanisms are used to 'park' (see chapter V for concept of parking) it in the formal or informal economy, when it is not needed, so that it remains productive. It earns rent by way of interest or appreciation of value of underlying assets purchased from the money and does not remain idle. Since the requirement is so regular and so large, it is operating almost like a money exchange and networks of chartered accountants and financial consultants are active in the operation of these entities as clearing houses. Ingenious interpretation of laws by professionals, structuring of entities aided by technology, have all been deployed to create a situation where money is constantly changing colour and being laundered and delaundered at will, making it nearly impossible to pin any amount down as being in one or the other category. This interplay between the black and white economy has become inextricably intertwined particularly since the rapid expansion of the economy with economic liberalisation since 1991.

The humongous amounts of black money that exist in India is facilitated by a vibrant informal economy for its useful deployment but its sheer size is quite counter intuitive to the generous tax exemptions available. I have come to the conclusion that the large amount of black money that the Indian economy generates is mostly due to two reasons. Firstly, due to a demand pull for meeting political party expenses and election expenditure by politicians. Since the BJP came to power in 2014, it has actively tried to take policy initiatives to dry up the availability of cash to political parties (Jaffrelot and Verniers, 2020). I discuss the demand for black money for running political party expenses and election funding in detail in chapter VII. The second reason that I discovered as to why Indians try to hide income and assets from the state is because they do not trust the state. This distrust is borne out of arbitrary governance that India's population faced over centuries and its distrust in the government of the day has not been removed even in its post-independence experience. There has been in government policy, a tilt towards socialism and continuous attempt to indulge in populist policies with scant respect for individual property and creating a business-friendly environment and sudden major shifts in policy by the government of India since independence. As mentioned in chapter VI, right to property was a fundamental right under the Indian constitution. In 1978, it was removed as a fundamental right under the 44th amendment to the constitution. This is a prime example of sudden policy shifts by the government. I discuss these factors in detail in chapter VI

This thesis examines the complexity of the Indian economy as an 'ecosystem' in which formal, informal and illegal intertwine in complex ways at different levels of incomes and wealth. I argue that liberalisation did not create the ecosystem but rather infused it with a greater volume of cash that lead to an elaboration and development of existing financial mechanisms. A prominent example of such an elaboration is the transition of the mechanism of *hawala* from an indigenous transfer mechanism to its modern *avatar* i.e. *hawala 2.0*. I explore this development in detail in the next chapter.

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Chapter 4

The Hundi and Hawala Systems And The Evolution of Mechanisms Related to Money Laundering in India

Chapter IV

The Hundi and Hawala Systems And The Evolution of Mechanisms Related to Money Laundering in India

4.0 Introduction

This chapter examines the indigenous systems of hundi and hawala and classifies certain mechanisms of money laundering, as they have evolved, to be more relevant in context of liberalisation and its unintended consequences. I develop my analysis through a detailed examination of the indigenous quasi banking[25] practices specifically of *hundi* and *hawala*. This chapter discusses the shift from *hawala* 1.0 to *hawala* 2.0, which is the modern avatar of *hawala*. *Hawala 2.0* is a term I have coined to illustrate the complex effects of liberalisation on an age old ancient institution. My focus on *hundi* and *hawala* is justified by the fact that they constitute the backbone of several other mechanisms of money laundering in the Indian financial ecosystem, which I have illustrated in chapter V. Other prevalent mechanisms too have been discussed in chapter V. The inherent characteristics of the Indian economy drew me to the inescapable conclusion that there was a structural need for de-laundering in the Indian economy. This has been discussed in chapter V. It is pertinent to note that hawala also plays a key role in money de-laundering.

Money laundering has had a long and chequered history in India. In a strictly legal sense, the history of money laundering as a crime is not that long. Even on the global stage, money laundering was instituted as a crime in the mid 1980s. However, if I was to consider the practices that constitute money laundering in contemporary India, the history of money laundering would be very long and chequered indeed. Thus, this chapter focuses on the history of practices that have been labelled as mechanisms of money laundering. It is interesting to note that till 2005,

[25] Several scholars have held hundi and hawala as underground, parallel or hidden banking mechanisms (Trehan, 2003; Daudi, 2005; Mahmud, 2012; Lambert, 2016).

money laundering was not a crime as per any statute in India. A key feature of Indian financial architecture, since independence, has been the relationship between the formal and informal sectors. [26] The rise of a formal corporate economy based on modern banking exists, side by side, with a network of traditional agents operating from the *bazaars* of the old cities together representing a manifest dichotomy. These agents function as quasi banking institutions. They accept funds for deposits, they transfer funds to different locations, they issue hundis to be used for trading and backing third party transactions in the informal economy (Dinesh, 2018). The also work towards legitimising bogus accounting transactions in lieu of nominal interests operating in plain sight, yet hidden from any regulatory oversight. I discuss this quasi banking function offered by these agents below. These agents operate in plain sight, yet hidden from any regulatory oversight.

4.1 Hundi Hawala: A Quasi-Banking Institution?

Indian Company Law 1956 defines banking as "a banking company which receives deposits through current account or any other forms and allows withdrawal through cheques or promissory notes" (Dinesh, 2018). Banking as a function implies taking deposits and dispersing loans on interest. Traditionally, this function in India was done by a well-recognised network of money launderers. . As per the Central Banking Enquiry Committee (1931), the practice of money lending activity can be traced back to the Vedic period, *i.e.*, 2000 to 1400 BC in India. It is the moneylenders who took deposits and against such a deposit issued *hundis* as they held credibility within the network of moneylenders who also accepted *hundis* of known money lenders against a reference called *hawala* . Traditional hawala networks were networks of moneylenders and traders aligned with them to avoid having move funds over large distances. So, like a modern bank, the hawala network, which was originally really a network of moneylenders providing the function of taking a deposit and issue a *hundi,* which was a paper derivative in nature of a promissory note which was acceptable as a negotiable financial instrument by a hawala operator/moneylender in another geographical location for a small fees.

[26] In India, since independence, a socialist pattern of fiscal policy has been pursued resulting in a highly differential system of taxation whereby, only a small percentage of population pays taxes. This results in a large informal sector, which is not liable to pay taxes, due to various exemptions in direct and indirect taxes.

Thus, it can be argued that *hawala* was basically a money transfer function traditionally. However, this definition of *hawala* would not constitute the whole truth as bonds of trust formed between the trader and the moneylender/hawala operator whereby just like a bank, the trader would receive hundi as a loan against his property and receipts of proceeds of trade, for which hundi was taken by the trader. Also, the trader would deposit his surplus funds for interest with the moneylender/operator. In the present system too this symbiotic role of moneylender /hawala operator continues. The role of currency exchange has been added, as discussed in the section on *hawala* 2.0 in this chapter.

According to the Reserve Bank of India (2008), "The existence of professional banking in India could be traced to the 500 BC. *Kautilya's Arthashastra*, dating back to 400 BC contained references to creditors, lenders and lending rates. Banking was fairly varied and catered to the credit needs of the trade, commerce, agriculture as well as individuals in the economy... An extensive network of Indian banking houses existed in the country connecting all cities/towns that were of commercial importance. They had their own inland bills of exchange or *hundis* which were the major forms of transactions between Indian bankers and their trans-regional connections". This chapter seeks to expand upon contemporary understandings of these indigenous quasi banking systems, with specific focus on mechanisms of *hundi* and *hawala in* South Asia. I carry out this analysis, within the sphere of evolving architecture of Indian financial sector in order to present a more comprehensive understanding of the genesis and growth of money laundering mechanisms in India.

The purpose of this chapter is twofold: *Firstly*, to provide a starting point for analysis of mechanisms of money laundering and interrelated informal economy in India. The next chapter, i.e. chapter IV, provides an in-depth analysis of the informal and black economy in India, which is inextricably linked to money laundering and illicit financial flows to the offshore from India. *Secondly*, to analyse the operational characteristics of the mechanisms that may even pre-date colonial rule in India, and have survived to remain relevant in the face of modern banking. To better understand the tradition set of mechanisms it is best to first understand indigenous banking systems, in terms of their form and interplay with formal banking, in the twenty first century. The existing misunderstanding is born out of unavailability of a uniform legal and financial definition of indigenous banking systems that predate modern banking and persistence of *hundi* and *hawala* (Martin, 2009). Since, these systems have collected countless labels in the last decade, often being villainised in international security literature, which has furthered a notion of notoriety around these terms (Daudi, 2005). *Thirdly,* to provide an empirical analysis of the characteristics of *hawala* mechanisms in contemporary India. This analysis focuses on the mapping of *hawala* operations in India and its key players and beneficiaries, which is based on the data I collected during my fieldwork in India. I believe this section is the most substantive part of this chapter, as it provides original on-ground research from centers of *hawala* activity in India, through its actual key players, which is a unique contribution of this study.

The discussion is broken into four parts. Part one, focuses on defining *hundi* and *hawala* briefly. Part two, chronicles the history of *hundi* and *hawala* networks in the backdrop of the evolution of the Indian economy. In this section, I have examined the impact of liberalisation on the practice of *hundi* and *hawala*, as a detailed and deeper analysis was essential. While liberalisation and increase in depth of banking resulted in the decline of *hundi*, the practice of *hawala* has become institutionalised as it found utility in the expanding emerging economy. As mentioned earlier, I have termed this modern institutionalised version as *hawala* 2.0. In the third section, I provide an empirical analysis of the operational characteristics of the *hawala* networks in India through my fieldwork findings. Additionally, this section outlines the resilience and continued appeal of *hawala* and its causes, through empirical analysis. In the fourth section, I enumerate the beneficiaries and users of *hawala* transactions in contemporary India.

4.2 Hundi and Hawala

4.2.1 Etymology of the terms ‘Hundi’ and ‘Hawala’

The terms *hawala* and hundi have their origin in Arabic and Sanskrit respectively. The term *hawala* is derived from the Arabic root *h-w-l*, whose basic meaning includes ‘change’ and ‘transfer’ (Martin, 2009). Patrick Jost and Harjit Sandhu (2000) note that the word *hundi* comes from the Sanskrit root meaning "collect." In this context, one of its most common meanings can be alluded to the collection box found in ancient *Hindu* temples in south India.[27] This is indicative of *hundi's* indigenous and ancient character. The Reserve Bank of India (RBI) has archived specimens of *hundian* bills from the early twentieth century and defines the *hundi* as, "financial instruments evolved on the Indian sub-continent used in trade and credit transactions. Technically, a *hundi* is an unconditional order in writing made by a person directing another to pay a certain sum of money to the person named in the order. Though normally regarded as bills of exchange, they were more often used as equivalents of cheques issued by indigenous bankers" (RBI, 2019). Thus, the indigenous character of the *hundi* has been well documented in Indian history (Martin, 2012).

4.2.2 Present day perception of the terms Hundi and Hawala

Since the rise of Islamic terror on the global stage, in the past four decades, negative connotations and labels have been attached to the portrayal of '*hawala*' and '*hundi*'. These labels include, 'Hawala', 'Havala', 'Havale', 'illegal money laundering network', 'illegal transfer of foreign exchange' etc. (Cassara, 2015a). Furthermore, in the wake of the 9/11 attacks, contemporary global debates on terrorism and international security have contributed to the perception of *hundi* and *hawala* as an "underground" or "black" channel to move terrorist funds across the Islamic world (Viles, 2008). Since then, the invisible nature of *hawala* transactions has resulted in concomitant negative stereotyping of *hundi* and *hawala* as remittance vehicles for terrorism.

[27] This includes Meenakshi Temple, Madurai, Venkateshwara Temple, Tirupati, Ramanathaswamy Temple, Rameswaram, Airavateswara Temple, Kumbakonam, Brihadeshwara Temple, Thanjavur, Sri Ranganathaswamy Temple, Srirangapatna, Guruvayoor Temple, Guruvayur, Kerala. Some of these temples are over 1000 years old and have been registered as world UNESCO heritage sights.

More recently, some authors (El-Qorchi, 2002; Martin, 2009; Sheraz and Farooqi, 2014; Thompson, 2019; Rahimi, 2020) have tried to destigmatise *hundi* and *hawala* by highlighting its prevalence outside of the Islamic world by labelling under the term "Informal Value Transfer System" (IVTS) (Passas, 2002) or "Hawala and Other Similar Service Providers" (HOSSPs) (Passas, 2003). While this term attempts to dissociate *hundi* and *hawala* from fundamental Islam, I prefer to use the terms *hundi* and *hawala* separately. A thorough evaluation of both concepts reveals that *hundi* and *hawala* are not merely labels for informal transfer mechanisms, and hence, cannot be uniformly bracketed under a single term due to their differentiated form and function. Besides, these terms are more suited to the context of this study and are widely recognised in India, across all sectors of the Indian economy.

4.2.3 Distinguishing between Hundi and Hawala: The problem of Definition

Much of the literature on the subject, often uses the terms *hawala* and *hundi* synonymously; which is not how they were originally intended and are still perceived in India. Authors such as El Quorchi (2003) and Jost and Sandhu (2000), for instance, claimed that they are the same and used these terms interchangeably in their works. Others like Passas and Ballard have distinguished between the two terms (Qorchi *et al.*, 2003).

In the context of Islamic Law, the terms *hundi* and *hawala* have been used interchangeably (Thompson, 2008, 2019). However, in the Indian context hundi has always denoted a financial instrument of exchange and *hawala* is the reference necessary to realise its value (Wheatley, 2005). Historically, the *hundi* was a financial instrument in use since ancient times and has had legal sanction, till even after independence and has fallen in disuse only with wider availability of banking. It is only in Pakistan that by popular usage, the term *hundi* was used interchangeably with *hawala*, for remittances being made by migrant labour (Daudi, 2005).

On the other hand, *hawala* was used as a term to denote a complete financial transaction based on a reference of payment, deposited at point A and payment carried out at point B; wherein A and B are geographically apart and often in different legal jurisdictions. Even historically, while *hawala* may not have been declared illegal in ancient and medieval times, the entire transaction has had a status of operating outside the legal framework particularly when the transactions straddling two different jurisdictions and resulted in avoidance of tax. In such a case hawala could be alluded to the lack of state sanction unlike the *hundi* which enjoyed both cultural and state sanction during the same time (Martin, 2012).

An important aspect of these transactions, that has received little or no attention is the historical context that surrounded their origins and subsequent evolution into their present-day functions (Thompson, 2008). As remedial work in this direction and to clarify the significance of these terms in contemporary academic discourse, the next section addresses the origins of *hundi* and *hawala*. I will enumerate the distinctive historical circumstances within which they were created, their intended purpose and their evolution to present day functioning.

4.3 The Morphology of Indigenous banking: A Chronological framework of *Hundi, Hawala*

I begin this analysis with the understanding that the operation of *hawala* networks today, can be best understood by gaining insight into how they evolved and operated historically (Ballard, 2005). Most accounts of growth of the Indian economy begin with independence from the colonial British rule. Yet, the large informal economy of India, which forms the backbone of its economy and includes mechanisms of money laundering, operates through institutions and structures that pre-date both independence, as well as colonial rule in India. In order to chronicle the evolution of *hawala* and *hundi* to its present-day function, I have divided the discussion into four phases of the Indian economy; namely, the ancient-medieval period, the era of British rule, the post-imperial *license-permit* era of independent India and the period post economic liberalisation of India in 1991. The last phase requires deeper analysis as it constitutes an important aspect of my hypothesis i.e. the impact of liberalisation on the *hundi* and *hawala*; which together constitute the historical antecedent of contemporary money laundering mechanisms in India. While *hundi* has fallen into disuse, *hawala* is used till date and is complementary with newer mechanisms.

4.3.1 Origins: Role in Ancient and Medieval Trading systems of the Indian subcontinent

4.3.1.1 Genesis of Hundi

Global trade over vast geographical distances is not a feature of the contemporary world. In fact, trading across the Indian subcontinent has been a constant phenomenon since 2000 BC (nearly a millennia) and can be verified by instances of trade recorded between the ancient city of Mesopotamia and the Harappan civilisation of the Indus valley (Ballard, 2015). This can be attributed primarily to the location of the Indian subcontinent, strategically positioned between the region stretching from East Africa till the Red Sea and across the Indian Ocean, through Mesopotamia and Iran to Central Asia and China (Ballard, 2005). According to Parthasarathy (2011), "From the late sixteenth century, the Indian subcontinent entered a 200-year commercial boom in which the supply and use of money expanded, markets became a growing feature of daily life for much of the populace and large merchant fortunes were built. In Bengal and other manufacturing regions, the rising demand for cotton textiles led to the reallocation and more efficient use of resources. Across the subcontinent, the production of cloth for export created a sizable long-distance trade in raw cotton, dyestuffs and the cloth itself" (Parthasarathi, 2011, p. 135). Thus, as need for exchange of wealth grew due to diversification of production and movement of population, a currency of exchange was required. Initially, the currency or means of exchange was by way of barter, reciprocity and redistribution (Parthasarathi, 2011). This could not meet growing demands of need of exchange value over geographical distances. As a substitute to decrease loss in transit, Indians created '*hundi*'. *Hundi* was a promissory note invented by traders in India and can be considered to be a forerunner of currency notes that we now call cash money (Sharma, 2006; Martin, 2009; Ballard, 2015). The backbone of this system was honour and trust. The customer was required to present his *hundi* for encashment and with the implicit trust in the issuer's partners; that they would honour this promptly. Likewise, the distant encashier would also be assured that all disbursement made would be settled in due course. This was crucial; as in the absence of a robust and effective means of guaranteeing settlement, the whole system would have collapsed (Passas, 2003).

4.3.1.2 Genesis of Hawala

It was the interaction between Indian and Arab Muslim traders that resulted in the birth of the *hawala* system. As trade rapidly expanded, due to the ever-growing needs of the Muslim traders and complexity of the trade, a means of facilitating value-transfers between the various ports and markets where business was conducted was needed. Otherwise, traders faced the dangerous task of transporting large sums of bullion over long geographic distances. It was as an answer to this problem, that the solution of *hawala* emerged. It made the process of long-distance traders financing their activities easier. Thus, *hawala* become the backbone for long distance trade for the Muslim traders operating out of the Red Sea, through the Indian Ocean (Thompson, 2019).

4.3.1.3 Working of Hundi and Hawala: a system of banking and exchange backed by personal ties

In the ancient times, this system functioned on the basis of close interpersonal relationships and kinship (Ballard, 2004; FATF, 2013). In the event of malfeasance, excommunication of the offender and his kinfolk was the resultant punishment. Excommunication was considered the equivalent of social death. Hence pre- modern trading networks were for the most part composed of people with distinctive linguistic and religious commitments whose pursuit of trade had led them to form wide-ranging diasporas, whose internal coherence was continuously reinforced by trans local ties of kinship and marriage and very often by sectarian religious commitments as well (Thompson, 2008). As per Markovits (2000), the role of *hundi* was indispensable in the caravan trade of the Shikarpuri and Sindhi merchants' trade between 1750 and 1947 (Markovits, 2000). During this time, it not only served as a system of credit, but wove together capital, goods, credit and merchants in a legible structure (Ballard, 2005).

As mentioned in the previous section, *hawala* emerged as a solution to facilitate long distance financial transactions in a safe and secure manner. The people who facilitated these exchanges came to be known as *hawaladars* and *hundiwalas* or holders of hundi or reference (Gilligan, 2001; Aman, Nenovsky and Mahamoud, 2014; Geshev and Marin, 2020) .The central means by which *hawaladars* provided this service to their customers was through the *hundi* - effectively a bill of exchange, as mentioned earlier (Martin, 2009). The trader could deposit his working capital to the *hawaladar*, who worked out of his home base. In exchange, he would receive a *hundi*. This *hundi* was negotiable in whole or in part from the issuing *hawaladar*'s corresponding partners in a range of distant markets; and once his business was done in any given market, he could translate his profits into a similar instrument issued by a local *hawaladar*. This was then ready to be used; either in the next trading centre to which he moved, or simply to be encashed as profit once he finally returned to his home base (Jost and Sandhu, 2003).

4.3.2 The Colonial period: *Hundi* becomes hard to replace for the British in India

The rise of British India under East India Company (EIC) and the advent of the late 18th-early 19th century signaled the dawn of modern banking and regulations. One of the first banks to be established was the Bank of Hindustan, which was established in 1770 and liquidated in 1829-32; and the General Bank of India, established in 1786 but failed in 1791. This period also signifies the peak of British Imperialism in India. Thus, within the context of these developments, *hundi/hawala* had modified functions for Indian merchants and their connotation changed within the changing legislations of the Indian economy (Martin, 2009).

During this time, the *hundi* remained an extremely pervasive feature of the Indian economy. This is evident from the fact that the British East India Company accepted 'hoondian on bills granted by Shroffs' to receive currency in the form of cash. These *hundi* bills of exchange could later be encashed in the form of silver from the company (Martin, 2012). According to CA Bayly (1983), the frequent use of the *hundi* as a bill of exchange by the British served as a reputation enhancer for the Indian merchant families that traded with the *hundi*. These merchant families enjoyed a position of repute and had garnered immense goodwill in society, further contributing to the all-pervasive character of the *hundi*. Besides, Indian merchants not only had access to fairly huge sums of capital, but their networks had greater reach and presence (once ratified by a reputed merchant) than banking networks of the time. Thus, their form and function was not just limited to caravan trade; but extended to providing military support, administrative expansion and finance other activities in any country, where the merchant network had a presence.

During the late eighteenth century, the relationship between *hundi* and the British EIC remained complementary; with north Indian merchants performing a variety of functions for the British *Raj*. The replacement of *hundi* with district treasury bills was the sign of autumn of the relationship between Indian merchants and British EIC (Bayly, 2012). In fact, many historical documents indicate that the British regime relied heavily on certain merchant communities for trading, as the district treasury bills introduced by the EIC could never successfully replace *hundi* for trade . The reason for this can be attributed to a nascent transport and infrastructure system in colonial India, which reduced the reach and overall efficiency of modern banking, due to which the *hundi* became nearly impossible to substitute. Various attempts of the government of India under the British *raj*, coupled with the advent of the technology like the telegraph, railway and cable, were unsuccessful in replacing *hundi* by modern banking networks (Sharma, 2006; Martin, 2012).

In 1908, the Bombay Government resisted the suggestion of substitution of the *hundi* for 'a system of exportation of opium in bond'. The primary reason for this opposition was the strength of the *hundi* among Bombay merchants, as well as its lower cost due to the lack or lower stamp duty of *hundi* in comparison to other methods. The fact that the trade between India and Afghanistan came to a halt on the stoppage of issuance of *hundi* in Peshawar in 1940 is indicative of its ubiquitous nature for Indian traders and the Indian economy (Martin, 2008). Furthermore, during this period the *Zamindari system* was prevalent in India. This system authorised a landholder called *Zamindar* to raise taxes/ revenue from the people and deposit it with the English East India Company. The progressively unfair and coercive practices of the *Zamindars* and increasing demands of the company resulted in alienation of the masses from the power that held sway over them (Abbas *et al.*, 2016). Thus, progressively the distance between the government and the people increased. Taxation which was initiated immediately after the sepoy mutiny of 1857 (and the battle that ensued cemented formal control of British in India) was perceived to be unfair and oppressive; resulting in large-scale tax avoidance and underreporting of incomes (Abbas *et al.*, 2016).

During this period, initially the British brought in gold to buy Indian goods and later resorted to mechanisms to destroy Indian business and tax profits when incurred as result of their own demand (such as during the two World Wars) at a higher rate by imposing a separate profit tax.

In this scenario, Indian businesses and traders developed mechanisms of tax avoidance by investing in property and valuables both in India and abroad, which are in use till date (Panigrahi). This can be regarded as one of the first instances of tax avoidance creating the foundation for what is known today as a black/informal/parallel economy in India. Common mechanisms of money laundering were share market transactions, forward trading, property investments, under and over invoicing of exports and imports. These can also be regarded as the earliest known mechanisms of money laundering in India. In the aftermath of the 1857 uprising, there was rapid institutional change. Consequently, the scale and the impact of the hegemony exercised by the British Raj expanded rapidly in the sphere of business and finance. Soon all government business, as well as the majority of European controlled business houses began to be directed through banks that were owned and run by Europeans or 'formal channels' (Ballard, 2015).

The introduction of western banking, backed by the British, is a major inflection point for this thesis. This presents the first instance of divergence between formal and informal channels for issuance of financial instruments. Due to this development, indigenous banking operators who were traditional moneylenders, also acting as *hawaladars,* for the found themselves pushed to one side of the financial marketplace. However, they soon realised that they enjoyed a competitive advantage over their foreign counterparts', especially in terms of credibility and work ethic. Other than demonstrating higher efficiency and security in implementation of high value transfers than that of their western counterparts, they possessed the skill and capacity to carry out their order of business, remaining largely inscrutable to the imperial authorities (Martin, 2009). Moreover, most Indians felt there was no legitimate reason to facilitate the imperialist ambitions of the British administrators to tax them dry. These events offer this thesis another inflection point, as this unfair taxation was seen as the foundation of public abhorrence and resentment towards taxation and tax authorities in India. This becomes clearer when we observe that matters didn't change much when India gained its independence. Despite, having gained independence and no longer subject to an alien *Raj,* its institutional structure and practices were largely retained by the indigenous administrators who inherited the structure. In fact, the '*license/permit Raj'* which they went on to create post-independence India, was aimed to reinforce state power and in turn drive economic activity of any significance into heavily bureaucratised state-run institutions (Delong, 2001).

4.3.3 Post-Independence India: *Hundi* during *License-permit Raj*; Hawala Rampant (1947-1991)

4.3.3.1 1947-1956: The beginning of planned economy in India

The post-independence exchange control regulation in India can be traced back to March 1947, when the Foreign Exchange Regulations Act (FERA) was passed in order to introduce exchange control regulations on a statutory footing (Batliwalla, 1967). At the time of independence, India had an anaemic economy with little industrialisation and no resources to fund liberal market friendly policies (Panagariya, 2004b). Indian political leadership decided to follow the Soviet model of planned economy and channel limited resources to focused areas with an emphasis on import substitution. To enable this, the Indian economy was restrained to a mechanism of major constraints on imports, any foreign expenditure and tight control on realisation of export income, rapid depreciation of the rupee and above all creation of shortages in all sectors of the economy. This resulted in huge pent up demand for all kinds of consumer goods, industrial products and forex. This resulted in a thriving black market which was fed by smuggling. *Hawala* became the preferred mechanism for funding, financing and sustaining the black market, as well as funding of smuggling of foreign goods (Bagchi, 2005).

The classic, often-cited instance of smuggling as the "settlement counterpart" to *hawala* is the gold trade, say, between the Gulf countries and South Asia started, in the post-independence period (Jost and Sandhu, 2003; Roy and Narayan, 2014). Given the labour/migrant relations between South Asia and the Gulf, the predominant remittance flows, currency rules, the popular desire for physical gold, combined with India's (since discarded) long-time ban on private gold imports, it is hardly surprising that gold smuggling across the Indian Ocean was an activity that fit into the *hawala* context as a natural clearing and settlement mechanism (World Bank, 2003).

4.3.3.2 1956-1970 Tightening Exchange Controls and License Permit Raj

By the second five-year plan (1956-1961), exchange controls started being heavily enforced. The Exchange Control Department (ECD) within the Reserve Bank of India (RBI), was empowered with the statutory power to administer FERA and was also involved in shaping policies. In 1956; after India had been constituted into a civil, democratic republic, the Indian government, showed concern regarding a growing black economy that was depriving an impoverished country of important resources needed for development (Ahluwalia, 2002). The generation of profits from black market activities across different sectors of the economy was recognised. This could be attributed to the requirement of a plethora of licenses, sanctions and permits to set up or register any new business. During this time, the tax rates were almost 97 per cent and inflation was at an all-time high (Rao, 2005). Interest rates were extremely high. As per an article titled 'The Structure of Interest Rates in India', in the journal *Economic Weekly* in May, 1960, "*In 1958-59, the minimum rate of the Industrial Credit and Investment Corporation of India (ICICI) was 6½ per cent, and its rate for foreign currency loans 7¾ per cent. The State Finance Corporations charge approximately the same rates; commercial banks which refinance medium term loans through the Refinance Corporation charge at least 61 per cent. For the borrowing firm, there are also additional charges and stamp taxes that raise the effective rate to the borrower by ¼ to 1 per cent, depending upon the size of the loan*" (Rosen, 1960). This led to businesses resorting to informal sources of finance, as cost of capital was extremely high (Kumar, 2002). Owing to this, most businesses in the formal sector suffered and were unable to set up industry on a large scale and benefit from economies of scale. The primary impediment to setting up big industry, besides need for a license was the requirement for bankable guarantees of equal value, to get loans from banks that could not be met easily. This led many businessmen to resort to classical mechanisms of money laundering such as *hawala* to generate white money (accounted money) to set up projects. Thus, almost all large businesses set up during this period were set up with the help of mechanisms of money laundering which will be discussed in the next chapter (Kumar, 2002). An interview with a leading Indian industrialist revealed that, "*Prior to liberalisation, licenses were obtained against considerations of 'donations' to bureaucracy and politicians. It was a marketable instrument and money could be raised through different mechanisms of project* *management through public sector banks and again by over-invoicing and overstating the project costs and embedding kickbacks. It may be noted that banking too was highly controlled, and banks too had limited opportunities of investing in projects. Thus, every project was effectively a house of cards built around the license*" (personal communication, December 15, 2017) [28]

Furthermore, he said, "*the public banks provided funding for such projects at rates which were much lower interest rate than available private funding. For example, when market rates were about 12 per cent per annum, the open market rates were about 24 per cent per annum. It is important to note that due to distortions in both, markets for goods to be produced, as well as financial markets due to closed system nobody worried about competition. In this system, it was possible for an industrialist with capacity to pay bribes to set up a business by manipulating project cost and effectively making no real investment out of his pocket*" (personal communication, December 15, 2017). Thus, I gather that in such a scenario there was no incentive for growth or obtaining economies of scale due to capping of production capacity by license and thus it is not the rate of interest or income tax which generated black money from projects in the formal sector, but the fact that capacity was capped and the license itself became the marketable instrument.

By the mid 1960s, exchange control policies grew even more restrictive and prohibitive. It became extremely cumbersome for the public to turn to the bank with frequent queries over trivial sums of foreign exchange (Batliwalla, 1967). The need for restructuring was fairly evident but the public had found an old viable alternative in *hawala*, to circumvent the need to turn to the banks to meet the demand for foreign exchange. Besides, stringent controls were here to stay for the foreseeable future. The 1960s saw a gradual but persistent tightening of foreign exchange regulations pertaining to foreign travel by Indian residents to the point where the administration of the regulations became somewhat arbitrary. Foreign travel was undertaken for a variety of purposes, and all categories of travel required prior approval. The Bank was the focal point through which all applications were cleared on an individual basis and approvals were granted on the principle of essentiality. Until 1956, pleasure travel by Indian residents was administered through a basic quota, which, at first, was released once in three years. Later it was enhanced and

[28] Leading industrialist and founder of xxx Group (name concealed) and its Chairman Emeritus. He has been a leader in the field of hydropower generation, graphite electrodes and multiple textile units all over India. Leading philanthropist and supporter of chess and several education institutions. He serves as the Chairman Emeritus of Maral Overseas Ltd. and served as its Director from June 28, 1990 to April 21, 2014

relaxed to once in two years. No exchange was, however, released for visits to hard currency areas. With the deterioration in the foreign exchange situation after 1956, the Bank was forced to review its policy;, and in January 1957 it took the draconian decision to ban all pleasure travel by withdrawing the basic quota of foreign exchange for such travel (Batliwalla, 1967). The denial of the travel quota, coupled with the gradual tightening of release of foreign exchange for other types of travel, drove some residents to finance their travels through illegal channels like *hawala* (personal communication, January 17, 2018).

As per a joint study conducted by the IMF and World bank (2003) on Informal Fund Transfer (IFT) systems, in the 1950s and 1960s, the main method of payment in the Indian subcontinent was through *hawala* which was a draft drawn on a trading associate at the time (World Bank, 2003). Import credit from the "money bazaars" generally took the form of loans against *hawalas* or *hundis*. These were simple drafts drawn on correspondent traders in India, Iran, and Pakistan by traders and foreign exchange dealers from the neighbouring countries, including Afghanistan. In addition, as currency export from India and Pakistan was illegal, there was a considerable differential between official and *hundi* exchange rates which increased its popularity (The World Bank, 2003). *Hawala* was also used extensively in trade with Iran, as well as in domestic trade. Furthermore, after the partition of India and Pakistan in 1947, virtually no payment connected with trade with India and Pakistan was transacted through banks (Qorchi *et al.*, 2003).

Recent literature, partly attributes the growth of the present *hawala* network to gold trading and smuggling operations in South Asia in the 1960s and 1970s (Daudi, 2005). To avoid gold import restrictions, traders and smugglers used boats to ship gold from places like the Gulf regions to South Asia. To remit funds back to their countries of origin or in order to purchase more gold, traders and smugglers (importers) found a solution in the growing population of South Asian nationals working in the Gulf States (Schaeffer, 2008). To settle their liabilities, *hawaladars*, in Dubai, for instance, would finance gold exports to their counterparts and clients in South Asia. The remitting workers received better rates because *hawaladars* charge higher fees to smugglers who made substantial profits from the gold trade (Roy and Narayan, 2014). Thus, the smuggling activities benefited from, and enhanced, the existing systems of funds transfers used by expatriates in the Middle East, Southeast Asia, the United Kingdom, and even in North America. This network, it is argued, formed the base for the large-scale *hawala* operations that exist to this day (World Bank, 2003).

4.3.3.3 1970-1980 Expansion of Banking and Redundancy of Hundi

Till 1970s, *hundis* continued to be prevalent due to lack of other financial instruments; despite the desire of the Indian government to discontinue its use. A chartered accountant with an expertise in capital markets in India informed me, "*It was only in 1980s that hundis were effectively made redundant by availability of multiplicity of financial instruments and penetration of banking which allowed usage of multi city cheque books*" (personal communication, January 17, 2018). This fact was further corroborated by the *hawaladars* who confirmed that they had neither seen nor used the *hundi* since many decades. Along with this, changes in the negotiable instruments act regarding rules related to honouring of cheque's, made *hundis* redundant. Section 138 in 1988 was introduced in the Negotiable Instruments Act 1881, to address the endemic issue of dishonouring of cheque's i.e. issuance of cheques by unscrupulous persons who had inadequate balance in their account (Jost and Sandhu, 2003).Since this was a civil offence, the process of achieving redressal from courts was lengthy and ineffective. The use of *hundi*'s had an advantage of having an element of commitment and contract and thus had an edge over a cheque in terms of actionability in a court of law (M. Martin). Section 138 made the offence criminal and did not deem it necessary to go into the cause of the issuance of cheque or the underlying contract. As this took on the role of an efficacious financial instrument for settling liabilities between parties, for both present and future liabilities for post-dated cheques, the *hundis* became redundant (Sharma, 2006; Martin, 2009).

As per a leading CA in Mumbai, "*hawala and its growth during post independent India was largely guided by the failure of the government to instil a sense of security to implement policies to develop a nascent economy, following principles of free markets. Instead the new government decided to build on the restrictive economic regime of post-world war years*" (Khanna, Personal Interview, 15 September, 2017). Thus, in post-independence India, *hawala* continued to be used by Indian indigenous communities extensively; due to limited penetration of banking and limited availability of formal financial instruments (M. Martin). *Hundis* too continued to be a financial instrument which though not recognised by the negotiable instruments act of 1881, but due to applicability of stamp act and plethora of British courts recognising the *hundi*, continued to be a valid financial instrument (Martin, 2009).

4.3.3.4 Persistence of Hawala despite penetration of Banking

A central question in my interviews with both chartered accountants and *hawala* operators in Delhi, Mumbai and Guwahati was, '*During the license permit Raj, what were the incentives for your clients to use hawala transactions, despite the presence of modern banking?*'. As a response to this question, a senior chartered accountant in New Delhi told me the following: - "*To understand hawala and its evolution during this period, it is essential to understand its demand in different sectors of the economy for unaccounted money. Hawala was the preferred mechanism for servicing those sectors of the economy which had a pent-up demand, but could not be serviced by the formal economy. These demands were curtailed or banned by law in newly independent India*" (personal communication, March 13, 2018). A follow up question to the same gentleman entailed an enquiry about the various sectors that generated this demand for unaccounted money. Besides, I included this question '*Could you state the various sectors in the Indian economy which were regular beneficiaries of the hawala system during the license permit raj?*' The various responses (often overlapping) to this question by *hawala* operators and chartered accountants aided me in generating *Figure 3.1* which shows the topology of different economic sectors, where due to regulatory restrictions, demand for unauthorised flow for foreign exchange was created and met.

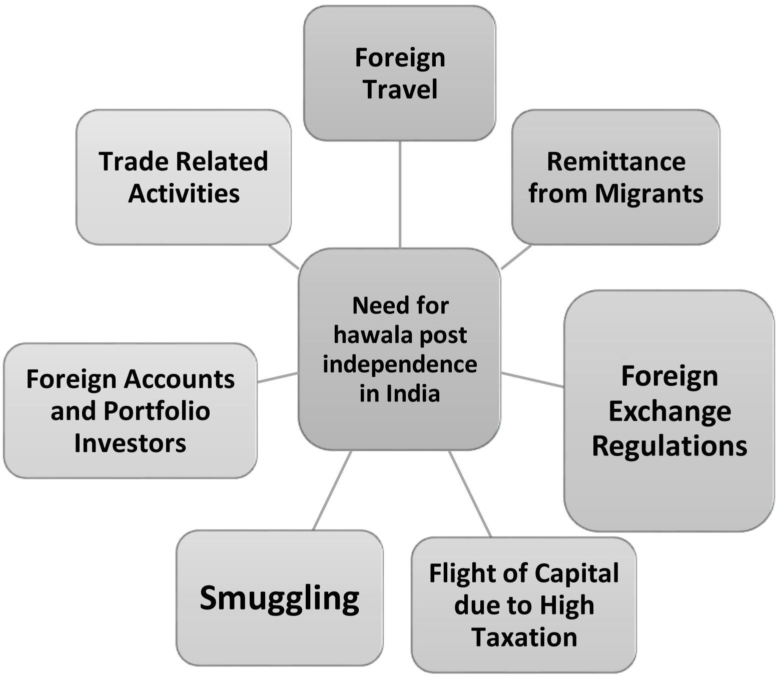

Figure 4. 1 Need *for hawala post-independence*

By the end of the 1970s, India had acquired a reputation as one of the most protected and heavily regulated economies in the world. Starting in the mid-1970s and then later on in the 1980s, a few tentative steps were taken to liberalise the regulatory regime. More extensive reforms followed in 1991. For Rodrik and Subramanian (2004), the minor reforms of the 1980s were important for what they signalled—an "attitudinal change" on the part of the government in favour of private business. They chronicle this change to 1980; when Indira Gandhi returned to a second stint as Prime Minister after losing power in 1977 (Rodrik; Dani and Subramania; Arvind, 2005). In contrast, scholars like Patnaik (1987) and Dhar (1988) discerned some acceleration of growth in the eighties, while Virmani (1989) asserted a break in the GDP growth rate from 1980– 81. Nagaraj (1990) and Bhargava and Joshi (1990) did not find the break statistically significant. Dandekar (1992) concluded that the evidence of a break 'cannot be rejected.' Ahluwalia (1995) also noted the increase in growth rate during the eighties (Sengupta, 2001; Virmani, 2003, 2006).

4.3.3.5 1980-1990 Rapid Growth of Indian Economy

The decade between 1980-1990 was a period of gradual changes in economic policy, after re-election of Prime Minister Indira Gandhi and her focus on attempting to increase the productivity in India. In a similar vein, Atul Kohli (2006) observed, "*the post-Emergency Indira Gandhi was a different Indira Gandhi. She downplayed redistributive concerns and prioritised economic growth; sought an alliance with big business; adopted an anti-labor stance; put brakes on the growth of public sector industries; and demoted the significance of economic planning and of the Planning Commission. As suits a complex democracy, these changes emerged in fits and starts; they were also often camouflaged, helping maintain some of Indira Gandhi's credentials as the leader of the masses. The changes were nevertheless profound; they involved a shift from left-leaning state intervention that flirted with socialism, to right-leaning state intervention in which the ruling elites recommitted themselves to a more sharply capitalist path of development*" (Kohli, 2006). Numerous public statements and policy changes indicated this shift; the shift was also understood well by participants and observers. The Times of India thus editorialised within a year: "*A change of considerable significance is taking place in India…the emphasis has shifted from distributive justice to growth". A close advisor noted that, after* *returning to power in 1980, Indira Gandhi "was clearly determined to get back to the firm foundations of economic reform"* (Sengupta, 2001, p. 55).

Thus, this was the period in which new business persons, with new ideas emerged in the Indian economy and challenged the hegemony of traditional business families who had ruled the Indian business landscape for more than a century. Traditional Indian capitalists, having served British interests as junior partners and regulated by the post-independent state, devised accumulation strategies based on non-technological resources. Relying on social and political contacts, administrative and accounting trickery, and short-term mercantile activity as opposed to production, the Indian conglomerates gained considerable notoriety. The protective umbrella of the state preceding the reforms deepened capitalist relations, thereby contributing to the maturity and consolidation of Indian capitalists (D'Costa, 2000). These capitalists having benefitted from the British rule, thrived during the two World Wars by supplying goods and services to the British. This was true of the Tatas who were the sole supplier of rails, in this part of the world. This also included the DCM group who made their fortunes by selling tents and blankets to the British during the wars. During this period, there was an emergence of new industrialists and software entrepreneurs. Furthermore, the more established conglomerates such as the Birla's and Tatas continued to diversify their portfolio (Piramal, 1996). The formation of state-owned *Maruti Udyog* was a major departure from the prevailing family-based corporations. Not only did the arm of the state become commercially involved, but it allowed a foreign partner in a highly controlled auto sector for the first time. The establishment of this joint-venture boosted industrialization in the Delhi region and supported numerous family-controlled but entrepreneurially-driven auto parts (D'Costa, 2000).

As noted by Thakurta (2003), during the socialist era, "... Indian politicians were known to curry favour with businessmen — licenses and permits would be farmed out in return for handsome donations during election campaigns" (Virmani, 2014). The license raj consisted of stifling controls imposed on prices, production, capacity, investment, imports and exports, capital markets, banking and finance, land, labour (Sinha, 2003). This provided ample opportunities for collusion between a corrupt government (politicians and bureaucrats), initially used to generate money to run parties and fight elections, but gradually became a means of generating personal income and wealth. Controls on pricing, production, investment and foreign trade in manufactured goods were reduced in the 1980s and lifted in the 1990s (Sinha, 2003). There was also a reduction in controls on banking and finance and some simplification of taxes (Sengupta, 2001).

Dhirubhai Ambani emerged during this period as a businessman, who took advantage of tax breaks and partial opening up of licensing, to set up largescale industries. He also took advantage of new regulations, allowing raising of funds from the public directly. In a survey by the Legatum Institute (2013), 81 per cent of Indian businessmen said *jugaad* was the key reason for their success. Dhirubhai Ambani was the "master of *jugaad*.[29] The licence-permit *raj* made it impossible for him to progress legally, so he exploited the corruption and cynicism of the system. He is alleged to have exported junk to get profitable import entitlements. He created industrial capacities vastly in excess of licensed capacity. He imported large number of textile machines as "spare parts". He lobbied for highly profitable changes in policy for polyester imports and telecom licenses (Aiyar, 2013). The *jugaad* he used to overcome hurdles was not distinguishable from crony capitalism. Here I quote a leading Indian economist[30] and one of the founders of the Centre for Policy Research, New Delhi, who told me the following:- "*I recall that Dhirubhai Ambani was hauled up by the government for having obtained a license for obtaining a smaller license for production capacity, but installing machines for much higher capacity. This was completely opposite of what was being done till then, where minimum capacity machines were procured at a multiple of their actual costs. Even in this case it was the established practice that the payment for extra capacity was made through hawala or by under invoicing exports*" (personal communication, August 1, 2017).

In similar vein, Thakurta (2003) says, "In 1987, a customs show cause notice to Reliance Industries alleged that: "Reliance appears to have unauthorisedly imported four additional spinning machines (valued at Rs. 53.02 crore) ...in a clandestine manner and without payment of customs duty (Rs. 119.64 crore) on these machines" (Thakurta, 1990). No industrialist in India could dare to undertake such activity in the heydays of Indian socialism, without making 'campaign contributions' to cronies in the self-labelled "socialist" government (Virmani, 2014). However, long before Dhirubhai entered the scene, Indian politicians were known to curry

[29] The Oxford English dictionary (OED) has officially accepted the word 'jugaad' which means, 'a flexible approach to problem-solving that uses limited resources in an innovative way'

[30] The interviewee served for several years in the Government of India, in the Planning Commission, the Administrative Reforms Commission and the Department of Economic Affairs, Ministry of Finance.

favour with businessmen – licenses and permits would be farmed out in return for handsome donations during election campaigns (Thakurta, 2003) . On being questioned about the inflection points in the economic history of India that can be attributed to the problems associated with political corruption, he said, "*I will not blame economic liberalisation of the 1990s or even the 1980s. I would instead say that the license permit raj was the biggest evil. It created a culture of corruption. I remember once, the former Prime Minister I.K. Gujral asked me to restructure urban development in India i.e. to create a system that homogenizes building and construction permissions. Often, corruption comes from by-laws and these laws are put in place by politicians*" (personal communication, August 1, 2017).

Panagariya (2008) argues that policies in the period since 1975 were marked by a gradual retreat from the closed economy license raj model. The rigors of the industrial licensing system were moderated by policies in 1975, 1976, 1980, and 1984. Similarly, import controls on capital goods and on imports by exporters were made easier. These reforms were piecemeal and limited compared to what came later in 1991. Yet, Panagariya contends that they lifted business activity, but in a modest manner appropriate to the piecemeal nature of reforms. In particular, he argues that the impressive growth performance of the 1980s stems only from the three-year period from 1988–89 to 1990–91 when economic growth averaged 7.6 per cent. Thus, what appeared to be green shoots of liberalisation that had started appearing in the Indian economy, it was actually emergence of new business barons who changed the rules of the game by dealing in much larger quantities focusing on specific items, using their closeness to politicians and bureaucrats to help them and their business (Kohli, 2006). The payment made for such favours to bureaucrats and politicians also required *hawala* channels as these were often made abroad, or made in India and parked abroad (personal communication, May 4, 2018).

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4.3.4 Hawala post economic Liberalisation: *Hawala* 2.0

The cumulative effect of high cost of capital imports during spate of the industrialisation that had begun in the 1980s, Indian industries grew at a very rapid rate, particularly, during the last few years of the decade (Chandrasekhar and Ghosh, 1999). This resulted in a severe balance of payments crisis, which culminated in 1991 in India seeking IMF intervention. To qualify for a package of 1.9 billion dollars, India put in place, a classic IMF prescribed model of economic liberalisation. The license permit raj was abolished. Duties were slashed and rationalised and considerable incentives were offered to set up industries; particularly in areas that didn't have industry in India (Çakar and Arbak, 2004).

An important question that I consistently raised during my interviews with *hawala* operators or their sub agents was whether hawala had changed post economic liberalisation and how. Most *hawala* operators I interviewed, claimed that their family had been in the *hawala* business since at least three generations and had been privy to the changes brought about in the operational characteristics of *hawala* as a consequence of economic reforms of 1991. Through my discussions with hawaladars and their associated finance professionals and chartered accountants, I developed a sense of the changes brought about in the character of *hawala* operations in India, as impacted by liberalisation. I conclude that the change in the institution of *hawala* post liberalisation is characterised by the following aspects: -

4.3.4.1 Return of Funds parked abroad by Hawala

During the period after liberalisation, there was a decline in smuggling of goods. Smuggling was now largely limited to contraband and drugs. Also, during this period taxes, including custom duties were reduced. This resulted in better earnings on investment in India. As a consequence, there was a rise in demand for flight of capital for purposes of parking abroad in tax havens. In the initial period of this phase, there was a return of funds by *hawala* of funds parked abroad to meet large requirement of funds for the equity component to set up projects in India. In the subsequent period of liberalisation, *hawala* was used primarily to take funds abroad to be round tripped via Mauritius or Singapore.

During this period, the rise in sophistication of communications due to increasing usage of internet in India, *hawala* operations became even more efficient and faster than before. As large infrastructure contracts became the rule in India, huge amounts of black money were generated and *hawala* was used to transfer the money; both within India through deployment via book entries for projects and also for round tripping to be sent abroad. During this period, there was a rise in terrorism in Indian states of Punjab and Kashmir. For these activities, large amounts of money came into India through the *hawala* channel. (during periods of high taxation till 1980s) or sent abroad by *hawala* from the pool of black money in India.

4.3.4.2 Evolution of Economic opportunities favouring Investment in India

There was an increase in opportunities for investment in India. Many of these opportunities were also able to deploy black money, particularly in real estate projects. Also, black money was invested in the formal economy using the mechanism of round tripping for investing in the Indian economy through India specific equity funds.

4.3.4.3 Entry of Professionals and formal Institutions

Professionals and formal institutions entered the space for absorbing the funds that were coming to India via portfolio investments and round tripping through Mauritius and Singapore, primarily. These professionals consisted of bankers'-chartered accountants and book builders who had links with hawala operators. Any large projects or series of large portfolio investment involved the role of all four. The chartered accountants created multiple finance companies with large portfolios of depositors, each having small deposits and thus a large capital base; on which transactions for converting black money to white and white to black could be carried out continuously, based on the requirements of the clients. Thus, the main players feeding the *hawala* business are chartered accountants, lawyers, businessmen and entrepreneurs. Usage of *hawala* has become integral to most large contracts, sale/purchase of properties, sale of business entities, in as much as commissions and kickbacks are often paid through *hawala*.

4.3.4.4 Growth of Black money and availability for Round Tripping

As the size of the economy has increased, the sheer volume of black money that needs to be handled has gone up. I deduce that post liberalisation, *hawala* has morphed into a critical instrumentality, actively deployed and relied upon by professionals engaged with handling of money on behalf of beneficial owners of the black money, who are mostly bureaucrats, politicians, businessmen and players in the real estate sector. Thus, even though *hawala* is illegal in India, it forms a critical pathway in implementing components of large deals and transactions mostly for purposes of pay-offs, kickbacks and commissions. An interview with a lawyer in Delhi revealed that in all large transactions, there is a component that depends on round tripping which needs to be handled by *hawala* (personal communication, July 19, 2017). He further added, "*Since liberalisation, the number and size of transactions has shot up. These transactions may include: -*

1. *Arranging margin money for setting up of a new project*
2. *Arranging promoter's equity for Infrastructure project awarded by government to private party independently or in PPP (public-private partnership) mode*
3. *Commissions for contracts for development of infrastructure such as roads, train tracks bridges etc.*
4. *Black money component in purchase or sale of land*
5. *Mergers and Acquisitions of business".* He told me, that in all such transactions, as listed above, the businessmen and entrepreneurs or corporate entries required support at various levels by different professionals to structure the deal and make it possible. Providing detailed figures, he pointed out that a 5-15 per cent cut was kept for 'commissions' of such professionals and enablers which may include government servants or politicians, besides professionals. Of this percentage; a major component was to be dispersed in cash for which *hawala* was the most reliable and secure mechanism. Giving further insights, he added that in case of construction projects, there was a provision of 10 per cent mobilisation advance. Invariably, this money was used to meet the costs of enablers to obtain the project. He continued with, "*Project size earlier in India, used to be about Rs 10-15 crore, now per package it is Rs 100-200 crore and may go up to more than Rs 500 crores*" (personal communication, July 19, 2017). Thus, the money that needs to be managed is in larger quantities. The requirement is not just to make the transaction in *hawala,* but also to help the recipient 'park' the funds so they may be utilised later by him. I have explored the concept of 'parking' in the next chapter in detail.

4.3.4.5 Evolution of Legal framework favouring Round tripping

This period saw the misuse of Double Taxation Avoidance Treaties (DTAA), particularly with Singapore and Mauritius, GDRs (Global Deposit Receipts) and participatory notes for round tripping illicit financial flows back to India. (See chapter V for detailed analysis on the mechanism of round tripping)

4.3.4.6 Hawala 2.0 and role of Technology

The important feature of *hawala* in this incarnation is its reliance on high technology and innovation of using of internet for providing the *hawala* or the reference. *Hawala* has become even more efficient due to technology and has spread its tentacles to foreign jurisdictions, by interfacing with formal banking in offshore hubs such as Dubai and Singapore.

4.3.4.7 Convergence of formal Foreign Exchange Trading and Hawala

There was another development related to *hawala* which can at best be described as convergence of formal and informal services in the hands of erstwhile *hawala* operators. Post economic liberalisation in India, licences were issued to private parties to deal in foreign exchange (Batliwalla, 1967) As per a senior chartered accountant in Navi (new) Mumbai, "*Invariably, larger hawala operators have obtained or associated foreign exchange trading licenses. These entities are trading in foreign exchange, both officially and unofficially, thereby generating large amounts of cash in both rupees and foreign exchange. For Example: A businessman who has international trading operations and imports large quantities of specialty chemicals and takes benefit of reduced valuation by under invoicing needs to make payments by hawala in foreign exchange of difference amount to the exporting party abroad. For this purpose, he uses hawala operators who pay in rupees in India. The rate that he gets from hawala operators is better than what he would obtain from the bank, obviously*" (personal communication, August 22, 2017). In fact, all the *hawala* operators I interviewed, claimed they formally worked as 'money changers' or professionals dealing in foreign exchange who provided competitive conversion rates to their clients.

4.3.4.8 Demonetisation drive 2016 and Hawala operations in India

The demonetisation drive of November 2016 represents an interesting case for the continued relevance of hawala operations in opposition to state regulation and enforcement. At this point, it is important to note that the immediate aftermath of the demonetisation drive initiated by Prime Minister Modi on 8 November 2016, intelligence agencies detected a sudden spike in *hawala* activities in many major metropolitan cities in India (Antony, 2016; Datta, 2016; Press Trust of India, 2017). Since the window for illicit and unaccounted wealth to enter the formal banking channel was so limited (fifty days), the risks associated with converting this money to legal tender were exponentially higher. These awarded operators of *hundi* and *hawala* networks; as well as associated players such as lawyers and accountants, a unique business opportunity. As per Jagvinder Brar, a partner with KPMG, "the rates for such illegal money laundering operations usually hover around 10 per cent, but I am told that they have now gone past 20-25 per cent and can climb higher"(The Economic Times, 2016a). Through my fieldwork, I confirmed that these figures were accurate. Furthermore, I discovered how hawala was able to overcome the barriers present in the process that had been put in place to plug the conversion of black money. I explain this briefly below.

At the time of the declaration of demonetisation of high-value currency in India, some exceptions were given. These were:-

1. Each individual could deposit a maximum of Rs 2,50,000/- without fear of scrutiny. This amount would be treated as savings.

2. Donations to religious organisations in cash remained tax-exempt

3. 51-day window was given for depositing cash by businesses and others in banks.

4. Gold purchase up to rupees 2 lakhs in cash was exempt from scrutiny since 1st January, 2016.

At this point, it is interesting to note that the immediate aftermath of the demonetisation drive initiated by Prime Minister Modi on 8 November 2016, intelligence agencies detected a sudden spike in hawala activities in many major metropolitan cities in India (Antony, 2016; Datta, 2016; Press Trust of India, 2017). Since the window for illicit and unaccounted wealth to enter the formal banking channel was so limited (fifty-one days), the risks associated with converting this money to legal tender were exponentially higher. These awarded operators of hundi and hawala networks; as well as associated players such as lawyers and accountants, a unique business opportunity. As per Jagvinder Brar, a partner with KPMG, “the rates for such illegal money laundering operations usually hover around 10 per cent, but I am told that they have now gone past 20-25 per cent and can climb higher”. (Economic Times, 2017). The short-term effect of this regime-change highlights two significant features of informal value transfer systems, as they are known today. Firstly, these networks demonstrate robustness to the degree of extreme regime change, as well as time constraints. Secondly, the confidence and institutional credibility these networks enjoy with their subscribers and operators are unprecedented particularly in times of crisis.

Specifically, I analyse how money was brought back into the banking system using the exceptions (1-4) as listed above, in combination with hawala as under the following:

1. Smurfing and *hawala*: Each individual could deposit a maximum of Rs 250000 without fear of scrutiny as this amount would be treated as savings by authorities. Finance professionals, normally engaged in bookkeeping exercise and regular laundering and de-laundering of money, collected black money in cash from their clients. This was carried out mostly from urban centres as rural agricultural income was tax-free and larger amounts of money could be put in banks from ‘cash in hand’ by a rural and agricultural person, provided it could be explained as agricultural tax-exempt income. Monies so collected would be sent through *hawala* to rural correspondents who would deposit it in respective accounts of the exempt rural person who in turn would deposit the money as a loan in a finance or shell company. This money would then be forwarded to the original depositor as a loan. The entry in the accounts of the original depositor of credit against finance/shell company and multiple rural persons as creditors to the shell company could be reversed anytime in the future, and monies returned by reversing the transactions and recollecting the original black money to be returned to the depositor by hawala.

Donations to religious organisations in cash remained tax-exempt. This facility was used to transfer large amounts to religious trusts by hawala to be shown in the trusts respective accounts as a cash donation. This was then deposited in the trusts bank account. Now, an agreed amount which was 75 per cent (typically) of the amount donated was returned as a payment for service by cheque or in new notes, when they became available, through *hawala* to the original doner.

3. A 51-day window was given for depositing cash by businesses and others in the bank. Cash was deposited with vendors in advance for delivery of goods or services later. For persons staying in smaller towns *hawala* was used to send funds to luxury goods shops in capital cities by hawala.

4. Gold purchases up to Rs 2 lakhs in cash was exempt from scrutiny since 1st Jan 2016. This too was used as a variation of smurfing to buy gold in different names using cash and taking delivery of same. This transaction made the gold holding white in name of different persons. Gold was also purchased in black that is without a receipt. Thus there was a run on gold demand and the payments to fulfil it through limited traders could only be undertaken by receiving payment by hawala from jewellers all over the country.

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4.3.4.9 Liberalisation: Strengthening of Hawala and Demise of Hundi

The comparative impact of liberalisation on *hundi* and *hawala* has been vastly different. With the expansion of banking and availability of widespread ATM's since liberalisation, the already dwindling use of *hundis* since the 1980s has now become almost extinct. My research revealed to me that the hundi was never illegal and is still not illegal in India as it is just a promissory note and fell to disuse due to higher penetration of banking (personal communication, June 6, 2018). Between the usage of hundi as a promissory note to be presented, on giving a reference i.e. *hawala*, there remained the process of transferring funds and also the reference i.e. hawala physically to the place where it was to be encashed. This process was earlier undertaken by physical movement and now it does not raise its head as a separate function (for example in the case of *Angadias*).

4.4 Field Work Findings: Operational Paradigm of *Hawala* in India

The *hawala* operations in India continue to be based on the same basic structure (based on personal relationships) as before; and have only become more efficient with the advent of modern technology. On the other hand, due to rapid growth in the economy and large amounts of black money generated, *hawala* has become integral to setting up of projects and making investments in India through round tripping. However, the 'informal' *Hawala* networks in India have evolved to form significant ties with formal sectors of the economy, which includes both institutions such as banks, as well as practitioners like advocates and financial consultants. I have thus termed this new version of *hawala* as *hawala 2.0* and enumerate its significant features through empirical analysis in the next section.

I find that, while the primary agents of *hawala* continue to be descendants of the age-old ethnic groups, its secondary agents are representatives of critical institutions in the public sphere. This includes professionals and registered private practitioners such as lawyer, bankers, chartered accountants, as well as financial consultants. This divergence can be attributed to liberalisation and is one of the major findings of this thesis. Fourth and most significant feature of *hawala* 2.0 is that it functions like a financial institution and provides services akin to banking for its users in a much as it provides a service to reliably transfer funds anonymously. In the next section, I discuss my research trajectory

4.4.1 Research Trajectory for Hawala

My research strategy was to cover prominent centers of *hawala* operations in India. This included New Delhi, Guwahati, Mumbai, Surat, Hyderabad, and Jaipur. While I was unable to visit the latter three cities in person, I was able to gather useful information from the principle *hawala* operators at their corresponding offices at the former three cities that I was able to visit. Prior to gaining access to primary players of *hawala*, I interviewed many chartered accountants (CA), financial consultants and lawyers in Delhi, Mumbai and Guwahati. These professionals gave me useful information regarding the modus operandi of *hawala*, given that *hawala* was a useful component and integral part of transaction planning and execution for their clients. In all transactions, there was a component that relied on *hawala*. To quote a senior chartered accountant in Delhi, "*For instance, in settlement of a land deal (sale or purchase), 30-40 per cent was paid or received in cash which can only be done in hawala".* (personal communication, December 16, 2017). Now, one may wonder why the transaction described here be via hawala instead of using a manilla envelope full of cash. The answer lies in security of payment and refund that hawala provides to both the buyer and seller to the cash component of transaction that otherwise has no record. What happens is the seller is committed to selling his property at a committed price mentioned in the sale agreement against money to be produced by the buyer in the presence of a registering authority. As no cash can exchange hands at this stage, the buyer insists on collecting the cash before going to the registering authority. However, the seller is reluctant to part with such a large amount of cash without any security for the same. In this situation, money is deposited with the hawala operator verified by the seller and the hawala reference is provided to him at the time of registration. This way, in case registration does not take place, that means the sale falls through and the buyers money is safe as he can give the reference to the hawala operator and get his money back. This example highlights the fact that hawala is not always used for transferring money geographically but can also be used as a secure banking mechanism.

In another noteworthy interview with a chartered accountant specializing in settlement of tax demands made on tax assesses (on closer examination and scrutiny of their accounts on selective basis), I was told that it was his practice to get the settlement done at much lower amount by the tax authorities than claimed by them, based on his submissions, which were considered favourably by the adjudicating authority. For this consideration, the CA had an arrangement with the concerned tax officer of paying to his nominee a fixed percentage of tax liability, which he was able to save for his clients. This would be authorised by him to be remitted by *hawala* and only when such clearance was done would he get the written order of assessment from the tax officer (personal communication, March 26, 2018). To complete this example, he pulled out his mobile phone and called up his client and said, "*The matter is settled. Deposit eight paisa now*". After about thirty minutes, his client called him and gave him the number of the *hawala* operator where he had deposited the money. The chartered accountant then knowingly pulled out a used old 10-rupee note from his pocket. He took a photograph of the note and sent it to the *hawala* operator via the popular cellular phone application *WhatsApp Messenger*, from his phone. My obvious concern and question to him was what he meant by "eight paisa".[31] He responded with, "*Eight paisa means eight per cent of the total money saved, which was to be remitted to the nominee of the official*". The message that would go to the *hawala* operator was the picture of the ten-rupee note he had just taken along with the message "10 kilo apples". This meant please

[31] A paisa is an Indian monetary unit, equal to one hundredth of an Indian rupee

give to the person who presents this note ten lakh rupees. The CA also told me that in many cases, the *hawala* operators do not carry smart phones and in such cases I would send the serial number of the note instead of the picture of the note. He told me in most cases, the CA takes the money in advance on an estimate basis and deposits it with a money changer (who may also be his book entry operator) and sends the message to him, authorizing him to take the money on his behalf. This case was an exception, as normally he would take the estimated amount in advance. He told me that nowadays, the client rarely interacts with the *hawala* operator and does so with the CA, as it enables him to make book entries for future benefit. This allows him to keep tax authorities at bay. Thus, it can be deduced that *hawala* operators have become facilitators and instrumentalities in the hands of CA's, just like bankers and financial consultants who are all working together for the benefit of the client. (personal communication, March 26, 2018).

Other chartered accountants I interviewed in Mumbai and Guwahati, corroborated these facts. Forthcoming as they were about daily dealings with *hawaladars*, they dismissed my request to meet actual *hawala* operators as they considered them to be mere instrumentalities in their hands. One CA in Mumbai remarked, "*What do they know? They collect money, settle it daily and maintain books. So, little money is actually being physically moved since they are receiving and remitting large amounts of money daily. The need for moving actual cash is minimal. All they are is glorified bookkeepers. All the work that required initiative is done by us*" (personal communication, 15 September, 2017). However, he did concede that chartered accountants' operations did rely on absolute reliability and operational honesty of the *hawala* operators, which was not just facilitation of movement of funds under the government radar, but also a guarantee of the same.

As a part of my fieldwork, I met real estate developers and property developers commonly known as builders in Mumbai, who were implementing several development projects, including building of townships in India, as well as parts of Middle East such as Dubai. Some of these builders were clients of lawyers who were professionally known to me. These high net-worth individuals (HNI) were quite forthcoming and willing to introduce me to *hawaladars* whose services they used regularly. They were kind enough to offer to take me with them to *Zhaveri Bazaar* to introduce me to the *hawala* operators who they dealt with regularly, as a part of business operations and logistics. I had been warned that they would not otherwise entertain me. Besides, I was aware of the fact that interactions in India are very gender conscious. I discovered that hawala activities and operations in India were a male sphere; resembling an 'old boys club' which required membership or some sort of 'entry' through a known contact. This combined with the fact that India has a history of gender stereotypes assigned to women; which could work against me and present an obstacle for my data gathering. More importantly, having initially received passive aggressive responses from supposed *hawaladars* in Delhi, I decided to approach *hawaladars* in Mumbai with caution.

Keeping this in mind, I visited the offices of *hawala* operators accompanied by the builders or accountants of builders who took the lead in requesting for interviews as well as making formal introductions. Their presence also assured the *hawala* operator of strict confidentiality. Following this research strategy, I was able to create an environment of trust with the *hawala* operators, which allowed them to open up to me. Thus, meaningful patterns emerged out of the interviews I conducted. Through this process, I was able to distinguish a distinct set of operational characteristics of *hawala* in India.

It is useful to recount here; one noteworthy encounter with a *hawaladar* at *Zhaveri* bazaar at his first-floor office. I noticed that most offices of *hawala* operators were located on the first or second floor of seemingly dilapidated buildings. Initially, the *hawala* operator requested me to wait for some time so that they could complete the transactions on hand. I observed that his operations resembled an old stock exchange or a betting counter with small slips of paper coming in, accompanied by large bundles of cash going out. The typical transaction size; from what I could gauge, was about Rs 2 lakhs to more than Rs 10 lakhs rupees. I asked him the size of a typical transaction and he said "*Here we deal with anything from few thousand rupees to 15-20 lakhs. Larger transactions, which may be in tens of crores or more, are only on appointment basis and delivery happens at the place of appointment. Generally, the place of delivery is of our choosing for purpose of security. Also, we give a very small-time window*" (personal communication, August 16, 2017). I observed that most offices of *hawala* operators were like any other money exchange establishment.

The portrayal of *hawala* in international literature has developed out of its position as informal or underground and thus, lacking legal accountability and sanction Not surprisingly, centres of *hawala* operations have often been villainised by field researchers who have characterised these centres as 'shady' or 'murky'. Furthermore, they are projected to be centres of crime with its primary operators and beneficiaries being drug traffickers and terrorists. An explicit example of this is the depiction of one of the oldest *hawala* centres of India in Old Delhi popularly known as *Chandni Chowk* by Meenakshi Ganguly (2001) in 'A Banking System Built for Terrorism': -

"In the labyrinthine depths of old Delhi, where the lanes are too narrow even for a rickshaw, men drink tea and chat in shabby offices. Nobody seems to be doing any work, until the phone rings. Then, numbers are furiously scribbled, followed by some busy dialing and whispered instruction. Although it's far from obvious in the innocuous setting, these men are moving money - to exporters, drug traffickers, tax evaders, corrupt politicians. And terrorists".

As per Daudi (2005), the descriptions of *hawala*, like the one illustrated above, portray it to be a peculiar financial system that is both dangerous and beyond ordinary analysis. References to the *hawala* system have become ambiguous over time and consequently, invoke a combination of confusing and sometimes conflicting images. The *hawala* system is often discussed in an alleged connection with money laundering, terrorist activities, or as a mysterious system for "moving money without money moving at all, and without leaving traces or records" (Daudi, 2005).

Contrary to these portrayals John F. Wilson (2002), a senior economist with the International Monetary Fund (IMF), argues that *hawala* should be understood as an "economic phenomenon," comparable in mechanics and economic structure to most remittance alternatives, which can only be regulated by reducing the economic incentives to engage in *hawala* (Qorchi *et al.*, 2003). Nevertheless, comparing my field-work experience to the former account; I find the description rather exaggerated and somewhat condescending; showing lack of understanding and familiarity with the area mentioned. Also, the depiction severely undermines its value and position in the city's economy. The narrow lanes are very much present. However, these men are not the ones responsible for the movement of money. They are merely booking the transactions and facilitating payments across geographical area, through correspondents like a bank. Actual movement of funds only takes place for settlement purposes at fixed intervals of time. It is definitely done before Diwali, the traditional new financial year for dealers of *hawala*. The comment about idling away and furious scribbling of telephone payment calls is not something I observed. Instead, what I saw and observed was deliberate writing of very short notes and messages and receipt or payment of large amounts of money based on identification, which was mostly, a couple of low denomination of used currency note. The actual currency note would be acting as proof of payment having been made. In case of receipt of money to be transmitted and paid to someone, only a small slip was issued. There were outwardly no signs of hectic activity and the so-called labyrinthine lanes, simple décor and congested pathways, all were purposely chosen to provide security and anonymity. In fact, the entire business tries to operate on appearance of the ordinary. Rustic simplicity is cultivated.

4.5 Topology of *Hawala* in India

In this section, I propose a supply chain model for *hawala* operations in India. *Hawala* is operated through a hub and spoke topology, designed based on hubs and sub hubs in India and also abroad. Through my interviews with players of *hawala* operations in India, I discovered that over a period of time, the *hawala* network has evolved from a point to point topology between hubs to a sophisticated hub and spoke system. This model optimizes the trade-offs that exist between costs, time, technology and socio-cultural realities of India. Hubs are points of control and spokes are pathways of providing the service; and maintain inventory and resource which reside at the hub at places or to places distant from the hub, through another hub or sub hub agents or sub-agents (Bryan and O'Kelly, 1999). Hub-and-spoke networks are utilised by many distribution systems including airline passenger carriers, telecommunications traffic, and inventory management over widely spread operations, defence logistics and express package delivery networks (Števárová and Badánik, 2018). Hubs serve as transshipment points and allow for the replacement of direct connections between all nodes with fewer, indirect connections. In a completely interconnected network, flow travels directly from the originating city to the destination with no intermediate stops. Of all network designs, this type results in the lowest travel times. Yet, as shown in the figure, it also results in a large number of links, many of which are underutilised. A reduction in the total number of links would reduce costs by bundling flows and by concentrating equipment and sorting at specific locations (Bryan and O'Kelly, 1999).

The hub is where relationships with other hubs reside (Aaltola, 2005). A hub can have many spokes, including those going to other hubs and the hub receives and remits its services using spokes. All processes exerting communication are performed at the hub (Horner and O'Kelly, 2001). Thus, a spoke represents the relationship between the *hawala* operator and the sub agent of the *hawala* operator.

When viewed in its totality, the structure of *hawala* operations which appeared to be a random network of operators and their agents at first glance, was actually a fully evolved; modern and sophisticated, highly optimised, purpose driven network. This network had built in redundancies and a long standing reliable regional tree structure, meshed with other regions with their respective tree structures. In fact, the topology of the *hawala* network in India, consisting of hub's in major cities and sub-hubs in tier II cities with agents and sub-agents spread all over; was as sophisticated as any modern service provider network including networks of airlines, banking or logistics. A representative topology is shown in the figure 4.2.

For instance, if a person from a village *Charali* in Assam; who is employed in Dubai wants to send money to his family, the cheapest way for him to do so is through *hawala*. He approaches his *hawala* money changer/operator in Dubai and informs his family to go from his village in Assam to the nearest town; where the sub agent of the *hawala* operator in Guwahati is sitting. The transaction will be serviced by the Guwahati hub, through a spoke directly reaching that town or through a tree structure reaching that sub dealer via a dealer. It may be noted that each hub deals with a vast hinterland consisting of smaller cities, towns, villages connected to the main city which is the hub by a tree like structure i.e. city to smaller city, from smaller city connectivity to towns and from small town to villages, just like branches of a tree through a network of sub hubs, dealers and sub dealers.

During multiple interviews with charted accountants, lawyers and *hawala* operators, I came to understand that *hawala* operations have traditionally been available between major business centres in the Indian states of Gujarat and Rajasthan (particularly Ahmedabad and Jaipur) and metropolitan cities i.e. Delhi, Bombay (now Mumbai), Calcutta (now Kolkata) and Madras (now Chennai) in a point to point topology. From the contemporary point of view, the major hubs are the metropolitan cities followed by Jaipur, Ahmedabad, Surat and Ludhiana as sub hubs, followed by all other capital cities of Indian states as sub-hubs. *i.e. Delhi, Mumbai and Calcutta (Kolkata). The main hubs now can be said to include Ahmedabad, Mumbai, Delhi, Kolkata, Chennai*" (personal communication, August 13, 2017).

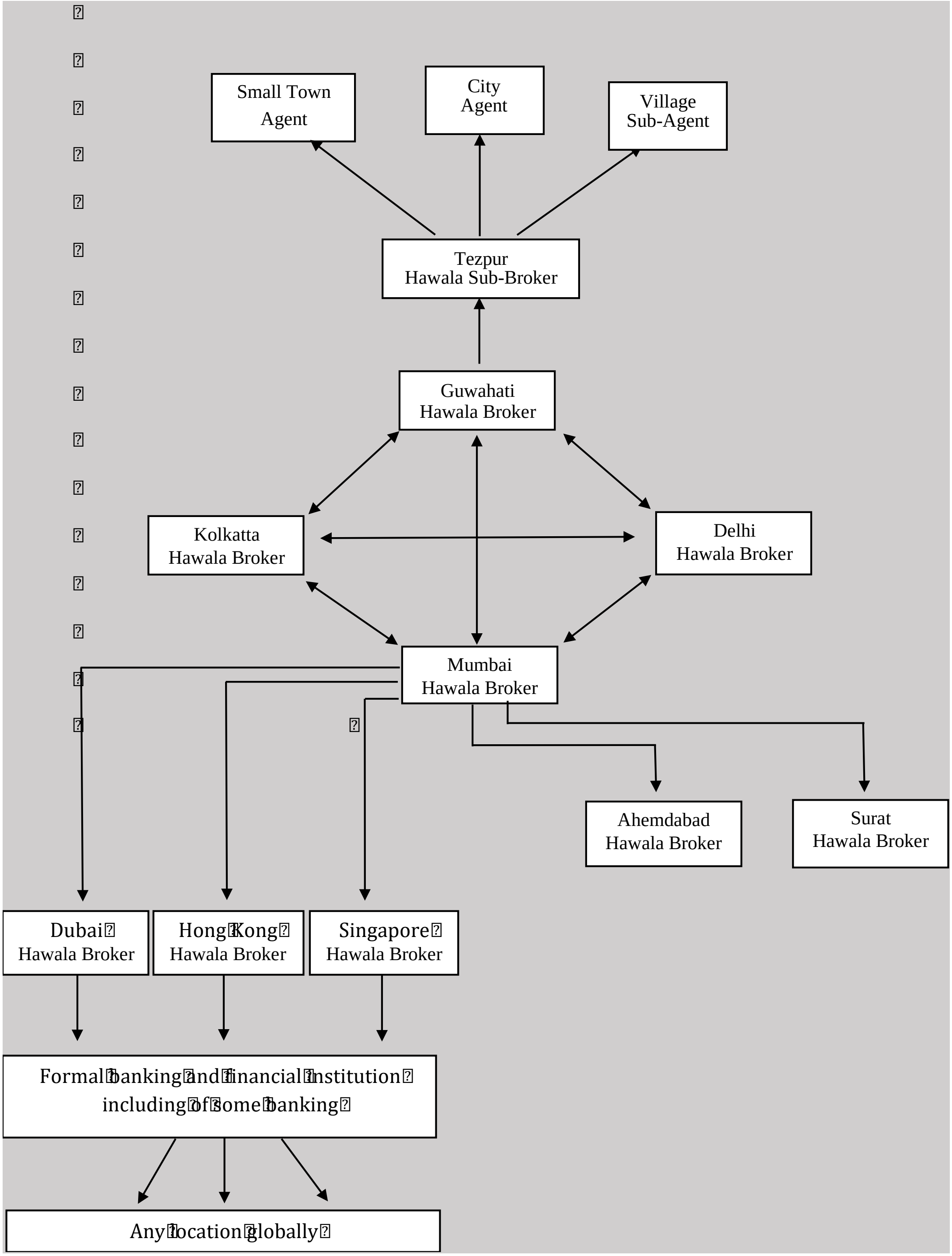

Figure 4. 2 Topology of Hawala Operations in India

Maintaining sub-hubs (or hubs) in a state capital is important, as bulk of money generated is through government sale and purchase which happens at state capitals that requires *hawala* services. As sub hubs, these sit above in hierarchy over agents and sub agents in tier II and tier III cities in India.

Through a network of these agents and sub agents, monies are collected and dispersed over a large network covering the nation; and even covering international hubs like Dubai and Singapore where offshore banking is used to reach any corner of the world. According to a *Hawala* operator in Mumbai, "*Traditionally, there were three main hubs of Hawala in India* These cities can be classified as Tier I or metropolitan cities in India as per classification of Indian cities. There were smaller networks emanating from the metro cities to regional towns and cities near them, called Tier II cities such as Guwahati, Jaipur, Lucknow, Madurai etc. Over the course of time, *hawala* operators have gained specialisation over certain routes and cities and formed 'hubs' for clearance of transactions in metropolitan cities. Gradually, this network spread to other Tier II cities such as Jaipur, Surat, Ahmedabad and Guwahati. Progressively, this network became exponentially wider and denser; spreading its tentacles to Tier III cities and townships in the Indian hinterland. This is where agents of hubs and mini hubs would ensure that deliveries were made to remote areas of remittances, from far off places to metropolitan cities in India and abroad. Originally, these were primarily wages that were being sent back home from migrant workers abroad, mostly in the Middle East. The motivation for the transaction was twofold. Firstly, low cost of remittance and also much higher rate of exchange. Secondly, low penetration of banking also made this the only fast viable means.

Transactions between satellites and hubs mostly consisted of traders' funds utilised for procurement of good and materials from hubs to be sold in satellite cities. These cities could be Tier II cities, related to metropolitan hubs (Tier I hubs) or small townships or villages in the hinterland when related to Tier II hubs. It might be useful to recall here, that these systems were operational in the Indian subcontinent since ancient times on a point to point basis. They were originally used for transferring *hundis* and cash for settlement using '*Angadias*' for physical movement of cash or value in form of artefacts in gold, antiques or previous stones. Even today, final settlement for the year is done a day before the beginning of a Hindu New year, i.e. the day after the festival of Diwali. The beginning of financial year for hawala operators is the day after the festival of *Diwali*, which falls in the month of October or November, depending on the Hindu lunisolar calendar in which dates keep changing vis a vis the solar Gregorian calendar. Due to the large number of transactions handled by the *hawala* operators, they had availability of funds at any moment for settlement of requests from other hubs (personal communication, December 5, 2017).

I will now consider some typical *hawala* transactions prevalent in India. These transactions are carried out by individuals deploying the hawala supply chain to their advantage to shift monies from point A to point B. From Figure 4.2 which shows the topology of *hawala* operations, it is clear that the transactions take place through a hub and spoke structure which captures the topology of the *hawala* business. This business is controlled by the operations at the hubs. The hubs act both as depositaries of funds and clearing houses for the conclusion of transactions based on reference i.e. *hawala*.

As a starting point for analysis, it would be useful to consider a typical *hawala* transaction emanating from an entity operating from the geographical vicinity of the lowest link in the *hawala* chain i.e. an office of a *hawala* operator in the hinterland connected to a Tier II city. This operator is an agent of or a subsidiary agent of an operator in a Tier I city. For the purpose of examining the path each type of transaction takes, I am taking the example of the hinterland town of Tezpur in Assam near the established hub of Guwahati. Tezpur, though a Tier II city itself like Guwahati; is not a trading centre and thus is not a hub for *hawala* operations. It has agents/dealer of the hub operators who are stationed at Guwahati. They have sub agents spread all over India. The job of the sub agents/sub dealers and dealers is to provide last mile connectivity to the *hawala* operations. For purposes of trading the hub is mostly, Kolkata. For purposes of investment in properties, the hub is Delhi and Mumbai. For purposes of remittance abroad, the hub is Mumbai. For remittance to different Tier II and III cities, the hub is dependent on the nearest geographical hub of the three.

Generally, *hawala* operators who are operating these hubs have multiple relationships in most of the geographical hubs. This includes the hubs spread abroad and thus, there is a network available through different routes between any two cities. An interview with an advocate in the Guwahati High court with clients spread over many North Eastern states in India (including Assam, Arunanchal Pradesh and Meghalaya), revealed several examples of *hawala* transactions in north east states in India (personal communication, October 20, 2018). Thus, I examine potentially representative transactions from Tezpur, a Tier II city to understand the working of *hawala* in India. These transactions are representative of the nature of transactions prevalent all over India in the *hawala* network: -

Case 1. An expatriate worker wants to send money to his home in a village in Assam near Tezpur.

The backbone of this structure, in general, has been the large transfers of incomes being repatriated by migrant workers (both domestic and foreign). In this case, the motivation is lack of banking facilities. Even today, he would be getting a better exchange rate, as banks are inclined to give better exchange rates to larger clients.

Case 2. A trader or small shopkeeper goes to Guwahati or Kolkata (Calcutta) to buy stock.

It came to me as a surprise that sizable percentage of operations in *hawala* are for legitimate trading purposes. A trader in Tezpur would need to have *hawala* transactions terminating in Guwahati, which is a Tier II city and a major trading centre in the North East of India; from where he procures raw material in bulk. He may also choose to travel further and procure material from Kolkata, which is a Tier I city. Thus, he will be travelling anywhere between 100-1000 kms to reach a Tier I or Tier II city in order to procure raw material.

For instance, an electrical appliances and fittings shop owner in Tezpur will travel to Guwahati for purpose of procurement. In case he runs short of money to procure the material; and having negotiated his orders, he will get money by *hawala*. It is important to mention that considering small shopkeepers only derive profit from the margin they save by avoiding payment of taxes, all purchases are in cash. Savings in tax can be anything between 10-50 per cent. Owing to the distance he has to travel and the safety of the amount involved, he may carry only a small percentage of the money required to complete the purchase. He ensures the shortfall is paid to the wholesale dealer by *hawala*. Similarly, he may go for procurement to Kolkata where he may carry out the entire payment in *hawala*. The difference may be that he may receive the payment in his own name by *hawala*.

Case 3. Remittance to Wards abroad for Education or Sustenance while awaiting settlement.

There are several young adults and teenagers from middle class families in India, studying abroad. These families are not in a position to show the adequate amount of accounted income (despite having the required funds) required to fund the education of their wards in sought after universities in USA, United Kingdom and Australia (to name a few). These could include government servants, politicians and businessmen whose actual income is unreported to tax authorities. These people need to send money abroad for fees and sustenance of their wards in say United Kingdom. This money is remitted through *hawala* from the sub agent in Tezpur to the operator in Guwahati who remits it to Delhi or Bombay to be remitted further to Dubai. It is then sent through normal banking channels to an account in say London. This example also demonstrates a common mechanism of money laundering and meeting of expenses from corruption and avoidance of tax or misuse of political power.

Case 4. Procurement of Property in Tier 1 city by politicians, bureaucrats or other investors.

Property in India, often has a large unreported cash component of as much as 60 per cent of actual value. A bureaucrat in Tezpur who wants to buy property in Delhi sends the cash component by *hawala* to Delhi via the *hawala* dealer at Tezpur, who forwards it to the sub hub in Guwahati, who further sends it to the hub i.e. Delhi. In Delhi, it is utilised against the cash component of the property. This can also be treated as an example of parking funds, as when the property is sold, the realised price will also be in the same ratio as the investment. Here, the money is just parked and not technically laundered.

Case 5. Capitation fees for ward for admission in Engineering or Medical school.

There is an overwhelming shortage of seats in medical and technical colleges, and higher educational institutes in India. Typically, to procure a seat in a medical or engineering college in India, the capitation fee is extremely high (typically Rs. 75 Lakhs- 1 crore). This money is sent to the Tezpur sub agent, then to Guwahati from where it goes to Bangalore via Bombay (depending on the relationship between the agents of these hubs). (See chapter 5, section 5.6 for a detailed case study on malpractices in education sector in India)

Case 6. 'Sponsored' Scholarships through Cash donations

There are NGOs that give 'sponsored' scholarship to students in lieu of cash donations from their parents. These are students whose parents are unable to show the money as accounted income to pay for their wards living expenses. To avoid paying the tax liability on the income they have stored it as black money; on which taxes are due. This money could be obtained as a consequence of corruption or kickbacks, if the parent happens to be a bureaucrat or a person in a position of power.

They resort to purchasing scholarships by giving cash donations to such institutions mostly located in the metros. These NGOs are located in Tier I cities. Alternatively, the parent in Tezpur would pass over the money to a person, who can show agricultural income that does not require to be taxed, who then pays the fee. It may be noted that it is not only middle-income politicians, bureaucrats and businessmen, but some of the most elite persons who have studied in premium universities abroad and have procured their scholarships from large industrial groups by way of favour to their powerful parents.

Case 7. Monies to be transferred to Candidates during Elections from party Headquarters.

During an interview, an Indian politician, who has served as the Chief Minister of a north eastern state in India, told me that at least 10 per cent of all budget may be considered to be connected to black money due to corruption & kickbacks to political functionaries (personal communication, August 13, 2017).

4.6 *Hawala* 2.0: Key Players

Prior to economic liberalisation, *hawala* was an activity more or less exclusively carried out by financial operators in informal and black sectors of the economy. It played a role in funding for smuggling and as a conduit for flight of capital, using the existing age-old mechanisms by traders between India, South-East Asia and Middle East. This was mostly concentrated between Mumbai, Hong Kong and Dubai. As the economy started opening up in the 1980s, *hawala* became an important institution in bringing back funds from abroad for funding of projects in India. I was informed of this development by a Delhi-based advocate during an interview conducted on 13.07.2017. This fact was substantiated by a chartered accountant in Mumbai during an interview I conducted with him on 15.09.2017. I gathered further insights from my discussions with him. He said, "*The demand for hawala operations grew due to the rapid growth in the Indian economy which generated larger amounts of black money, available for round tripping for investment in capital markets, as well as projects in India*." The demand pull for round tripping can be attributed to better returns in India. As the requirement increased, the faith and relationship matrix of traditional *hawala* operations, needed to be supplemented by formal methodologies. This included due diligence for meeting legal requirements. This brought in the CA and lawyers as prime players, followed by finance professionals. Banks too got involved when the innovation of participatory notes and GDR's was made possible through double taxation treaties particularly with Singapore and Malaysia. This gave the investor choice of tax regime with distinct fiscal advantages of negligible or no tax on his profits (personal communication, September 15, 2017).

Thus, under *hawala* 2.0 era, the traditional *hawaladar* merely became a service provider to corporate consultants and big business. Another factor aiding the evolution of *hawala* 2.0 was the simultaneous rise of the internet and its widespread usage in India. IT technologies allowed maintenance of transactions using sophisticated algorithms and increased the reliability and speed with which *hawala* business could be conducted. In this period, *hawala* has become a link in the global logistical chain for handing money movements.

With the rapid increase in state budgets and infrastructure spending by both central and state governments, large amounts of funds were being moved in each Indian state's capital cities, by way of government contracts. Earlier, *hawala* business had three main hubs, with about 2-3 sub-hubs, associated with each hub. There was a need to move large amounts of funds to state capitals to maintain political parties and conduct elections. To meet this twin requirement for black money, each state capital has developed into an active hub. A *hawala* operator in Guwahati mentioned, "*Earlier, we were only an agent for the hawala operator in Calcutta and we would operate through him for all transactions. Now we operate as full-fledged operators. We have sub agents all over the state of Assam and a one-on- one relationship with hawala operators in Bombay and Delhi. This is akin to the growth of banking which had earlier presence only in the main cities and slowly permeated into the hinterland. Now, hawala is able to remit funds due to its pre-existing network of dealers and sub-dealers even more efficiently to recipients in the hinterland*" (personal communication, February 11, 2018)

4.7 The continued appeal of *Hawala* in India

The *hawala* system in is extremely popular and widespread in India. This popularity can be attributed to certain intrinsic as well as evolving characteristics of hawala. These qualities include efficiency, cost effectiveness, reliability, and potential for anonymity (El-Qorchi, 2002). This anonymity is maintained through a specialised system of securing of the accounts through coding. In this section, I list the features of hawala that have contributed to its continued appeal in India.

4.7.1 Anonymity of transactions through Coding

The coded nature of hawala transactions also provides to its users anonymity and confidentiality of the transaction as there is complete lack of any residual paper trail. The books of a *hawaladar* are usually coded by mentioning some agricultural commodity like apples or walnuts, and not the actual amount or the currency. Proving what it signifies is difficult without any other corroborating information. Most often, the initials of the parties involved are used. Thus, codes and passwords are used in many instances to describe the terms of the transaction and to ensure that the funds end up in the hands of the intended recipient.

A senior chartered accountant in Delhi told me about the traditional single-entry bookkeeping practices of traditional accountants called '*Munims*'. He said, "*Every munim writes Rs lakh in a* *different way through a code like 2 cows or 1 buffalo. Only the munim knows what this means. Hawaladars used to follow a similar pattern*" (personal communication, March 26, 2018).

4.7.2 Cost Effectiveness

As per a joint study conducted by the World Bank and the IMF (2003), *hawala* transactions are a more cost-effective option (in comparison to formal banks), for many individuals, for three primary reasons. Firstly, they facilitate the avoidance of currency controls and bureaucratic red tape which is characteristic of developing economies such as India. Secondly, most hawaladars offer more favourable exchange rates than most formal banks. Lastly, when the value of transactions is low and the transactions are frequent (such as in the case of migrant remittances), it is more cost effective to use hawala to transfer funds. (World Bank, 2003). According to the findings of Jost and Sandhu (2000), there is a difference in exchange rate of about 12-19 per cent, on a comparison of hawala rates and official exchange rates.

As per interviews conducted with *hawaladars* and chartered accountants in India, the total cost of hawala transactions consists of four components: -

4.7.2.1 Exchange rate (if any)

As far as foreign exchange conversion cost is concerned, the rate given by the *hawala* operator is better than bank rate. It involves net delivered foreign exchange value at the foreign location. If the bank exchange rate is 72 rupees for purchase of 1 US $, the *hawala* operator will offer a rate of 71.50 to 71.80 rupees, typically. Similarly, if dollars are to be sold, the bank may offer 70 rupees against 1 US $ while the hawala operator may offer a better rate of up to rupees 71 or 71.5 against 1 US $.

4.7.2.1 Place of Delivery (with consideration of distance and size of the centre of delivery, in terms of hawala operations)

Depending on where delivery has to be made, there will be a cost of remittance. This cost will be less for larger centres within the country and relatively less for tax free jurisdictions such as Dubai. In case money has to be remitted to a foreign bank account, then it is first sent to Dubai and then arrangements made to remit it through commercial banking networks through offshore accounts. Cost of sending it to Dubai is charged upfront and the banking component is deducted from the amount by the bank concerned.

4.7.2.3 Size of Transaction

The size of transaction also determines the charge for the transaction which can vary from 1 per cent for transactions of few hundred thousand or below to 0.025 per cent for transactions of Crore plus. Even lower costs may be levied on a negotiated basic for specific larger transactions or regular transactions. It must be noted that the charge is much lower than what is available through normal banking channels. For very large transactions it has the advantage of instant remittance.

4.7.2.4 Frequency of Transaction (from or to the same party)

In case very large number of transactions are happening, either to or from a particular party, there can be a lower fixed charge for such transactions on a negotiated basis. In conclusion, we can assume excluding the exchange rate, the charge for *hawala* transaction varies between 0.15 per cent to 2 per cent. A *hawala* operator in the bustling *Chandni Chowk bazaar*, Old Delhi, informed me, "*Typically for a transaction worth 1 lakh, I will charge 100 rupees; for a transaction worth 10 lakhs I will charge 1000 rupees, but if it is 10 million, I will charge 5000 rupees. If the value reaches 100 million or 10 crores, I will charge 25000 rupees, provided the transaction is between hub cities and it involves regular clients. More often than not, we are willing to hold* *funds of regular clients awaiting instructions for remittance. These clients get good rates from us*" (Anonymous Hawaladar, personal communication, October 10, 2017).

4.7.3 Adaptability of Hawala

As documented in the phases of hawala since ancient times, Hawala has shown immense adaptability to structural changes in the Indian economic entity as well as other converging factors for change such as advances in information technology (IT), IT enabled banking and modern accounting practices. Speaking on adaptability of *hawala*, a *hawala* operator who goes by the name 'Jackie Bhai' (pseudonym), in *Bara Bazaar*, Guwahati informed me, "*Traditionally, our role was to take money in one city and pay it out to whosoever produced the hawala. Originally this hawala used to be a hundi. Later, it became half a piece of a torn note. Till recently and even now, identity of the recipient is established by the presentation of a note whose number has been noted by us at the time of receipt of funds. One difference now is that in case of credible clients, we release funds based on facsimile of the note. We do not insist on production of actual note. This is based on electronic receipt of facsimile or number of the note along with receipt of the message requesting for release of funds. The message and the facsimile must be coming from a telephone number which has been sanctioned by the remitter of the funds and registered with the hawala operator at the time of deposit of funds or issuance of funds at the time of delivery*" (Jackie *Bhai, Personal* communication, February 22, 2018).

As per another *hawala* operator in Guwahati who chose to remain anonymous, "Cryptocurrency is the most reliable route for large amounts of money due to its global availability and invalidity of governments to track the same" (personal communication, August 21, 2018). It may however, be noted that this route is also followed by illegal transactions for terror funding and/or transactions intended for payment towards illegal activities such as payments for contraband etc.

4.7.4 Cultural Affinities

It is very important to understand that a *hawala* transaction consists of typically three or four sets of players. Three, in case the remitter and recipient are same party and four, in case they are two separate parties. The second players are nowadays mostly a chartered accountant and/or book keeper. Generally, this role (as far as the client is concerned) is played by the chartered accountant. The third party is the actual *hawala* operator. The *hawala* operator works through a network of family connections which go back several generations to interrelated families, specialising in different geographical areas or different types of hawala transactions. In fact, over the last five decades with modern education and training, *hawala* operators for purposes of form and last mile connectivity still maintain age old offices or points of transaction called 'Gaddi' (can be translated to 'seat' from Hindi). These are what are referred to as 'dingy" offices in 'labyrinthine depths' of Indian cities in most international security and anti-money laundering literature. Today's *hawala* operations are a complex of financial services package consisting of money changing, book entry operations, money lending and *hawala* using latest technology and statistical modelling to assess the need for physical cash in rupees and other currency, to minimise actual physical movement of currency. The operators are highly automated and networked but the *hawala* accounting is not kept in rupees, but in innocent commodities such as 'apples', 'walnuts' etc.

It cannot be over emphasised that all the evolution and sophistication of *hawala* as an instrumentality available to today's businessmen, politicians and dealmakers is based on the strong cultural ethos of hard work, absolute honestly in transactions, complete reliability and confidentiality. There have been cases where *hawala* operators have been raided by law enforcement and tax authorities, but have indemnified their clients to the last penny. In an environment where long standing banks go bankrupt and savings of widows and orphans are wiped out, the reliability of *hawala* operators enjoys a rock-solid reputation with the business community. Their clients included biggest corporate entities, political parties at the high end of the economy and players in the informal and black economy across the entire spectrum of the economy.

4.7.5 Trust

Trust is the fundamental tenet of hawala (Schaeffer, 2008). Most literature on hawala (Ballard, 2002; El Qorchi et al, 2003; Monsutti, 2004; Passas, 2006; Rudner, 2002; Subramanian, 1987; Torri, 1991; Wilson, 2002) argues that the most distinctive characteristic of hawala is the implicit trust it induces among its beneficiaries (both regular and incidental) (Torri, 1991).As per Dr Tandon, Assistant Professor, NIPFP, "*hawala was a system designed purely for remittances in India. I feel that is the mainstay of hawala. Hawala is important for those who do not want to wait for the bank in the banking system or those who don't want to be visible in the system; such as a small exporter in a small town in India. When you speak of companies, I wouldn't say hawala would be large. They're under so many regulations. Hawala for companies wouldn't be zero though. Let's take an example: A person who wants to avoid paying GST (Goods and Services Tax). He can pick up goods in cash and show it in his books. But the system is designed to do things above board. In bigger companies it would be completely negligible*". Furthermore, she said, "*A survey was done few years back on hawala remittances to India. It was a conventional fund transfer mechanism. Let's say in an emergency situation hawala would be quicker and cheaper. Currency conversion rates are better. So, there are two comparative advantages; ease of transfer and better rates. The point is that there is a cap on people's preference to be underground. For a guy who has obtained money through illegal means, hawala is the only option. For anyone else, why would an FDI or FII use hawala. Even an individual like you, would you want to use hawala? The propensity to use hawala is not driven primarily by better rates, but the necessity i.e. lack of paper trail and source of the proceeds. If tomorrow, hawala gives you a better return than sending through banking, then also you would be lured by hawala*" (Tandon, personal communication, March 9, 2018).[32]

4.7.6 Convertibility of Rupee

The lack of full convertibility of the Indian rupee into a foreign currency is one of the reasons for the persistence of *hawala* in India. The Indian rupee is partially convertible i.e. Indian rupee cannot be exchanged (above a limit) without the prior approval of the RBI and

[32] The interviewee is an established tax evasion and tax avoidance expert in India. More importantly, she joined National institute of finance and public policy, a think tank under the ministry of finance, New Delhi under the 'unaccounted incomes project' where she worked on the specific chapter on money laundering in India.

Government of India (also other departments like Income Tax, etc.) (Ray and Das, 2019). However, this was not the case till the mid 1990s. Since independence, a web of exchange controls were imposed on foreign exchange convertibility under Foreign Exchange Regulation Act (FERA) of 1947. These were further tightened by FERA 1973. In 1990, from a period of regulation, the government moved towards management of foreign exchange under the Foreign Exchange Management Act (FEMA) of 2000. In mid 1990s, some relaxation was allowed under FERA amendments, in light of aligning it with the spirit of liberalisation. In effect, FERA banned all transactions in foreign exchange, except when specifically permitted. Further, it may be noted that the exchange rate was 1 rupee to a dollar in 1947 and depreciated to 32 rupees in 1993 moving on to 74 rupees in 2020 as per the RBI data.

Under this factual matrix arose two opportunities for persons with black money to take advantage of the possibility of exchanging rupees for dollars which were obtained through *hawala*. Firstly, as the value of the dollar grew; holders of black money found it convenient to convert their currency to dollars and store the cash in bank lockers or safes. The fact that a large volume of rupees could be significantly reduced in volume in dollars made it attractive, purely from storage space requirement point of view, as there was a cost to the storage by unit volume for a higher value of rupees. Furthermore, the advantage in conversion lay in the fact that as the rupee value fell, the dollar could be encashed in the future. Thereby, the black money earned an effective interest. Secondly, the black money holder had the option of sending money offshore by converting it to dollars through *hawala* and returning it back through *hawala,* when needed, in rupees in India. Again, due to increase in value of the dollar, over time, the transaction resulted in receipt of a higher value. This way, hawala created an opportunity to store black money and earn a return simultaneously.

In the next section, I examine the main users and beneficiaries of *hawala* mechanism in India. I examine the beneficiaries of hawala transactions in India for two reasons. Firstly, the segmentation of hawala users into regular and incidental highlights the fact that hawala is the economic route chosen by many individuals owing to necessity and not choice. This is apparent in situations where no other alternative is available to the individual such as an NRI wanting to sell ancestral property in India where a large part of the transaction is carried out by receiving cash. This cash is often part of the black economy. Secondly, an examination of the beneficiaries is indicative of the all-encompassing reach of hawala in India. A large part of the population of India has at some point availed of hawala services either inadvertently or by choice.

4.8 Beneficiaries and Users of Hawala Transactions

As per interviews conducted with accountants, *hawala* operators, sub agents of *hawala* operators and sub-sub agents of *hawala* operators, I classified the users and beneficiaries of undergrounding banking in India into two categories: -

1. Regular Beneficiaries/Users
2. Incidental Beneficiaries/Users

4.8.1 Regular Beneficiaries

4.8.1.1 Migrant Remittances from abroad

As suggested by global trends, there has been an increase in international migration over time – both in numerical terms and proportionally. In 2019, around 272 million people migrated from their home country (IOM, 2020). This accounts for about 3.5 per cent of the global population in 2019 . One of the main challenges for the 100 million people in India who migrate from their native villages and town for work is how to send money home. Access to formal financial service points is required for migrants to remit funds. Such service points include mobile banking, post offices and banks (Agarwal, Champatiray and Oza, 2011). On the other hand, informal channels include sending cash through acquaintances and friends, and *hawala* couriers. Informal channels are a popular choice for migrants as reiterated by a study by the Centre for Micro Finance (2010) titled 'Putting Money in Motion: How Much Do Migrants Pay for Domestic Transfers'. As per this study, informal channels are used by 57 per cent of migrants in India .

In the study sample, while over 50 per cent of the migrant participants have expressed interest in remitting through formal channels like banks; in reality only 31 per cent did so. It is intriguing that despite presence of formal channels like *India Post* which has 150,000 branches across the country, majority of the migrants still use informal means. One reason for the success of informal channels is the ease and convenience with which these transactions take place. The process of opening a bank account for migrants and their families is not easy, as it requires identity and address proof which is difficult for them to attain. Furthermore, transactions, especially in remote locations are usually slow. Time per transaction is, for instance, an average 150 minutes at a bank compared to 48 minutes per *hawala* transaction. Many of these migrants are daily wage labourers and their working hours also overlap with the hours of the formal channels. Other barriers to accessing bank accounts, include difference in the attitude of bank officials, who are difficult to deal with compared to *hawala* couriers. The only disadvantage while using informal channels is the risk they bear (CMF, 2010).

If banks were to introduce changes to make their services more accessible, it could certainly increase usage of formal channels over informal channels. Strategic placement of bank branches, along large migrant corridors at both destination and source areas would make transfer of money easier, especially, in rural and other hard to reach areas. They could also further decentralise by appointing business correspondents where licensed institutions and individuals could offer services and conduct business on their behalf. Use of technology such as mobile phones, biometric authentication and smart cards could not only reduce costs, but make transactions faster and safer. One such initiative was unveiled by India's largest public sector lender, the State Bank of India (SBI), in July 2015, to enable home loan applicants to expedite their Home Loan Application (HLA) process. Within this initiative, access to formal banking services is provided to customers by opening a 'no-frills' account requiring minimum KYC (Know Your Customer) documentation, with provision of a remittance facility (Moneyworks4me, 2015). This scheme was called 'Project *Tatkal' and allowed applicants* to get loan approvals within 10 days on receipt of application form (Jha, 2015). Another scheme has been unveiled by the National Payments Corporation of India (NPCI), wherein funds can be transferred even when the sender and receiver do not have accounts in the same bank. This is called the Immediate Payment Service or IMPS.The facility can even be used on regular phones that have SMS facility and not just smartphones. A pre-requisite of this service though is that both the beneficiary and remitter need to have bank accounts. Presently, as per the CMF study, the post office is the most expensive remittance option with nearly a 6 per cent fee on the total amount remitted. Additionally, the

Aadhaar programme (Unique Identification Authority of India) by the Government of India needs to swiftly expand its reach to areas with substantial number of migrants. This would significantly lessen the time taken by migrants to prove their identity to banks. In order to achieve universal financial inclusion, domestic migrants need to be included as well (CMF, 2010; UNCTAD, 2013).

4.8.1.2 Smuggling

The *hawala* system has increasingly become the platform for money laundering process. Conducting money laundering through banks and formal means leaves behind a paper trail that can be accessed during an investigation later. So, it is not a preferred method. Since an important element in *hawala* transactions is trust, it requires little to no paperwork. While the birth of the *hawala* system may date back centuries, the growth of the present *hawala* network has its roots in trading and smuggling operations in South Asia in the 1960s and 1970s. Boats were used to ship gold to south Asia from places like the Gulf Cooperation Council (GCC). This was done to avoid gold import restrictions. To send funds back to the countries of origin and for the purchase of gold, the growing population of South Asian nationals in GCC countries was used (Shah, 2015). Let me explain this by way of an example. There is a large population of Indian workers in Dubai. They need to send their savings to their families in India. They have the option of sending it by regular banking channels or through hawala. Many choose *hawala* as it costs less, gives a better exchange rate and is faster. Let 'X' be the workers who need to send their savings through *hawala*. Let's say at any given time the amount collected in hard currency i.e. equivalent dollars to be 'A'. Now, the hawala operator has in Dubai the amount of 'A' dollars against a liability of equivalent rupees, to be delivered to the families in India, say 'B'. At this point, a smuggler approaches the *hawala* operator to demand dollars 'A' from him against promise of payment of rupees 'B' by him in India to the correspondent of the *hawala* operator in Dubai. The advantage to the smuggler is that if he were to exchange his revenue from gold smuggling in rupees in India, the rate he would get would be very poor. The smuggler takes the dollars and buys equivalent gold and sends it by small fishing boats to India collecting rupees in exchange in India. He deposits these against his liability of rupees against the dollars he obtained from the *hawala* operator. The buyers of gold sell it to jewellers in cash and members of the population buy gold jewellery from the jewellers. Hence, entire population is entangled in this ecosystem of gold smuggling and hawala. Thus, the ecosystem consists of not just the hard working migrant diaspora abroad but also the general Indian population who have a constant need for gold, despite government efforts to ban gold and restrict the same. This need can be attributed to the humongous demand for gold in most Indian households for both weddings as well as religious purposes. Despite an insatiable demand for gold in India, the government under PM Morarjee Desai, had virtually banned possession of gold under the Gold Control Act, 1968. According to Nilesh Shah (2012), "The demand for gold remained as firm as ever and gold smuggling became the order of the day, accounting between 30-70 per cent of actual imports, according to unofficial estimates. The hawala market was developed to pay for gold smuggling through remittance. An unaccounted black market emerged as cash was used for buying smuggled gold or paying for the rupee part of hawala trades. Drug trafficking started as smugglers diversified their business risk. Black economy and tax evasion became rampant, corruption became integral and acceptable. The Indian economy kept losing its shine till the early 1990s crisis forced a course correction" (Shah, 2012).

Most *hawaladars* participate also in the formal economy, as they have a main profession that they engage in and being a *hawaladar* is an alternative hidden venture for them. I spoke to one such *hawaladar*; he said "*I run a currency exchange outlet in South Delhi in a premium location. I also sell imported perfumes at subsidised prices. But, my main source of income is conducting hawala transactions, which are complementary to my money exchange business. I would definitely say that it is my main source of income. We have been doing this since the time of my grandfather and many of my uncles are also involved in this business. Many of my regular clients are parents who send money in a weekly or monthly basis to their children studying abroad. A regular client of mine has a daughter studying in Berlin and he sends her money every week. In the long run, it works out to be much cheaper for him as the bank charges him an extra 15 euro per transaction. Since I charge 2-3 per cent interest on international transactions for regular clients, it saves him a substantial amount of money.*" (personal communication, August 24, 2017)

4.8.1.3 Terrorist Financing

There have been concerns about usage of *hawala,* as a means to fund terrorism. *Hawala* came under the limelight, when, during an investigation into the 9/11 terrorist attacks; an anonymous fund transfer by *Al-Qaeda* operatives was traced. The money transfer was traced by investigators to an exchange house in the United Arab Emirates and a suspected *Al-Qaeda* functionary from a Boston transfer facility (Roth, Greenburg and Wille, no date). Therefore, the absence of authentication of sender and recipient can lead to use of *hawala* for malicious terrorist activity. I have not gone into great detail about terrorism related *hawala* dealings, as I was unable to get any *hawala* operator to engage with me on this subject. They often acted in a suspicious manner and completely closed down any form of communication when prodded further on this topic.

4.8.1.4 Retail Traders (Small and Middle Income)

One of the primary beneficiaries of the *hawala* system are the small and middle-income traders in India. Traders from small towns that engage in buying and selling of finished products and procuring raw materials regularly travel from small towns, two-tier cities, and villages to major metropolitan centres such as Delhi, Mumbai, Bangalore and Chennai. To facilitate their work and conduct transactions, large amount of cash is involved. For safety, protection and their peace of mind while carrying out these regular inter-state operations, they prefer to make use of *hawala* and *hundi* as modes of payment and exchange. For instance, a handicrafts trader from Surat visits Delhi every week to procure raw material and sell his finished products. He transfers money through *hawala* to his wholesale seller, before he embarks on his journey. Simultaneously, he exchanges the cash he receives for his finished products for a *hundian* bill of exchange. This saves him the effort of carrying cash both from Surat to Delhi and back. During my field work, I also observed that most *hawaladars* have set up shop in old wholesale markets that have existed for generations due to the intensity of daily market operations. This can be attributed to the volume of sales, as well as the high velocity of money exchanged.

4.8.1.5 Political Parties through Angadias

Angadias may be described as the unofficial couriers and informal quasi bankers for traders all over India, particularly in the Gujarat and Maharashtra region. In fact, most *Angadias* are natives of the Gujrat *Kathiawad* community. They are discreet, reliable and maintain a low profile as a community. *Angadias* have been prominent in Indian business dealings since much before the time India got Independence from British rule. Hence, they have been hailed as the nucleus of India's cash based economy. They transfer high value commodities like diamonds, precious gems, large sums of money, in a matter of a day and charge a nominal fee for transfer of small packets of money. While the legality of *Angadias* is rather questionable, the dependence of the diamond industry on the *Angadia* network, as a facilitator is undeniable (personal communication, August 27, 2018). For example, when the *Angadias* take a two-week vacation, due to the Indian festival of Diwali; many diamond traders also close shop. According to a former president of the Surat Diamond Association (SDA), "They have become the heart of the industry, in transporting goods between Mumbai and Gujarat" (Vora and Umarji, 2013).

While the role of *Angadias* have been the mainstay of business activity since Independence, their role in aiding politicians to mobilise voters across India their work has recently come to light. An Income Tax official who chose to remain anonymous told *India Today*, a leading news magazine, that the activities of many *Angadiyas* had been halted in Rajkot, Surat, Ahmedabad and Vadodara. Other senior officials of the income tax department made the following remark, "From small traders to leading politicians, all of them transport their unaccounted money through this route. In fact, a monthly settlement does take place with *Angadia*s, which are never reflected in their book of accounts". Speaking on facilitation of political activities by *angadias,* Advocate Rahul Sharma, former Indian Police Service (IPS) said, "These *Angadias* are so deeply-rooted that no establishments or political parties in Gujarat have the power to stop this illegal business. Their networks are so strong that most of them handle foreign funding during elections" (Ghunawat, 2017). On the condition of anonymity, I spoke to an *Angadiya* who highlighted the importance of the trust and honour code followed by *Angadiyas*. He mentioned instances where in case of theft while transporting diamonds, *Angadiya*s are known to return the whole price of the package (personal communication, December 2, 2017). They are able to do so as *Angadiyas* have a strong backing by their networks which are community based and have strong communal values. When one *Angadiya* is in trouble, the whole community rallies behind him to sort out his worriment.

4.8.1.6 Satta or Gambling

The meaning of *satta* is future trading by betting on prediction of price movement or occurrence of some event. This is considered as gambling in colloquial terms. Some primary examples are betting done on cricket matches, prediction of rainfall on a particular day in India or price of a commodity on a particular exchange or specific date. The main law with regards to gambling is the Public Gambling Act 1867 (Government of India, 2020). The activity of gambling is frowned about and gambling in 'games of chance' is not allowed. However, there is a close association between cricket and gambling and betting on the sport in India where cricket has been the most popular sport since decades. The report of the Law Commission, titled 'Legal Framework: Gambling and Sports Betting including in Cricket in India', acknowledges that there is a large illegal betting market in the country, particularly in the sport of cricket. The commission observed that the betting syndicate engaged in betting on cricket has proven to be evasive where the law is concerned (Law Commission of India, 2018). The Economic Times, a leading newspaper, interviewed a Mumbai based punter who does cricket betting said, "... betting on cricket varies from Rs 5,000 to incomprehensibly large numbers. Up to 50 cell phones are used to connect with bettors. About 30 minutes after the match is finished, settlements are done. These transactions are settled through *hawala*. Usually when in an area, a person wins a certain amount and in the same locality, another loses the same amount, the loser is asked to pay the winner in cash" (The Economic Times, 2016b). The punter also said, "It'll be very difficult for the government to curb illegal cricket betting as it is a very efficient closed-door system"(The Economic Times, 2016b). It has been estimated by the Federation of Indian Chambers of Commerce and Industry (FICCI) that the betting industry in India is worth around least Rs 3,00,000 crore and 80 per cent of that is contributed by cricket. As per experts at FICCI and the Centre for Sports Security, respectively, the illegal betting market is worth Rs. 9.9 lakh crore (150 billion dollars) a year and bets worth 200 million dollars are placed on each one-day international match by the Indian cricket team . With such large-scale betting and the massive amounts of money involved, *hawala* and money laundering becomes the inevitable preferred mechanism to facilitate transactions . FICCI has also advocated for legalizing betting in sports arguing that the government stands to earn Rs. 12,000 -19,000 crore every year from it. The tax on government sanctioned horse racing has proven to be very lucrative for the government, with some states charging up to 20 per cent on bets. FICCI has argued that "The revenue earned from betting can be utilised to augment the infrastructure for other sports and enhance tourist facilities"(Lal, 2016).

4.8.2 Incidental Beneficiaries/Users

4.8.2.1 *Humanitarian, Emergency, and Relief Aid*

In countries engaged in war, rebuilding after war or civil unrest, *hawala* is often the only option. As a result of this, majority of aid organisations working in these regions opt for the informal financial sector for domestic or international remittance services for humanitarian and emergency purposes (Qorchi *et al.*, 2003; Daudi, 2005). The reason for usage of *hawala* for remittance is due to the high cost and logistics related issues of formal channels. The informal system of *hawala* becomes the only option under such circumstances. Religious institutions use *hawala*, on occasion, due to state restrictions on their followers in a particular country.

4.8.2.2 Selling property of the deceased by Migrants

A *hawaladar* I interviewed, described some fairly common yet incidental beneficiaries of *hawala* channel. There are Non Resident Indians (NRI) who have relatives back home in India. In cases of sudden death of the relatives, the NRI suddenly becomes the recipient of an unprecedented amount of money. Owing to practical, as well as safety considerations, the NRI would prefer to transfer this income back to his resident country. By utilising *hawala*, he avoids reporting the income at the source, as well as in the destination jurisdiction, thus, avoiding tax in both jurisdictions (personal communication, November 24, 2017).

4.8.2.3 Personal Investments and Expenditures such as 'Hawala' Tourism

The *hawala* system is often used for legitimate personal expenditures and investments, as for many individuals, it is the most convenient way to cover expenses related to tuition fees, travel and medical care. A sub-agent of a *hawala* operator in Mumbai, told me that it is very common for businessmen to arrange funds in domestic currency of the destination they are travelling to. They make arrangements beforehand for funds to be transferred through *hawala* to their destination country. He said, "*It is a common sight, where their associates; with a bag full of money greet them in local currency. It has become a constant feature of corporate gifting*" (personal communication, August 27, 2017).

4.9 Conclusion

The *hawala* network in India remains a socio-economic entity with tentacles spread everywhere. Some findings emerge from this step-by-step analysis of the Indian economic narrative of growth in the backdrop of illicit financial flows. Firstly, an age-old system of trust to facilitate trade has survived the annals of time due to a complex mix of factors. These complex mixes of factors will be assessed and analysed in the next chapter in the backdrop of the black/informal economy in India. A major factor being observed here is institutional credibility, trust and confidence. I observe that the skills, network and institutional credibility generated over the last four phases (ancient-medieval phase, British phase, post-independence phase and post liberalisation phase) by 'informal' channels has obtained unmatched resilience and a robust invisible institutional structure of their own, such that it has not been easy to press them into abeyance. It is thus not surprising, that despite consistent and coercive steps by the state to support formal banking systems so as to render them irrelevant during the different phases of the Indian growth narrative to a state of redundancy, *hawala/hundi* networks continue to thrive to this day.

Additionally, structural shifts in the Indian economy, both prior to and after independence have created a unique opportunity for players in the informal economy to re-organise and innovate. This includes the recent policy of demonetization. These systems which are the backbone of the parallel economy and constitute the infrastructure supporting the parallel economy did not evolve overnight but are a result of socio-economic evolution over centuries as societal groups and sub-groups adapted themselves to changing environment of governance with variations in security, opportunity and fairness. Conceptualisation of taxation, public perception of taxation as being fair / unfair and laws related to taxation too played their role in evolution of practices, as these institutions evolved over several decades.

In order to analyse and decipher present day instruments and acts that constitute money laundering, one must perforce acknowledge the existence of a sophisticated ecosystem which supports, nurtures and feeds on the money which is outside the formal system of financial transactions and may or may not be black money. The institutional infrastructure that supports this parallel economy, also provides structural elements that facilitate smooth movement of money over time and geographical space. Simultaneously the money may go through a process of cleaning itself to become part of the formal economy and vice-versa. The vast pool of informal economy, which is lawful, acts as a buffer. It may be of some importance to note that money laundering in such a scenario is a two-way process with formal money often being converted into unaccounted money to fuel the black economy for a number of reasons intertwined in fiscal needs that arise out of an interplay between the accounted or white and parallel or black economy. This is the subject of analysis in the next chapter (V).

Chapter 5

The Indian Economy and the Mechanisms of Money Laundering in India

Chapter V

The Indian Economy and the Mechanisms of Money Laundering in India

5.0 Introduction

In this chapter, I examine the mechanisms of money laundering and their relationship to the processes of economic liberalisation. Specifically, I analyse whether the processes of liberalisation were causal to the emergence of money laundering practices or whether the relationship between liberalisation and money laundering is more complex. To this end, I have discussed the changing nature of the indigenous money transfer mechanisms of *hundi* and *hawala* in the previous chapter. The mechanisms of money laundering in India need to be analysed in the context of the working of its economy. Indian economy constitutes three types of overlapping economies; namely, the formal, the informal and the black economy. These together, with their interplay, determine the Indian financial ecosystem; within which money laundering and its supporting mechanisms have evolved and persist. Previously, I have also established the inter-relationship and linkages between the formal, informal and black economies in India (see chapter III). This chapter explores the various mechanisms employed for money laundering i.e. converting black money to white money by constructing and analysing India-specific typologies of money laundering.

There is lack of consensus on a universal internationally accepted legal definition of money laundering as it varies from one country to another (Van Fossen, 2003). The Financial Action Task Force (FATF) (2011) on money laundering defines money laundering as "the processes where criminal proceeds are disguised from their illegal origin with the purpose of legitimizing the illegal proceeds" (FATF, 2011). This definition allows me the flexibility of specifying what is considered criminal or a predicate offence, and/or illegal activity, as well as mechanisms of legitimising illegal proceeds. Thus, for the purpose of this thesis, I adhere to this definition by the Financial Action Task Force (FATF). In the context of Anti Money Laundering literature (AML), the term 'typologies' is attributed to the varied mechanisms or techniques employed to launder money or finance terrorism (Nance, 2018). In the 1990s, financial institutions and multilateral organisations such as the FATF and the Asia Pacific Group (APG), started carrying out regular 'typologies' research to generate up-to-date empirical data to combat global money laundering and counter financing of terrorism. The typology exercises are structured around bringing together money laundering experts from around the world to discuss the latest issues in money laundering. They have three tasks: a. to exchange information concerning ongoing cases and related operation, b. to identify the primary diffusion mechanism of FATF entity and describe current trends in money laundering, and c. to identify and describe effective (and failed) counter-measures. There is a common understanding in academia that the FATF blacklist is the primary diffusion mechanism used by FATF. The current system of enforcement in the FATF regime is the International Cooperation Review Group (ICRG). This began in 2007. In 2009, G20 called upon the FATF to strengthen the ICRG procedures by publicly declaring the names of countries with deficient AML regimes. This research is carried out to monitor emerging threats to international financial security and to advise policy makers along with law enforcement agencies to formulate and implement better anti-money laundering policies (He, 2010; APG, 2012). The construction of the India specific typologies is expected to be a useful contribution of this study to country specific typologies research. While there are some sector specific (Blum *et al.*, 1999; Thanasegaran and Shanmugam, 2008; Unger and Ferwerda, 2011; Guiora and Field, 2014; Omar, Johari and Arshad, 2014; Terry *et al.*, 2018; Chohan, 2019; Teichmann, 2020) and some region specific (Goredama, 2003; Chaikin and Sharman, 2007; Chohan, 2019; Shah, 2020) typologies research available, I discovered that the country specific typologies within these classifications for India were limited to regional trends in South Asia. Examination of these typologies makes two contributions through this research. Firstly, it adds to the literature on country specific typologies. Secondly, it provides testing ground for my hypothesis H1, H2 and H3. On testing each of the hypothesis against the respective money laundering typology, I have been able to show the impact of liberalisation vis-à-vis each of the typologies.

A unique finding of my thesis is the mechanism of 'parking', where money is neither laundered nor delaundered. While it doesn't technically qualify as a full cycle of laundering (since it only reaches the layering stage), I have included it as a mechanism of deployment of black money in India for two reasons. First, it is highly pervasive in most major sectors of the Indian economy such as real estate, agro-trading and business of precious jewellery, including diamonds. Secondly, the process of parking is heavily intertwined and often clued in with other mechanisms mentioned in the section on typologies of money laundering in India.

According to Dalmia (2013), "The definition of "Money-Laundering" in India is comprehensive enough to cover most of the instances of converting the black money into white, as the same will depend upon the willingness of Enforcement Authorities for strong implementation of, which is in any case subject to judicial scrutiny" (Dalmia, 2013). As mentioned earlier (chapter II), during the course of my fieldwork, I started most of my interviews with the opening question, '*What do you understand by the term money laundering*?'. Barring few exceptions, almost all the interviewees responded with the answer, "*Money laundering is the conversion of black money to white money*". Thus, in the Indian perception; across the political, business as well as academic spectrum, the concept of money laundering is inextricably linked to the concept of black money. This chapter explores the various mechanisms employed in laundering/converting black money to white money by constructing and analysing India-specific typologies of money laundering. Due to this, I have made considerable effort in examining the relevance of black money in India. I discuss this in the following section in some detail.

5.1 The relevance of Black Money in India

In order to gauge the size of the global economy, we are guided by official statistics on trade, output and investment. However, in order to truly understand any economy, we need to consider what is officially recorded, as well as what is hidden. Globally, money hidden from tax authorities of the domestic economy is the foundation of shadow economies, which have been calculated (roughly mostly) on a worldwide basis (Schneider, 2010). However, tax evasion as the foundation for justification of black money is an oversimplification of the reality in the case of India. Black economy is an expression that encompasses many conceptual terms, but irrespective of the various definitions, it consists of some activities that have persisted over several decades (NIPFP, 1985, 1986). These activities primarily constitute mechanisms of money laundering and its associated crimes such as illegal employment, smuggling, drug trafficking. Thus, the black economy can be understood broadly, as reflecting illegality in an economy, even if it does not capture all criminal activities within a society (National Institute of Financial Management, 2012). According to the Indian Council of Research on International Economic Relations (ICRIER) (2018), legal businesses controlled by the government, government expenditures' and taxes have also contributed to the creation of black money (Singh and Bagchi, 2018). In India, the black economy pervades all sectors of the economy; this includes elite professions such as businessmen, politicians, bureaucrats, police, legal representatives, medical personnel, chartered accountants, and education professionals, among (Virmani, 2006; Sarkar, 2012; Kar, 2013). According to Kumar (2002), the size of the black economy has been rising since India's independence in 1947. It has been estimated to have consecutively increased over the years: it was 4 to 5 per cent of GDP in 1955/1956 (Government of India 1956); 7 per cent in 1970 (Government of India 1971); 21 per cent in 1980/1981 (NIPFP 1985); 40 per cent in 1995/1996. It was 50 per cent in 2005/2006 (Kumar, 2017).

The plethora of official and unofficial reports and papers for measuring the size of the unaccounted/black economy in India have been guided by divergent methodologies and have gathered criticism over their many underlying assumptions and approximations (Thomas, 1999; Raghavan, 2019; The Financial Express, 2019a). Moreover, it can be observed that the estimates for the same year have been divergent in different studies (Ministry of Finance, 2012). The Indian media is replete with articles and news reports with a wide ranging gamut of estimates of the black economy in India (from 2 per cent to 120 per cent) (The Financial Express, 2019a) and more recently, various accounts of Indian money held abroad by Indians in tax havens (Ministry of Finance, 2012). For this reason, measuring the size of the black economy seems like a redundant exercise. The data available to measure black economy lacks accuracy, as any determination of the size of the economy requires not only quantum of money deployed in it, but also velocity of that money, quantum of credits and valuation of relationships which can be converted to productive business transactions. Such data in formalised economy is available by way of corporate financial figures, banking data and government data. Except for the amount of money in the black economy, which too is at best a guesstimate, all other data cannot be covered by a formal system to its very nature. It is important to consider that there is a vast pool of subsistence and informal economy, which strictly speaking is not black, but exempt from tax as per law. As per a senior accountant, who I interviewed, this large informal economy forms the sea from which the black economy derives strength and sustenance. For example, the entire rural economy in India is tax-free. This consists of at least 60 per cent of Indian population (anonymous, personal interview, 4 March, 2018).

I was informed by one finance professional, who I interviewed, that the effective tax-free status of rural economy was used to launder black money. This was done by setting up a finance company to ostensibly collect small investments, cumulatively from a few hundred thousand persons whose name is taken from the electoral rolls. The money placed in the finance company as petty deposits entirely comes from proceeds of corruption. Chartered accountants invariably set up and manage such companies. They are consultants to bureaucrats and politicians whose illegally obtained money they manage. This money is converted to white and used for investment and withdrawn and made available as cash during elections (personal communication, January 17, 2018). During an interview with a former member of the Planning Commission in India, I was given many insights on the ramifications of the black economy in India. He told me that the fountainhead of the river of black money was government spending and corruption related to such spending by way of kickbacks and commissions. This corruption was 10-30 per cent of government spending by way of purchase of goods and services, award of contracts and pilferage in distributions of various awards and services (personal communication, August 1, 2017).

As per many political observers and economists, the black economy has continued to grow in India (Kumar, 2017). Given that the black economy continues to grow and form a significant part of the Indian ecosystem within which it operates, it is imperative to understand what fuels the black economy in India? As per Professor Arun Kumar, an expert on the black economy in India, the black economy in India is sustained by the malaise of widespread corruption in India (Kumar, 2002). Kumar (2002) argues that the only way to counter endemic corruption was to break the triad of politics, business and the executive that was responsible for the institutionalisation of black money in the Indian economy. In an interview to Economic and Political Weekly on 15th November, 2016 he said, "*Every act of corruption is a nexus between the corrupt politician, businessman, police and the bureaucracy or the executive. Unless you break this triad, the black-income generation will continue. The politician and the others have to say that now they will not do these things. That consciousness comes about only when there are movements*". I examine this triad in the next section.

5.2 Black Money and The Triad of Business-Politician-Bureaucracy [33]

The layered character of the Indian state gives rise to corruption as well as a patron-client relationships. Historically speaking, the creation and sustenance of potentially powerful interest groups was the result of a state structure based on a feudal capitalist system of accumulation. When the British rule came to India, they did not dismantle the existing patron-client nexus. Instead, they created agents of accumulation and surplus transfer from among the local patrons, in the name of democratic decentralisation. The post-colonial state structure in India, created a powerful nationalised sector which vested huge powers in few industrialists and bureaucrats, to control and manipulate resources (Datta, 2011).

Taking a historical-structural view of the growth of the black economy in India, I take the view that the origins of black money and subsequent money laundering cannot be traced to any single structural break or policy shift in the Indian economy, such as economic liberalisation in 1991. This thesis suggests that neither the pre- liberalisation years nor the "license-permit raj " of yester-years, nor its dismantling post economic liberalisation-1991 can be considered to be the root cause of the growth of black money in the country. This can also not be attributed to any single factor such as high tax rates or high rate of inflation and speculation. Research suggests that a common feature to both periods (1947-1991) and (1991-2017) has been nexus of Politicians-Businessmen-Bureaucrats (the triad) that has only become more powerful over time with structural shifts in Indian economy. The pre reform era of controls and regulations created 'rent seeking' (Bhagwati, Krueger and Snape, 1987) opportunities that were exploited by the 'triad' (Kumar, 2002) of politicians-businessmen-bureaucrats. The era of deregulation saw an increase in illegality and crime due to systematic violation of rules and laws.

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[33] The triad - term coined by Kumar (2002)

A politico-business relationship is a glaring example of a patron client nexus (Khan, 2011). Prior to the economic reforms, the sphere of government control was very expansive which created various opportunities for politicians and bureaucrats to indulge in rent seeking behaviour . From 1951-1991, despite the regulatory framework of socialist policies, the politico-business nexus was significant; to acquire industrial licenses and monopolies by inducement, patronage, donations , bribes and exchange of gifts had become the order of the day (Kumar, 2002). With the political machinery at their disposal, the local clients developed a wide network of beneficial relationships, industrialists enjoyed immense surplus while politicians indulged in a shameless loot of the state resources. Politician-bureaucrat relationships thrived as the politicians were largely dependent on the bureaucrats for their survival and continuance in office. Since bureaucrats had the power to reject or delay the request for a subsidy, license or a permission to initiate investment they asked for bribes or concessions. Hence, businessmen started to fund powerful bureaucrats and politicians with private benefits/rewards besides political election funding. Those who were employed at a lower level but enjoyed political patronage had more influence than the civil servants which resulted in rampant corruption, indiscipline, unaccountability and lack of performance. The public delivery system at the regional and *panchayat* levels suffered as well- in the field of health, education, social services, employment generation schemes, public distribution systems, police and the lower level bureaucracy.

Post economic liberalisation, the state's sphere was reduced and minimized but the struggle for competitive privileges resurfaced among the business or corporate organisations. With the 1991 economic reforms in India, there was a substantial strengthening of the government business relationship. With liberalisation in 1980s and 1990s, corruption became more entrenched, because greater regulatory control spread to large public sector projects, military contracts, infrastructure and also to foreign investments in automobile industry , construction of steel plants or oil extraction. The search for investments and extra funds drove the rent seekers to shift to other sectors i.e. power, IT, telecommunication, civil aviation and petroleum. In fact the 'Big Businesses' provided an estimated 80 per cent of the financing for major parties in 1996 (Datta, 2011). Consequently, it can be observed, that corruption and black money has grown over time, as is evident through the rapid unearthing of more and bigger scams such as the 2G Spectrum

Scam, Food Grain Scam, Commonwealth Games Scam or the *Wakf*[34] Board Land Scam (Joel, 2017).

In chapter VII, I discuss how black money is generated and sustained by a demand-pull for funding political parties and election expenditure. I find limited evidence through interviews carried out, that imprudent macroeconomic policies alone drove illicit flows from the country. This finding finds support in the findings of the IMF, Panagariya (2008), and others who observe that macroeconomic policies in India have been prudently managed and played a stabilizing role. According to Dev Kar (2010), "The reason that changes in the deficit and inflation do not adequately explain illicit flows is probably because macroeconomic drivers have a far stronger influence on *licit* capital movements (involving private portfolios) than on flows that are illicit. Model simulations strongly indicate that the cause of illicit outflows from India lie in a complex web of structural and governance issues. The results show that reform itself had a negative impact on illicit flows and that liberalisation of trade and general deregulation led to an increase in illicit flows rather than their curtailment" (Kar, 2010, p. 8).

In the next section I discuss the deployment of black money in India. Through this discussion, I provide a brief overview of the reason for the existence and evolution of money laundering mechanisms in India. It is this black money that is often deployed in the formal and legal informal economy in India. Sometimes, it is used for consumption needs or it remains black or 'parked' without being utilised, as I explain in the subsequent sections. Another possibility could be the flight of black money to safe havens abroad. In order to become part of the formal economy in India or abroad or to become part of the legal informal economy within the country, mechanisms of money laundering are employed. I discuss these mechanisms under section 5.5.

5.3 Deployment of Black Money in India

How is disposable black money deployed in India? I use the word disposable for two reasons. Firstly, a large percentage of black money generated in the black economy is re-deployed in the black economy. It is further utilised for convenience payments such as bribes (Sarkar, 2012).

[34] An Islamic religious or charitable foundation created under an endowed trust fund

Secondly, a large part of the black income has to be 'parked' in the domestic economy for future exigencies. Most literature classifies the utilisation of black money into two categories. Firstly, the black money can find its way into foreign jurisdictions i.e. tax havens. In popular discourse, billions of dollars of Indian money is deposited in Swiss bank accounts.[35] Secondly, this money can be utilised in the domestic economy through money laundering i.e. conversion of illegal or tax evaded black money into legitimate 'white' money. The oldest and primary mechanism of to meet both these ends is to deploy the mechanism of hawala, whose extensive use has been documented in the previous chapter. I have further classified the deployment of black money as follows :

1. Parking of Black Money in India
2. Capital flight : Illicit Financial Outflows from India
3. Conversion of black money to white or disguised as legitimate income
4. Use of black money to meet immediate consumption

Parking of black money in sectors like real estate, gold and diamonds can also be classified as the inter temporal transfer of black money; prior to final utilisation as black or white money. I discuss this phenomenon in detail in the next section.

5.4 Parking of Black Money in India

In this section, I describe a unique feature of the Indian economy, which can also be classified as a mechanism of money laundering. However, I have excluded this mechanism from the typologies of money laundering, as in India under this category black money is retained and deployed as black money, to be used in the future as black money or to be converted to white, sometime in the future, by deploying any of the mechanisms of money laundering. The process of parking can be thought of as a process of *layering* in classical money laundering operations.

[35] As per most recent information (as of June 2021), making headlines in Indian newspapers, funds deposited by Indians and firms in Swiss banks was approximately 2.55 billion Swiss francs (over Rs 20,700 crore) in 2020 (Press Trust of India, 2021b).

The difference here is that the funds are productively deployed and can be withdrawn, as and when required using the mechanisms of parking.

I was introduced to this concept and structure by a CA in Mumbai, but could not fully understand what was happening, as it seemed to be a bit surreal. Subsequently, I interviewed a senior Fellow of the Institution of Chartered Accountants of India (ICAI), who I was told was a leading light in the field of finance and was adviser to several HNI, including politicians, bureaucrats and businessmen. He explained the system in great detail, and I use his inputs extensively to describe parking. In fact, the term parking is used to describe this activity quite extensively in the network of professionals and their clients who are involved with this activity. According to him, "*black money in India is generated by various means but mostly it is generated by commissions and kickbacks on contracts, over and under invoicing, outright false accounting of non-existent expenses, tax avoidance on income by professionals by underreporting income and misreporting of expenses*" (personal communication, December 1, 2017). Fig 5.1 gives a representative topology of various methods used for parking. Black money can be parked by way of investment in gold and silver, in art and antiques, in agricultural commodities, in NGOs running hospitals or schools, by a book entry mechanism, in political parties by showing donations, booking of property and by converting political or administrative favours to rent. In many cases those accruing black money are not interested in converting it to white money, as they find enough avenues to keep their money in black and deploy it in the informal or black economy to earn better returns than they would get in the formal economy.

Parking of black funds can be affected by several other methods in addition to the one mentioned above. It may be affected, for example, by using the real estate sector. Finance professionals park funds through the mechanism of booking multiple flats (residential or commercial units) in any new proposed development. In this exercise, a very small amount of money is paid in white as deposit per unit for booking the flats. The difference in market value and book value of the flats is deposited in black money for which no receipt is issued. The black money is thus parked while earning value appreciation and encashing the booking to any third person at any time in future results in realisation of the enhanced value of the cash amount (reflecting the actual value at that point in time). According to the CA I interviewed, "*this is a standard mechanism of parking using appreciation in value of dwelling units. Additional advantage of this mechanism is that the money remains under the control of the investor and the right to acquire the unit is directly in the name of the investor against the small booking amount of, say, Rs 10,000*" (personal communication, December 1, 2017). For a more complete analysis of parking of black money and examples of mechanisms used to do so, I discuss the following in some detail:-

1. Parking through Real Estate Sector

2. Parking through Converting Favour to Rent

3. Parking using Agro (agricultural products) Trading

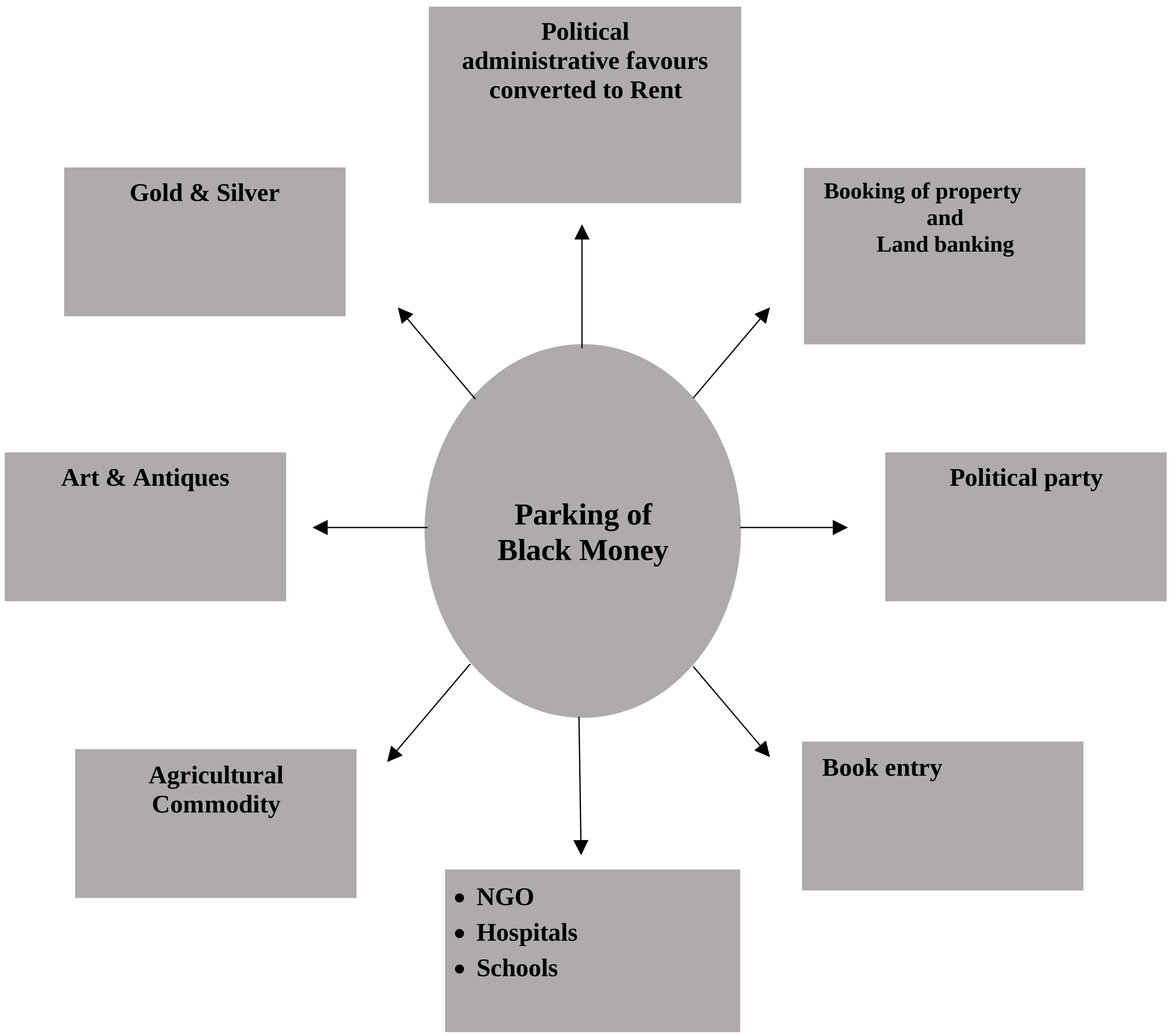

Figure 5. 1 Mechanisms of Parking of Black Money in India

5.4.1 Parking through Real Estate Sector

Another mechanism of parking is in the real estate sector i.e. in investment in open spaces of a commercial building/shopping mall and leasing the same to the builder for a fixed monthly return by way of a lease charge. Typically, such investments involve 40 per cent in cash, 60 per cent by cheque. The 60 per cent by cheque is arranged by way of loan against the property by the financial experts through banks at approximately 11 per cent. The return of the lease charge which typically is 14 per cent of the total amount is used for meeting the interest cost on the loan against property. This allows the money to be parked which can be realised at the time of sale of property. During an interview with a well-known builder in Navi Mumbai, I noted the following remark, "*Most people in India who suddenly acquire money from some inheritance or windfall gain want to avoid reporting the full value of the transaction to avoid taxes. Real estate provides opportunities to park such funds".* When I enquired further about how he benefits from such a transaction, he gave me the following response*, "We help park funds of individuals with black money to reduce our own financial liability as cost of borrowing money from the market is at least 20 per cent. This ensures we can procure at about 14 per cent. This also helps us keep the cost of property taxes lower. I have a business unit within my organisation which accesses such individuals and motivates them to invest in such properties. Further, being senior officials, they rarely withdraw the money before the project reaches maturity and full potential of value is realised. Instead, they get more of their friends to invest. They feel particularly safe investing with us builders, as they know that our business exists at their mercy and they can pressurise us if we do not honour our commitments. It is a symbiotic relationship, as once they have parked with us they are also sympathetic to our routine problems and help us overcome them.*" (personal communication, August 19, 2018).

5.4.2 Converting Favour To Rent

This is emerging as a favourite method for politicians and bureaucrats in power as per a political leader who has been in power in one of the states in India. On assurance of anonymity, he told me that people approached him with request for favours in the name of the public good and while he was "willing to do anything for his public", he also knew that the favour seekers have a profit motive. He also felt that the favour seekers often ignored the public interest after the favour was granted. Hence, the politicians have to cut a sorry figure in front of their voters. The politicians have now devised a new mechanism of perpetuating the returns from the award of favours granted by them, which have long term cash flow implications. This could be, for example, awarding a license for manufacturing cement or a permit for producing some restricted item such as a liquor licence (personal communication, October 18, 2017). It is now an established procedure by the empowered favour granting authority to ask for an equity share in the corporation or its business as an incentive to exercise the decision to benefit the favour seeker. Alternatively, they enter into an irrevocable agreement between the corporate entity and another entity owing allegiance to the politician/decision maker for revenue per unit of the end product. For instance (I was told by a former finance minister of a state), in case of cement, the rate was 5 rupees per every sack of cement produced. This ensures that the favour for which, a lumpsum amount of 10 crores could have been taken is converted to a long-term revenue stream, which gives effectively, a much higher return. This is very attractive for the politician as it gives him a regular revenue, even when he is not in power. This also amounts to parking the black money by way of converting favour to rent.

These insights made me curious about the motivations behind parking these funds as opposed to immediate laundering. For this purpose, I further inquired from CAs and political party office bearers about the incentive behind parking these funds rather than laundering. The politicians explained to me that the primary need for parking the funds was that in their line of business, they did not need much white money, but needed large volumes of unaccounted money. They needed these funds firstly, for party expenditure and secondly for election funding. Thus, they needed to generate money through deal making and dealing in favours and collecting money against these "exercise of their discretion" in cash or converting the favour to rent by becoming partners in the revenue stream. According to the Treasurer and office bearer of a national political party, "*periods during which a politician makes money are the periods when they are in power and that too only if in charge of a lucrative ministry, whereas they need to spend heavily during elections and regularly in order to meet party expenses, even when out of power. Thus, they felt no desire to convert the black money that had been earned through kickbacks or corruption to white. In fact, only the amount that that was needed for personal well-being was converted to white money and laundered. This was a small fraction of total money earned.*" (personal communication, April 13, 2018), Thus, the requirement for deploying black money for political party management and fighting elections is displaced in time from the ability to generate income by the politician; as generation of income depends on handing out favours for a consideration which is possible only when the politician is in power and that too with a lucrative portfolio. Furthermore, when asked about how bureaucrats deployed their unaccounted money, a charted accounted remarked, "*Even bureaucrats park their funds like politicians, as they need unaccounted cash for transfer to other positions and postings and also to make payments if they come under scrutiny. In any case, it is difficult for them to keep white money as growth in assets could be traced to them as unaccounted money and open them to legal action under anti-corruption laws*" (personal communication, January 7, 2018).

5.4.3 Parking Using Agro Trading

Another avenue for parking of money was indicated to me in an interview with a member of the RSS. [36] He is the owner of several petrol pumps and cold storage units in Uttar

[36] I interviewed Mr. xxx (name anonymized), as he is a member of the RSS, (Rashtriya Swayamsevak Sangh), considered the parent organisation of the BJP, the current ruling party in India

Pradesh- largest state of India. He indicated that local bureaucrats and politicians often parked their money in the stocking of agricultural produce. Large quantities are stored in cold storage units in the name of small farmers. These stocks are actually owned by bureaucrats and politicians. These stocks are bought at a minimal price at the time of harvesting and are gradually sold in the market at a good profit margin. He said, "*Since the entire transaction involves agricultural produce, it is not taxed while money keeps circulating and gains value in cash*" (personal communication, January 11, 2018). Moreover, this transaction is particularly convenient for politicians and bureaucrats of the regions, as they carry influence in the area and are privy to the movement of prices.

Some analytical insights emerge from this discussion. I have concluded that in India, black money does not lack time value, it is not idle money. It is systematically deployed and this deployment has been systematically institutionalised over the years. Also, the informal structure in India has several formal structures which are 'managed' or perpetuated by professionals mirroring the accounting practices of the formal sector. This includes accountants, market specific operators or *Arthis* who facilitate the deal making, local deal makers who act as aggregators and integrators of transactions (Haq *et al.*, 2013).[37] Lastly and most importantly, I think that the requirement of black money for trading in the informal economy, election funding, political party management and land banking is so massive and productive that in India there is a requirement for de-laundering (see chapter VI) i.e. converting white money to black money.

The next section has been compiled after discussions with lawyers, accountants, builders and real estate agents, as well as two members of the Special Investigation Team (SIT) on black money. Various mechanisms are employed to facilitate money laundering at any or all the stages aforementioned. However, before getting into a detailed analysis of these mechanisms, it is particularly useful to distinguish among various directions that the money-laundering flows may take concerning developing economies, such as India. When illegal domestic funds are laundered within the Indian economy or re-invested within then, it is said to be

[37] *Aarthis* are agricultural lending and commission agents, indigenous to the Indian subcontinent (primarily India and Pakistan)

‘Domestic money laundering flows' (Ajilore, 2010; Kar and Spanjers, 2014). Some laundered proceeds that are generated in India could return in part or full from foreign jurisdictions or tax havens in the integration stage and are called ‘returning laundered funds. Also, laundered money could take the form of ‘Inbound Funds’ where proceeds of the crime are generated and placed abroad, but are integrated into the Indian economy ultimately (Masciandaro, Takáts and Unger, 2007). Lastly, funds that do not return to India and ultimately reach secrecy jurisdictions or banks abroad are ‘outbound funds' which constitute capital flight from developing country to developed countries (Andreas, 2004).

5.5 A Typology of Money Laundering Mechanisms in India : Converting Black to White

This section sets out to understand the changing typologies and emerging trends of money laundering activities that have evolved in India (see Fig. 5.2).

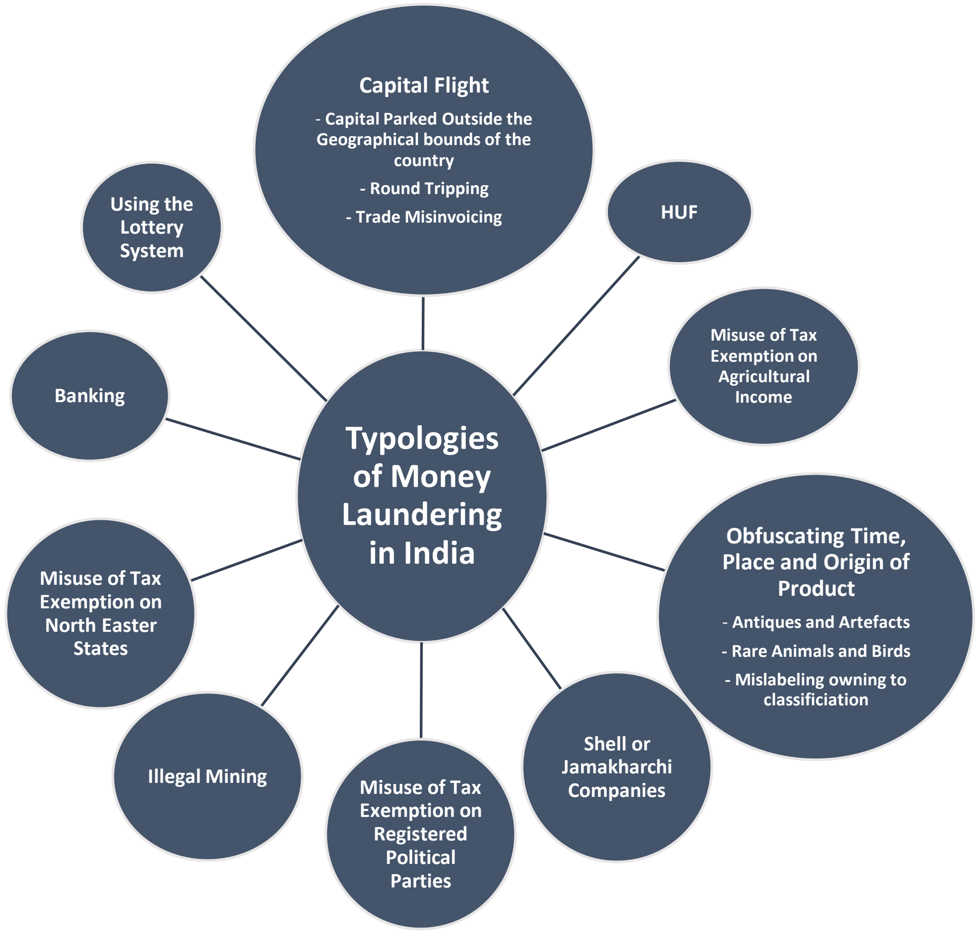

Figure 5. 2 Typologies of Money Laundering in India

5.5.1 Capital Flight from India

There are various ideas in economic literature, associated with the terms 'capital flows' and 'capital flight'. In 1973, Kindelberger formalised the concept of capital flight by defining it as a transfer of national resources and a consequence of growing political uncertainty (Archiv, 1995). One year later, Bhagwati, Kruger and Wibluswasdi (1974), argued that illicit financial flows employed trade misinvoicing to evade tariffs on imports and stringent exchange controls (Bhagwati and Krueger, 1973). The alternative concepts and definitions associated with capital flight, as well as the methods used to quantify them, have evolved over time. The

Latin American debt crisis of the 1980s, provided the impetus to devise new methods to accurately measure capital flight (Gruen and Gower, 1999). In 1983, Dooley provided estimates of capital outflows as cumulated external debt inflows, by adjusting the value for changes in external assets. Dooley's mechanism was adjusted by Erbe (1985), by excluding banking assets from the measure of capital flight (Gruen and Gower, 1999).

In the last decade, the focus has shifted to assessing and measuring illicit financial flows. This contemporary approach has been popularised in public discourse by Kar (2011) of the US based think tank, *Global Financial Integrity* and Henry (2012). In a broad sense, capital flight comprises of cross border transfer of both illicit as well as licit capital (Cobham and Janský, 2017). The difference between licit and illicit outflows can be summarised .According to Cuddington (1986), the legal part of capital flight consists of short-term capital movements, initiated as a result of private investors portfolio investments. These movements are motivated by various macroeconomic conditions such as expectations of exchange rate depreciation and changes in fiscal policy. On the other hand, illegal capital flight is motivated by a desire to avoid being reported in the country of origin. The primary difference lies in the fact that earnings on illicit capital outflows, normally stay parked in the foreign jurisdiction (Cuddington, 1986). However, in the Indian context, a major exception to this distinction is the mechanism of round tripping of funds, which I have analysed in the subsequent sections (see section 4.9). Since a significant portion of illicit financial outflows return to India in the form of investments, it is ,therefore difficult to measure the amount of wealth held abroad accurately.

Thus, illegal or illicit capital flight is generated through mechanisms that are not reported in the balance of payments movement statistics or national accounts. These mechanisms include smuggling, trade misinvoicing, bulk movements of physical currency, round tripping and hawala transfers (Kar and Spanjers, 2014). As per a report conducted by Global Financial Integrity in November 2010, India lost more than $460 billion between 1948 and 2008 due to many companies and HNI's transferring large amounts of money overseas. As per the report, the outflows of illicit money increased after the economic liberalisation of 1991 (Kar, 2013). For the purpose of this thesis, I will analyse the mechanisms of trade misinvoicing and round tripping, in the backdrop of the popular claim that capital flight was exacerbated or was a consequence of economic reforms of 1991(Kar, 2013).

As per my research, capital flight from India can predominantly be divided into three categories or mechanisms of capital flight:-

a) Trade Misinvoicing

b) *Hawala* Transactions (see chapter IV)

c) Round Tripping

Through my interviews, I discovered that, often, the mechanisms facilitating capital flight work in a complimentary manner. For instance, revenues transferred abroad through trade misinvoicing to reduce tax liability, can be brought back to India through the hawala route. There are other routes to bring back these funds, particularly after economic liberalisation, in the form of FDI (foreign direct investment) and FII (foreign indirect investment). I have described this in detail in section 5.5.3 on round tripping. I discuss the trade misinvoicing as a mechanism of money laundering in section 5.5.4. In chapter IV, I have discussed the mechanism of hawala in detail. Before I analyse the mechanisms of round tripping and trade misinvoicing on the matrix of my hypothesis, I have discussed the role of international tax havens in facilitating the 'parking' of illicit funds abroad. This discussion is useful as tax havens facilitate the interplay of funds laundering through these three mechanisms. More importantly, I am referring to monies sent abroad as 'parking' as opposed to money laundering which would be the case if the funds were utilised abroad as legal funds. However, since liberalisation considerable amount of money goes abroad and comes back to India as round tripped funds. So, the part of wealth that returns can be considered to be 'parked' abroad.

5.5.2 Capital ‘parked’ outside the geographical boundaries of the country : The role of tax havens

A significant aspect of the discourse on black money is linked to the amount of funds held outside the geographical borders of the country. The existence of secrecy jurisdictions called tax havens, facilitates the parking of illicit financial flows in foreign jurisdictions. According to Jason Sharman (2006), “the term tax haven lacks clear definition and its application is often controversial and contested” (Sharman, 2006). While there is no internationally accepted definition of a tax haven, a tax haven can be described as a jurisdiction that has low or no taxes rates in comparison to other jurisdictions (Shaxson, 2011). As per the OECD, tax havens appeal to investors as they act as “money boxes” to hold passive investments, booking paper profits and most importantly, to hide transactions from tax authorities (Christians, 2008). In the simplest and most practical sense, a tax haven is a state where companies or individuals can hide money and pay little or no tax, thus depriving their nation of its rightful revenue. Tax havens hinder transparency in international financial flows and facilitate tax evasion and tax avoidance (Maelen, 2012). The legislative reach of national governments does not normally extend beyond its national boundaries and tax havens, with their lack of transparency, the opportunity to hide beneficial ownership, ease of setting up opaque companies/trusts, low or no taxation on income or wealth, make them extremely attractive avenues for those seeking secrecy for their unaccounted or black income. Furthermore, their opacity through privacy laws makes them nearly impenetrable for law enforcement agencies. They provide a veil of secrecy to the identity of the owner which facilitates individuals to circumvent reporting requirements, by routing their profits through tax havens (Kar, 2013) . More recently, there is a growing body of literature that relates to capital flight from developing countries, like India (Christensen, 2003; Kar, Cartwright-Smith and Hollingshead, 2010; Kar and Freitas, 2012; Kar and Spanjers, 2014) . Much of this work emphasizes the urgent need to plug the outflow of illicit capital, mostly in context of reduction in financial aid from developing countries. Moreover, the concerted action against tax havens is a consequence of the global drive to combat the misuse of these secrecy jurisdictions for money laundering and terrorist financing (Choi and McGauran, 2018).

In Indian public opinion, billions of dollars of Indian money are parked in the numbered Swiss Bank accounts. In fact, most Indians perceive the idea of 'tax havens' or the 'offshore' to mean Swiss bank accounts (Sengupta, 2016). However, the reality is far more complex. Most HNI's holding offshore accounts, do so through a network of multiple offshore accounts in different jurisdictional locations to obfuscate ownership identity. A persistent question with all my interviewees was "*What are the preferred jurisdictions for flight of Indian capital?*" The majority of interviewees indicated these to be Isle of Man, Cyprus, Singapore, Dubai, Mauritius. Surprisingly, I was told that Switzerland is no longer the preferred jurisdiction due to the increasing transparency in Swiss banking laws.

According to Raymond Barker, the Director at GFI, the offshore system is 'the ugliest chapter in global economic affairs since slavery (Shaxson, 2011, p. 158). While on one hand tax havens provide an avenue for loot, on the other hand the corruption and inequalities that are generated due to this promote more emigration and disinvestment (Henry, 2003). The macroeconomic repercussions of such a trend are extremely disturbing. The unfortunate truth is that most conventional explanations for lack of development in countries like India ignore the role of the international community in perpetuating a system of capital flight, tax evasion and perverse privatisation. Often the entire blame is pinned on technical policy failure within the country, without realising the negative impact of the first world corporations, governments and financial institutions. In the words of John Christensen of the Tax Justice Network, "Whilst it is important to recognise that many of the financial crimes perpetrated against the people of developing countries originate from their local business and political elites, we need also to recognise that many of these transactions would not be possible without a sophisticated 'pinstripe infrastructure' of financial services practitioners who act as an 'offshore interface' between the criminal activities and the mainstream global economy" (Christensen, 2003, p. 3).

An examination of the role of tax havens under a Polanyian perspective reveals that there is emphasis on the role of the state in setting the rules and framework for market activity. Polanyi stands for governance of markets through state intervention (Block and Somers, 1984). Thus, under his view, if we were to view the forces of liberalisation, privatisation and globalisation in India since 1991, we can say that the state has become a mere 'night watchman', as far as regulating markets is concerned. Global economic integration has led to the removal of barriers to trans-border economic activities, making transaction not only fast but also less costly. Polanyi has inspired many contemporary political thinkers such as Peter Evans (Evans, 2008). He writes about the importance of embedded institutional arrangements in relation to emerging economies like India and Brazil to underwrite the functions of business and market economy. According to Linda Weiss, it is possible to exercise state intervention even in fierce market competition. She gives the example of Asian and Latin American economies that used capital controls successfully after they witnessed a financial crisis as a tool of recovery (Weiss, 2004). Also, the OECD being the club of rich nations tries to exercise and maintain its hegemony by dominating the UN and tilting all the proposed reforms and models in favour of the elite in these nations. This is unfortunate as the UN is the only international platform where the poor nations can find a voice. Thus, there is need for an independent body that regulates taxation and sets standards which these states are obligated to adhere to. Illicit financial flows can be curtailed only when greater transparency in capital flows becomes a reality (Blum *et al.*, 1999).

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In recent years, there has been a concerted effort by the G 20 and OECD countries towards effective international exchange of information to combat the ills of tax avoidance through tax havens. Post 2013, they have been working together to advance a Common Reporting Standard (CRS) on Automatic Exchange of Information (AEOI). As per a circular titled 'Automatic Exchange of Information (AEOI)' by the Income Tax Department in India, "The CRS on AEOI requires the financial institutions of the "source" jurisdiction to collect and report information to their tax authorities about account holders "resident" in other countries, such information has to be transmitted "automatically' on yearly basis. The information to be exchanged relates not only to individuals but also to shell companies and trusts having beneficial ownership or interest in the "resident" countries. Further, the reporting needs to be done for a wide range of financial products, by a wide variety of financial institutions including banks, depository institutions, collective investment vehicles and insurance companies" (Income Tax Department of India, 2020). In June 2015, the Indian government in line with this latest development decided to adopt the CRS and made a commitment towards automatic exchange of information. India also joined the Multilateral Competent Authority Agreement (MCAA) to honour this commitment under the stipulated time. By 2019, 102 jurisdictions had been incorporated into the automatic exchange information regime and 105 jurisdictions have become signatories to the MCAA (Income Tax Department of India, 2020). More recently, in June 2021, the G7 group of countries announced (in principle) the advancement of a plan that requires corporations around the world to pay a minimum 15 per cent tax on profits (Bay, 2021). This move has been touted as a significant move aimed at plugging the actions of the largest global multi-national companies who reduce their tax liabilities by setting up bases in tax havens (Al Jazeera, 2021).

Under the matrix of my hypothesis, this mechanism falls under H1 and H3, since post liberalisation there are many more avenues to legally parking money in overseas tax havens. In the next section, I analyse round tripping as a mechanism of money laundering. The impetus for FDI by western financial institutions through IMF, made India open up its economy. This also opened up the avenue of round tripping through FDI, which as per my research is one of the main direct causal links that facilitated money laundering mechanisms as an unintended consequence of economic liberalisation and falls under my Hypothesis H1.

5.5.3 Round Tripping

According to the IMF (2015), round tripping has been defined as "channelling by direct investors of local funds to special purpose entities abroad and the subsequent return of the funds to the local economy in the form of direct investment" (IMF, 2015). For the purpose of this thesis, I would like to make some corrections to this definition. Firstly, my study is focused on funds re-directed back to the domestic economy and not solely on Indian funds held abroad. Thus, it is imperative to clarify that funds held abroad can be brought back through routes other than FDI. Other routes include export over invoicing and external debt. Also, in case of FDI or external debt, the funds repatriated have essentially a foreign identity and the domestic government has little control over them. Given that these fund flows are volatile and can be triggered to leave the domestic economy again by sudden changes in the domestic economic climate, it would be incorrect to consider round tripped funds as assets that have been recovered for good. In the Indian context and for the purpose of this study, I define *Round Tripping* as the process of sending money owned by an Indian entity (individual or corporate) from India to another jurisdiction through illegitimate means ; and then getting it back to India legitimately as an investment in India through capital markets or as equity for setting up of a project under the control of the same entity that originally held the money in India.

The concept of round tripping has been analysed in detail in literature, particularly in context of China. According to the World Bank (2002), Hong Kong has been used to channel foreign investment into China by taking advantage of favourable differences in the treatment of domestic and foreign capital. In fact, in 1996, Hong Kong accounted for almost half of the total FDI to China (Geng, 2004). Since 1997, there has been a decline in this trend which can be attributed to a comparative rise in FDI flows which have been round tripped from the British Virgin Islands, a well-known tax haven (Geng, 2004). Comparable in certain respects to this relationship is the nexus observed between India and Mauritius.

5.5.3.1 The Mauritius Route

The economic reforms of 1991 led to the relaxation of rules for foreign investment in India, which was followed by significant inflows of money through Mauritius. According to Tax Justice Network (2020), "The use of a Mauritian conduit company offered a sweet deal, since the company was as per the domestic laws in Mauritius not subject to tax on sale of shares in an Indian company, resulting in no tax being liable in either India or Mauritius on investment returns from Indian companies" (TJN, 2020). The motivation behind round tripping in India can be attributed to the favourable treatment provided to investments from certain countries which have a Double Taxation Avoidance Agreement (DTAA) with India, such as Mauritius, Singapore and Cyprus. This propensity of Indian FDI to originate from countries that have preferential agreements with India is reflected in Indian FDI statistics. India has a Double Taxation Avoidance Agreement (DTAA) with Mauritius which allows companies with an office address in that island country to escape paying capital gains tax in India. This treaty has been misused extensively. Between April 2000 and April 2011, out of the $132 billion (Rs. 5.9 lakh crore) of total FDI inflows into India, $55 billion (Rs.2.4 lakh crore) or 41.5 per cent came from Mauritius alone. The FDI inflows in the same period from Singapore was $13 billion, $9.5 billion from the US and $6.6 billion from the UK (Kazmin and Mundy, 2016; Thakurta and Jain, 2017) .

The financial journalist Nicholas Shaxson in *Treasure Islands: Tax Havens and the Men Who Stole the World* talks about Mauritius as a popular hub for round tripping. He writes, "A wealthy Indian, say, will send his money to Mauritius, where it is dressed up in a secrecy structure, then disguised as foreign investment, before being returned to India. The sender of the money can avoid Indian tax on local earnings" (Shaxson, 2011, p. 165). Thus, it would not be entirely incorrect to say that India's biggest source of FDI is the informal economy in India itself, where the funds leave India for a short while and come back to India as legitimate investment.

Justin Robertson (2019) has examined the India-Mauritius Double Taxation Avoidance Treaty (DTAA) and its 2016 amendment in great detail. I found his comprehensive analysis of the revision to the India-Mauritius tax treaty particularly useful for my study. In his analysis, the India-Mauritius treaty was a result of India's desire to seek foreign direct investment (FDI). He argues that the consequence of this desire resulted in the investors taking advantage of Mauritius as an offshore tax haven to invest in India. He says, "The growth of the Indian economy left India in a position with more flexibility to change policy direction. Growing consistently at 7 per cent made it easier to close the capital gains loophole with Mauritius without the earlier concerns of economic damage to India. A number of specific economic indicators underpinned the altered approach to Mauritius. First, foreign exchange reserves rose. In earlier periods, India's precarious balance of payments was particularly hazardous with low foreign exchange reserves. Despite India's growth, it was really only after 2010 that foreign exchange reserves reached sizeable proportions. By 2000, foreign exchange reserves had only increased to $38 billion from $3 billion in 1990". (Robertson, 2019, p. 251). With regard to the 2016 amendment to the Treaty, he propounded the view that after three decades, as India developed, it could afford to seek investment without giving tax breaks. According to him, this was the primary reason for the amendments in the treaty (Robertson, 2019). As per my fieldwork research, I find that his analysis is slightly flawed in assuming that the treaty was signed to attract FDI. The fact is that this was an unintended consequence of the treaty. The treaty was signed primarily to help avoid double taxation on the income of the citizens of the two countries. In fact, India looked upon Mauritius favourably as the majority of the population was of Indian origin (48.5 per cent of the Mauritian population follows Hinduism) with continuing close social and cultural ties amongst the people. Lack of such a treaty was hindering economic ties between the two nations. However, an unintended result of the treaty was that investors saw an opportunity to exploit differences in provisions of taxation regime between the two countries with reference to dividend income and capital gains tax.

In India, for an Indian investor, the tax on dividend income could be as high as 42 per cent as per the Income Tax Act, 1961 (Department of Revenue, 2011; The Financial Express, 2020). This liability of income tax, under the treaty, was exempt for a Mauritius entity investing in India and deriving income by way of dividend. When this dividend income was received in Mauritius, there was no tax on this dividend income under the Mauritius tax regime because the same was incurred outside the territory of Mauritius. This combined effect of Indian and Mauritian tax laws, effectively reduced the DTAA to a no taxation treaty. The problem was further compounded by the loss of capital gains tax on transactions where the value was generated in India but the asset resided in Mauritius in the hands of a holding company (TJN, 2018). Thus, the holding company could change hands in Mauritius, effectively transferring the value of the underlying asset in India with no capital gain tax liability to the seller or buyer as transaction was outside Indian borders. The trend of investing in Indian equity through Mauritius based holding company resulted in zero tax on dividends and complete avoidance of capital gains by selling the shares of Mauritius holding company, instead of the Indian company taking advantage of the low capital gains tax of 3 per cent in Mauritius.

Between 200 and 2017, as much as 34 per cent of FDI to India came from Mauritius which is completely out of proportion of the size of Mauritius economy and represents investment by multinationals routed through Mauritius for taking advantage of its tax haven status vis a vis India (TJN, 2020). Thus, the 2016 amendment to the treaty were not as Justin Robertson holds "… ruptured due to a new configuration of domestic elites in both countries, shifting domestic structural economic conditions and revised international norms concerning the offshore system" (Robertson, 2019, p. 250). Based on my interviews with CAs, I was repeatedly given to believe this to be incorrect. What was attempted was to levelize the playing field in response to an unintended result of the treaty. Furthermore, in 2020, the Income Tax laws were changed to treat dividend income to be taxable in the classical manner removing any leakage of tax to Mauritius.

5.5.3.2 Azadi Bachao Case vs Union of India

In the landmark Union of India vs. Azadi Bachao (2003) case the highest court in India passed an ordinance in favour of the taxpayer, declaring treaty shopping to be legitimate on economic, as well as legal grounds. I interviewed the designated senior lawyer Mr. Pritesh Kapur, appearing on behalf of the respondent, Azadi Bachao Andolan. He said, "*See, it is not for the court to judge the wisdom of policy. It designated treaty shopping, as not against any law so the court ruled in favour of that*". Further, he explained the judgement, "*One important principle of the treaty that the Supreme court upheld was that it has to be interpreted as a bilateral agreement not as a statute. As per Indian law, the treaty overrides the law. The government has the power to enter into a bilateral treaty, and it is not the job of the court to question a conscious policy decision of the government. The job of the court is to honour the words of the treaty*". This ruling made round tripping extremely business friendly and was exploited for thirty years, before this loophole was plugged by amending the Mauritius Indian tax treaty (Supreme Court of India, 2002). The latest Vodafone capital gains tax case in India is a prime example of the same in India.

In the Hutch-Vodafone merger deal in India, a capital gains tax was levied by the Indian tax department to the tune of 2.9 billion dollars (ET Bureau & Agencies, 2012). The Supreme Court of India, however, bowing to the mind-set of encouraging FDI struck down this tax demand and exempted Vodafone on account of it having utilised tax havens to bring this money into India. The Supreme Court of India also went on to say that tax competition and tax havens should be encouraged to attract more FDI. This highlights the unfortunate mindset, institutions of globalization and capitalism have infused in India.

Furthermore, this case study highlights how MNC's use their presence in multiple tax regimes to reduce their tax liabilities in regimes where the income or gain occurs. Vodafone acquired Hutch Essar in India for $10.9 billion. The acquisition was not direct but done by acquiring shares of Cayman-based CGP Investment (Holdings) Ltd which held beneficial ownership of Hutch Essar through Vodafone International Holdings B.V. (VIH), one of its Dutch-based holding companies As both VIH and CGP Investment (Holdings) were based outside India, no capital gains tax on the transaction was paid. Indian tax authorities issued a show-cause to VIH as to why no tax was paid. For this reason, VIH filed a writ in the Bombay

High Court questioning the jurisdiction of Indian Tax authorities. In September 2010, the Bombay High Court ruled in favour of Tax authorities upholding their contention and imposed tax with a penalty on Vodaphone. VIH appealed this decision to the Supreme Court of India, which ruled in January 2012 that no tax was to be paid. The matter did not end there as tax authorities in India felt that tax was due to them as humungous gains had occurred in the transaction due to operations in India. (Whalley and Curwen, 2014).

In the March 2012 budget, the government moved an amendment to India's tax regime, with retrospective effect, intending to include tax mergers and acquisitions undertaken overseas but involving Indian operations. Vodafone, in turn, stated that it would invoke international arbitration. The Indian government changed the law and established a committee to investigate the matter. This was the *Shome* panel. It suggested that retrospective laws must be the 'rarest of rare cases. Further, it recommended that capital gains tax should be imposed on the seller and not the purchasing company. Despite these recommendations, another tax demand was presented to VIH in early January 2013. Interestingly, there was no deadline linked to the demand. Recently, the Indian government has challenged the arbitration award in Singapore Court. The government is of the opinion that the matter of taxation is not covered under the treaty and taxation is a sovereign right of the country (Whalley and Curwen, 2014).

Subsequently, Vodaphone took the matter for arbitration and in December 2020 the arbitration award went in favour of Vodaphone, declaring that tax demand of the Indian government of Rs 22,100 crores was being overturned. The Permanent Court of Arbitration (at the Hague) decided that India's demand for Rs 22,100 crore by retrospective amendment as capital gains on Vodafone was a breach of the provision of agreement regarding fair and equitable treatment. Since then, the Government of India has gone to Singapore High Court against the award (Whalley and Curwen, 2014). The Indian government's attempt to impose an ex post facto law in order to collect tax on the transaction retrospectively and the fact that this transaction occurred 'offshore' between corporate entities registered outside of India's jurisdiction makes this a very interesting case study for international tax law.

5.5.3.3 Participatory Notes

In India, foreign investment can be made via two routes- Foreign Direct Investment and Foreign Portfolio Investment (earlier known as FII or Foreign Institutional Investment).Facilitating the ability of individuals and corporations to round trip their funds held in tax havens or sent abroad by *hawala* was effectively made attractive by free trade agreements, taxation treaties and innovation of the financial instrument called participatory notes. This is an Indian financial instrument popularly known as 'P-note'.

At first glance, Participatory note (P-notes) appear to be same as American Depository Receipts (ADR) but actually they are different is several key aspects. In fact, they may be considered to be informal ADRs. To better understand the difference between a P-note and ADR, it is best to examine the nature of ADR. In case an Indian company wants to take advantage of trading its shares on the American stock exchange or if a broker wants to provide his clients the facility of participating in the Indian stock market, the broker can initiate the process of issuance of ADRs in a particular stock of the Indian stock exchange. A fixed quantity of shares are deposited in the American depository which holds the shares. The depository then issues ADRs which represent a multiple of the units of shares held. For example, 10 shares of HDFC bank quoted at Rs 2200 at an Indian stock exchange may constitute 1 ADR of HDFC for Rs 2200 X 10 plus a brokerage premium, when ADR is first issued. It is then listed on the American stock exchange and normally traded. Invariably, it follows the price movement of the share in equivalent US dollars. The depository receives the dividend which it passes on to the investor, minus its charges and tax. Thus, the transaction of ADR is specific to the Indian Company whose ADR is being traded and issued. Further, in the case of ADR, there is no anonymity of either the seller or buyer and taxation as well as tracking of the transaction is fully available. Participatory notes are instruments used for making investments in the stock markets in India. However, they are not used within the country; they are used outside of India for making investments in stocks listed on Indian stock markets, which is why they're also referred to as offshore derivative instruments (Dhiman, 2012).

P-notes are offshore derivative instruments with Indian shares as underlying assets. Brokers and foreign institutional investors registered with the Securities and Exchange Board of India (SEBI) issue the participatory notes and invest on behalf of the foreign investors. Brokers must report their participatory note issuance status to the regulatory board each quarter. The notes allow foreign investors with high net worth, hedge funds, and other investors, to participate in the Indian markets without registering with the SEBI. Investors save time, money and scrutiny associated with direct registration. However, it may be noted that as opposed to ADRs where the company specific ADRs are available to the investor, in case of participatory note the investor can advise which shares he wants to be procured for his P-note (Lang, Lins and Miller, 2003). He trades and makes his profit in complete anonymity. Further, the P-notes can be traded as financial instruments but are not quoted on foreign stock exchange as there is no uniformity of shares underlying each P-note. Citibank and Deutsche Bank are the largest issuers of these financial instruments which fall in the category defined as Offshore Derivative Investments (ODIs) with Indian equity shares as underlying assets. This has the advantage of remittance of any dividend or capital gains collected from the proceeds of trading in equities to the investor (Dhiman, 2012).

Thus, P-notes are particularly popular due to the fact that they permit the investor to remain anonymous. According to the government commissioned White Paper on Black Money (2012), “These instruments are traded overseas outside the direct purview of Sebi surveillance, thereby raising many apprehensions about the beneficial ownership and the nature of funds invested in these instruments. Concerns have been raised that some of the money coming into the market via P-notes could be unaccounted wealth, camouflaged under the guise of FII investment” (Ministry of Finance, 2012) .

Thus, P-notes have been particularly popular with FIIs for participating in the Indian stock market due to the little regulation they face and anonymity they allow.

5.5.4 Trade Misinvoicing

Trade Misinvoicing (TMI) is one of the oldest and most frequently used mechanisms of money laundering, that allows fraudulently transferring value across borders, through service or merchandise trade. The key element in this technique is the misrepresentation of the price of the good or service to transfer additional value between the importer and exporter (Kar and Freitas, 2012; Forstater, 2018). FATF (2006) defines trade- based money laundering as "the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origin". This would include the basic techniques of money laundering such as over and undervoicing of goods and services; multiple invoicing of goods and services; over and under invoicing the shipment of goods and services and falsely described goods and services. The techniques employed in cases of trade-based money laundering vary across sectors, as well as jurisdictions. Raymond Baker, a world-renowned financial crime expert has rightly pointed out, "Anything that can be priced can be mispriced. False pricing is done every day, in every country, on a large percentage of import and export transactions. This is the most commonly used technique for generating and transferring dirty money"(Bermingham, 2016). Thus, simply put, most trade-based money laundering mechanisms come down to misinvoicing of some form (Cassara, 2015b).

In the past, many studies have been conducted to calculate the extent of illicit financial flows by comparing trade data, reported by the exporter and importer country, in order to estimate the discrepancy between the two figures cited. One of the earliest studies on the subject was conducted by Morgenstern in 1950. He questioned the reliability of global trade statistics by documenting cases of data discrepancies in bilateral commodity and gold trade data (Federico and Tena, 1991). By 1964, these ideas were formalised in the works of noted economist Jagdish Bhagwati who found; both commodity as well as country wise estimates for Turkey for the years 1960 and 1961 (Bhagwati, 1964, 2009). According to his findings, the high rate of misreporting of data through fake invoices was a consequence of strict exchange controls and tariff rates. However, in spite of reduction in import tariff rates, followed by removal of quantitative restrictions under economic liberalisation measures, TMI continued to be a significant feature of the economy in Turkey. Celasun and Rodrik (1989) argue that the increase in export over invoicing in Turkey could be attributed to the opportunities available to avail export subsidies. Tokdemir and Gunluk-Senesen (1997) conclude that liberalisation has not led to a decrease in trade misinvoicing (Celiisun and Rodrik, 1997; Tokdemir and Günlük-Şenesen, 1997). In the subsequent sections, I will analyse whether the same findings (or the opposite) are true for my case study i.e. India.

5.5.4.1 Export Misinvoicing

Export misinvoicing is the difference between the exports recorded in India and the imports from India recorded by its trading partner country. For instance, if the value of imports reported by the partner country is less than the value of exports reported by India, then it would be a case of Export Over-Invoicing (EOI). EOI is thus indicative of a flow of funds into India. On the other hand, if the amount given by the trading partner for sale of product is less than the imports documented by the trading partner, it is a case of Export Under-invoicing (EUI). In this case, the funds have been parked in a different place. In this context, Zdanowicz, Welch and Pak (2002) document the extent of undervaluation of exports in India; as also the overvaluation of imports concerning the trade with the USA in 1993. Although the study is old, it does illustrate the magnitude of the problem. There is a huge variation between the world average export and import price in respect of the trade data with the U.S (Zdanowicz, Welch and Pak, 2005).

5.5.4.2 Import Misinvoicing

Import misinvoicing indicates the discrepancy calculated between the imports reported by India and the exports reported to India by its trading partners. When the value of imports reported by India are higher than the value of exports reported by a trading partner country, it is indicative of a part of the funds being siphoned off outside the country. This has been termed Import Over-Invoicing (IOI). On the other hand, when imports are valued lower than the exports reported by the partner country, it implies that the trading partner is getting the payment from another mechanism. One of these mechanisms could be 'parking' which I have described in detail. These funds are parked in another sector and used to make final payoffs. Another mechanism could be receiving the traded products with only partial payment of the products. Thus, for both export and import misinvoicing, there are two possibilities each. Export and import misinvoicing is together considered as trade misinvoicing which has been discussed by me in the next section.

5.5.4.3 Trade Misinvoicing (TMI) and Economic Reforms 1991

In this section, I focus on the impact of economic reforms in India on capital flight through misinvoicing. As mentioned earlier, the period prior to economic reforms in India was characterised by several restrictions. For instance, non-tariff barriers were imposed on imports of almost 65 per cent of products till 1990. By the eve of economic reforms 1991, the tariffs on imports exceeded 350 per cent with the import weighted average tariff for all imports being as high as 87 per cent. In this situation, the incentive to misinvoice was rather compelling for business to evade custom duties, in order to keep their businesses profitable. As per most economic literature, that is one of the main reasons for TMI is high tariffs and custom duties which creates higher incentives to under invoice imports (Bhagwati, 1964; Lessard and Williamson, 1987; Ndikumana and Boyce, 2000) Thus, it is not surprising that the practice of TMI was rampant in the 1970s and 1980s due to severe protectionist trade policies in effect, during this period. The growing cases of TMI resulted in various studies analysing the consequences of these measures on cross border trade (Morgenstern, 1963; Bhagwati, 1964; Naya and Morgan, 1969; Pitt, 1983; Federico and Tena, 1991).

The reforms of 1991 brought about a paradigm shift in the form of a liberalised current account. The list of restricted items, as well as quantitative restrictions on items for import was substantially reduced. Under the New Economic Policy (NEP) 1991, the maximum tariffs as well as the average and dispersion rate of tariffs was to be reduced in an incremental way. A dual exchange rate system was introduced in 1992, which facilitated Indian exporters in converting 60 per cent of their export income at market exchange rate, with the rest being exchanged at a lower official rate.

Furthermore, the maximum tariff rates fell to 45 per cent by 1997-98 from a rate of 355 per cent in 1990-91. Also, in 1996-97 the import-weighted average tariff was reduced to 24.6 per cent in 1996-97 from a high of 87 per cent in 1990-91. Owing to these measures, the Indian economy underwent a period of rapid growth. This growth resulted in a decline in the ratio of external debt to Gross National Income (GNI). From 1999-2003, export under invoicing steadily declined in the trade sector. This period witnessed a sudden boom in export of services which led to a surplus current account. This trend was reversed in 2004, with a decline in export of services, which fuelled the expectation of a depreciation in the value of the currency. This increased the motivation for misinvoicing and subsequently led to capital flight to the offshore.

Also, by the year 2005-06, the fiscal deficit fell to 4.50 per cent from 7 per cent in 1998-99. A reduction in custom duties and tariffs, followed by steady improvement in the economic position of the country should be logically followed by a reduction in TMI. This was not the case in the years following liberalisation. On the contrary, from 1992, there was an increase in import under invoicing. A significant part of this over invoicing could be a result of the capital boom that the economy underwent in this period. This influx of capital enabled the setting up of various industrial projects that involved the import of capital goods. These newly set up businesses facilitated the accumulation of illegal assets in foreign jurisdictions by Indian corporates. According to a CA in New Delhi, "*After increase in trade velocity, volumes went up, speed of transaction increased and considerable amount of monies were generated for investment in Indian money as margin money of promoters emanating from over invoicing of foreign equipment and know how. There was a huge requirement for margin money of investors*". (personal communication, April 27, 2018)

In 1995-96, with the tightening of credit and collapse of public issue market, the motivation for over invoicing of imports decreased. By 1997-98, there was a sharp increase in over invoicing of imports, which could be attributed to the desire to take capital out of the country. The incentives to over invoice imports for flight of capital parried the incentives to under invoice imports to avoid tariffs. As a result, this period witnessed a decrease in net import under invoicing. By 1998, under invoicing decreased from 2 per cent of its GDP in 1996 to 0.18 per cent of its GDP to near negligible levels in the year 2000. These near negligible levels saw a steep rise in 2001 to about 2.6 per cent of GDP . Aside from short decline in 2002-03, import under invoicing has been increasing steadily, reaching a high 3.1 per cent of GDP in 2005. Another factor affecting TMI is the anticipation of currency depreciation in the economy. In a situation where the currency is assessed to be overvalued, the exporter indulges in under invoicing exports, to extract a higher return on domestic currency in return for export receipts (Tandon and Rao, 2017).

This is indicative of two aspects of the relationship between economic liberalisation and trade misinvoicing. Firstly, despite strengthening of the economy and lowering of tariffs under the NEP, there has been continued trade misinvoicing since 1991. Secondly, empirical research does not establish a direct correlation between higher trade misinvoicing and initiation of opening up of the economy. A major factor contributing to misinvoicing of trade can be the proportion of openness of the capital account in India with respect to other nations (Gupta, Patnaik and Shah, 2011). According to Gupta, Patnaik and Shah (2011), "*capital controls in countries with large trade flows are correlated with high levels of trade misinvoicing. After controlling for factors such as macroeconomic stability, corruption, currency overvaluation and political instability, the openness of the capital account still has a significant role to play in determining trade misinvoicing. Trade invoicing* should be viewed as a channel for de facto capital account openness" (Gupta, Patnaik and Shah, 2011, p. 891). Furthermore, since the 1980s the Indian economy has remained inert with respect to liberalisation of the capital account. As per Lane and Ferretti (2007), international financial integration of the Indian economy increased from 24 per cent in 1985 to 32 per cent in 1995 and then to 58 per cent in 2004. However, despite this increase, India remained much below the international average during these years. As per some authors, a key determinant of trade misinvoicing is the amount of black-market premium for foreign exchange (Pitt, 1984; Biswas and Marjit, 2007; Buehn and Eichler, 2009). Export under invoicing can be triggered by a high black-market premium on foreign exchange, as it incentivises exporters to under invoice trade receipts and sell foreign exchange at a higher price. According to Fisman and Wei (2007), misreporting of trade data can be offset by imposing export quotas on goods. Moreover, exporters are motivated to hide export output to hide their export proceeds to evade domestic taxes (Berger and Nitsch, 2008). Other determinants of trade misinvoicing can be attributed to a sense of insecurity among the entrepreneur class in India. These factors include, among others, a fear of loss in wealth due to sudden policy shifts by the Indian government. These policies could include the policy of nationalization of banks in 1969 or a confiscation of private property under the Privy Purses act (Tandon and Rao, 2017).

In case of India, it must be appreciated that neither full convertibility of capital account took place, nor was liberalisation carried to its logical conclusion. What emerged in economic terms was a mixed bag of business-friendly policies. These were directly enabled by the emergence of globalisation and liberalisation in India, while advances in technology made it possible to handle larger transactions in trade and finance with much higher efficiency. Examining the mechanism of TMI on the matrix of my hypothesis, I find that it falls under H2 and H3.

5.5.5 Obfuscating 'time' and 'place' of origin

This mechanism of money laundering is particularly applicable to antiques, treasure troves, banned products such as ivory, *shahtoosh (*chiru antelope wool), endangered animals, animal skin and animal parts. It is also applicable to products which may be banned due to political reasons for import from a particular country, such as products from South Africa during apartheid.

5.5.5.1 Antiques and Artifacts

The colonial rule in India popularised the practice of collecting Indian antiques, when the British carried back with themselves many rare ancient artefacts to England. Almost 3000 thefts of such artefacts has been recorded between the years 1977-1979. According to the UNESCO, between 1970-1980, more than 50,000 artefacts of historical significance were smuggled out of the country. With time, the demand for such Indian antiquities has grown with a demand from other countries in Europe and Middle East. This demand for Indian antiquities has been causing the widespread and rampant plundering of heritage Indian archaeological sites. These products are sold at private auctions and underground markets, completely outside the purview of legitimate economic activity (Banerjee, 2018).

Traditionally in India, the price available for Indian artefacts is much lower than what can be realised in the international market, due to high demand in such markets from collectors (particularly in the West). Most sought after artefacts in overseas markets are antique statues in stone or bronze, taken from old Indian temples. Despite lax recording of provenance and proper records of antiques and artefacts, there are several documented cases. A noteworthy case of theft and subsequent smuggling was that of the '*Pathur Nataraja,'* an idol of the hindu god Shiva, dated to the Chola period. The statue was accidentally acquired by a landless labourer in Kerala, who sold it to a buyer instead of declaring it to the local authorities of the region. After being sold and re-sold from one buyer to another, the statue was finally sold to an oil development company in Canada. Subsequently, the statue was sent to London for repairs where it was discovered as a smuggled stolen artefact. It was then returned to India in 1991. Another noteworthy case was the case of the *'Sivapuram Nataraja'*, another bronze statue of the dancing god Shiva stolen from a temple in Thajavur in 1956. In 1973, it was illegally sold to an American collector Simon, who reported to government officials, that he spent thousands of dollars on the purchase of the *Nataraja* (The New Indian Express, 2018). The fact that more than a hundred erotic sculptures were stolen from the famous Indian historical temples of Khajuraho in the 1960s and 1970s is well documented in Indian history (CCP, 2019).

Regular demand for such artefacts has created a market for their duplication, production and subsequent smuggling/exporting. As statues using age old techniques continue to be made even today, the real antiques can easily be mislabelled as 'modern day artefacts' and exported with falsified provenance accompanying the artefact (personal communication, December 27, 2018). This is a criminal act since export of antiques and artefacts has been strictly regulated under different laws. The 1972 Antiques and Art Treasure Act, put in place a stringent ban on the export of any object of an archaeological nature and individual ownership of such artefacts was brought under severe scrutiny by the law enforcement authorities. Furthermore, under this act, attempts were initiated by the Indian government for return of stolen or illegally smuggled antiques . My research of this mechanism is also derived from my discussions with a financial consultant and antique and artefacts collector from Bangalore. According to him, "*A common mechanism of money laundering is by investing in an antique in India, which is then exported by mislabelling it as a 'handicraft' produced in present times. This is then evaluated by experts and duly certified for its provenance and antiquity to be sold abroad. Often, they are sold to dealers or auction houses in Europe or US to realise a value which has a premium over the value paid*" (personal communication, February 12, 2017).

The revenue generated through such transactions is usually large, and is then either, kept in offshore accounts or brought back to India. The pathways used for bringing it back to India are:-

a. By *hawala*

b. By payment to an Indian entity towards mis invoiced exports from India of software or garments as during the 1980s, there was no income tax on these categories at that time.

c. Thirdly, cash surpluses abroad can be utilised for part payment of goods proposed to be imported into India thus reducing custom duty liabilities.

Prior to economic liberalisation, the route adopted for selling artefacts was through smuggling; as custom checking by Indian authorities was very thorough and invasive. The smugglers would get the money back as hawala or deploy it in buying consumer goods abroad to be smuggled into India to be sold at a premium. Post liberalisation, the mechanism using misinvoicing and hiding the actual provenance as described above was used to transfer value abroad. In effect, the black money was deployed in a trading transaction and converted to white money. Examining this mechanism on the matrix of my hypothesis, I find that it primarily falls under H2.

5.5.5.2 Rare Animals, Birds and Forest produce

One of the most recognizable types of wildlife trade in India, since independence, is the bird & rare animal trade for export. There has been a thriving underground market for banned items for exports such as exotic birds, animal parts, rare woods such as sandalwood and catechu. The Wildlife Protection Act 1972, puts several restrictions on capturing rare Indian birds for the purpose of illegal trade. According to an estimate by the World Wildlife Fund (WWF), illegal trade of nearly 300 out of 1200 indigenous birds species was illegally carried out in India. Other crimes auxiliary to illegal wildlife trade include tax evasion, arms and narcotics trafficking in India (WWF, 2014).

A lawyer who has been involved in cases of illegal trafficking of banned and rare animals and birds banned for export, revealed the following modus operandi of obfuscation. According to him, "*These products are smuggled out of India by mislabelling and obfuscating the source, both in time and place of procurement. They have markets in various places globally such as mainland China and many Arab nations; like Saudi Arabia and U.A.E. The cash* *generated through the sale of these items is brought back through the hawala route or is parked abroad. It is often disguised and brought back as donations to NGO's. Sometimes the money is brought back by under invoicing imports to reduce applicable duty".* This mechanism of laundering proceeds of illegal bird trade, has not been significantly affected by economic liberalisation in India (personal communication, April 12, 2018).

However, I discovered through interviews that there has been a significant growth in demand from mainland China since its rise in economic power since late 1980s. Due to this convergent factor, this mechanism falls under H3 under the matrix of my hypothesis.

5.5.5.3 Mislabeling owing to increase in permitted product classification

There may be cases where the product itself is obfuscated to take benefit of the price difference between the actual and the mislabelled product. Prior to 1980, imports were heavily restrictive due to import licensing which prevented foreign goods from reaching Indian shores (Kaur, 2018). Customs authorities were extremely stringent, inflexible, and at times, extremely invasive in their examination of imports, as well as exports. Thus, scope of misrepresentation was extremely limited, as everything was checked and cross-checked by the custom authorities. Prior to the appearance of the first green shoots of liberalisation in the 1980s (Kohli, 2006), almost everything was either banned or had a customs duty which could be as high as 300 per cent (Thomas, 1994). Import of banned items was punishable by imprisonment or heavy fines. The list of banned items was diverse and including products ranging from gold to newly emerging electronic goods which included the televisions with large screens, a highly coveted item in that era. An informal discussion with a retired professor on 28th July, 2017 in Delhi, gave me a useful historical insight into the policies dominating Indian public life during the *licence permit raj.* He related to me, his experience at the customs authorities at the Delhi airport, upon his return from his earlier place of residence abroad. He said that though he was well within his rights to bring in the used washing machine under the provisions of 'transfer of residence' rules, as declared by customs ,it was completely dismantled during checking. When he enquired from custom officials, as to why they were taking so many pains, he explained that many persons stored contraband in hollow spaces, while importing washing machines. This was carried out sometimes, even without the knowledge of the person importing it. During this period, it was common for unscrupulous businessman who saw an opportunity to mislabel and misrepresent their products.

With the ushering in of some economic reforms in the 1980s , more heads of classification became available for import and export of goods. These reforms were part of international trade agreements and the various relaxations they offered, led to an increase of mislabelling by unscrupulous individuals. A glaring example of such mislabelling was the infamous *Jain Shudh Vanaspati Ltd. vs State Of U.P. And Ors. (1983) Case* of import of beef tallow as vegetable oil. When import of *Vanaspati* oil was allowed, the classification of this oil was misused by Jain of Jain Vanaspati Oil Pvt Ltd (JSP) to import beef tallow (Chawla, 2013). There is a direct relationship between economic liberalisation and increase of transactions of such kinds. This includes both the increase in actual quantity, as well as classification of goods. Thus, under the matrix of my hypothesis, mislabelling as a typology of money laundering; broadly, falls under the hypothesis H1. However, in cases of smuggling of antiques and rare animals and birds, liberalisation had no direct consequence. It should be noted that one direct consequence of liberalisation was a sharp drop in smuggling of gold artefacts and consumable goods.

5.5.6 Misuse of Tax Exemption on Agricultural Income

India is an Agrarian economy. Agriculture is the mainstay of the Indian economy owing to its high share in employment and livelihood contribution in India (Kalamkar, 2009). Despite recording a steady decline from 36.4 per cent in 1982- 83 to 18.5 per cent in 2006-07, India's rural population still accounts for about three-fourth of the total Indian population. However, this percentage had been declining at a marginal pace from 80 per cent of the total population in 1971, 76.7 per cent in 1981, 74.3 per cent in 1991 and 72.2 per cent in 2001 (Kalamkar, 2009). As per World Bank data in 2019, the Indian rural population was estimated to be 66 per cent of total population of India (World Bank, 2019).

Agricultural land is classified by the government (for purposes of valuation) on the basis of its fertility and availability of irrigation facilities. Despite all kinds of subsidies in India, due to the uneconomical small holding of land in the hands of farmers, the productivity is poor and generation of revenue not commensurate with the investment and effort that goes into the process. This leads to a movement towards underemployment, low yield and poor productivity. Given that this sector is largely poor, unregulated and unreported, it lends itself open to misuse by unscrupulous elements.

The use of both human entities and land has been creatively institutionalised for the purpose of both sinking and generating unaccounted money. This is achieved by using land for purposes of showing income by inflating the crop or showing sale of non-existent crops as agricultural income exempt from taxation, thus converting black income from elsewhere into tax-free agricultural income. This is achieved by utilising the identities of a large number of farmers and members of the rural population into accounting entities; yielding book entries that can be manipulated to generate and release large amounts of cash, both accounted and unaccounted (personal communication, September 15, 2017). As per the Income Tax laws in India, cash transaction up to Rs. 10,000 are not brought under scrutiny and are allowed as an expense (Section 40A (3) & 40A(3A), Income Tax Act, 1961). A large number of farmers and members of the rural population are used to create small entries of receipt of funds in tightly control finance companies. A leading CA in New Delhi, with many businessmen as clients; with large turnover in informal as well as black economy, told me how the large population in the Indian hinterland, which is part of the agricultural economy and thus not subject to stringent reporting as per tax laws, can be used for spreading small amounts of deposits in their names (as well as taking payouts by small withdrawals in their name), a practice akin to smurfing. [38] He further illustrated his thoughts with the following example, "*For instance, 15000 rupees from 100,000 persons results in a book value of rupees 1500000000 and gives them the power to show that they have this much money in hand. Often, these names are randomly selected from a voters list from remote areas like small villages and economically backward areas. As an investment company, one now has crores of rupees in white; with a provision to reverse the entry in the books as per the requirement*" (personal communication, December 1, 2017). Speaking on the issue of using agriculture as a sink for converting black money to white (and vice versa) at a minimal cost, a lawyer in Delhi who chose to remain anonymous during an interview conducted on 10.01.2018, told me, "*reporting income from other sources such as from fallow land bought at throwaway prices as agricultural income in books of accounts. This creates an avenue for money laundering. However, when this land is bought, 40-60* per cent *of the value is delivered in cash, which has to be supplied from the black money reserves of the buyer or through reconversion of white money to black money".* I have termed this phenomenon 'de-laundering' (see chapter VI on the process of 'de-laundering' in India). Furthermore, he said, "*they show agricultural income in order to collect black money elsewhere. This is tax exempt; so, if I'm an industrialist who has black money and I show it as agricultural income then it is made white. This automatically becomes accounted. This has been widely institutionalised in India*".

5.5.6.1 Large Agricultural Land Holding: The Land Ceiling Act

Due to zero taxation on agricultural income, normally there is no generation of black money in the agricultural sector. However, due to the implications of the Urban Land (Ceiling and Regulation) Act 1976, which restricts land holdings in the hands of a single individual to a limit of 12.5 acres of land . In practice, there are larger farm land holdings in rural India which tend to be in hundreds of acres. These excess acres of land are held as *benami*

[38] The interviewee is a fellow of ICAI (Institute of Chartered Accountants of India)

properties, in names of relatives or false imaginary identities. [39] For purchasing land above the 12.5 acre limit, black money is needed and income from agricultural produce from such land, also becomes black money, in the hands of the beneficial owner. Any proceeds of sale of such land also generates black money. This has been illustrated in figure 5.3.

5.5.6.2 Misuse of Jan Dhan (People's Wealth) Accounts post demonitisation

In 2014, the government of India announced a new scheme called JAM trinity which signified a cumulative of- the *Jan Dhan Yojana* (Peoples Wealth Scheme), *Aadhaar* unique identity number programme and the mobile phone programme. This move was part of a larger anti-corruption drive by the Modi-led Indian government with the aim of promoting the twin objectives of financial inclusion as well as transparency in financial transactions. Touted as the most sophisticated programme by Paul Romer, chief economist at the World Bank, the *Aadhar* Card programme would instill a seamless infrastructure for biometric identification and authentication for all Indian citizens. Under a national financial inclusion programme aimed at mitigating the ill-effects of lack of financial services available to the rural and urban poor, the *Pradhan Mantri (*the Prime Minister*) Jan-Dhan Yojana* (PMDB) was launched in 2014. The PMDB 2014 was a comprehensive financial inclusion initiative with a plan to open 7.5 crore new accounts within five months with insurance and pension facilities. The *Pradhan Mantri Jan Dhan Yojana* combined with the mobile banking scheme was developed as a tool to cut intermediaries and aid direct transfers and provide subsidies to the poor. Thus, the JAM trinity was initiated to provide better financial services to the poor through easy access to bank accounts, loans and insurance. The enormous rise in the number of *Jan Dhan* accounts, in its initial years, is apparent from the fact that The *Jan Dhan Yojana* won a Guinness World Record for having opening the maximum bank accounts in a single week

[39] The literal meaning of benami is a property that has no name. The person who buys the property does not buy it in his name. Instead he purchases it in the name of relatives, friends and in some cases even in the names of their pets. While the purchase is made in someone else's name, the person who pays for the property is the real owner.

for the week falling between 23rd and 29th August in 2014 (Ravi, 2018). The strong interlinkage of the three programmes would enable swift transfer of money into the bank accounts of the poor population without fear of 'leakages' or corruption.

After the demonetisation drive of 2106, many cases of misuse of the provision of exemption of agricultural income from income tax under section 10(1) of the Income-tax Act, 1961, came to light. Several people cleverly deposited their demonetised 500- and 1000-rupee notes into the recently opened *Jan Dhan* accounts of the ill-informed rural population (Muralidharan, 2016). . In an exercise akin to smurfing, recently set up Jan Dhan accounts for the poor population of India by the government with the intention of using them for direct transfer of state benefits to the account holder were used for returning black money of HNIs and corporates to the mainstream, taking advantage of the exemption threshold limit of Rs 2.5 lakhs, deposited per individual from any scrutiny.

By December 2014, almost 1.9 crore accounts were opened, out of which 1.2 crore accounts were located in rural areas (Chowhan, 2014). As part of my field work, I interviewed a political analyst from the leading think tank, Centre for Policy Research in New Delhi and on the subject of digital financial inclusion; she said "*The statistics on Jan Dhana programme on financial inclusion in India show coverage of up to 100 per cent in many rural areas. And, it is true that in most rural areas bank accounts have been opened for almost all citizens. But it is not the complete picture. Most of these accounts have no balance, and there has been no activity on these accounts since they were opened. People in rural areas have no idea how to conduct transactions and there is serious lack of manpower. The agents tasked with training and handling these branches has each been allotted multiple villages. And lastly, when these villages hardly get electricity for 2 hours a day, how does the government expect for a scheme like this to work smoothly? A thorough follow-up along with regular appraisals and making sure that all basic facilities like electricity and manpower are provided is the first step towards financial digitisation in rural India. It is only when the basics are provided then we can expect the people to undertake long distance transactions and make them habitual*" (personal communication, July 16, 2017).[40] However, the government has identified this

[40] The interviewee is a sociologist, former research associate at Centre for Policy Research, India

mechanism and is now scrutinising such accounts. As a result of this money launderers have used the accounts of scores of rural persons instead of just a few, seeking safety in numbers . Since a deposit of Rs 10,000; on an average does not invite scrutiny, instead of depositing Rs 10 crore in one account; 1,000 Jan Dhan accounts are used, preferably across districts and even states Muralidharan, 2016). Under the matrix of my hypothesis, this mechanism falls under H2.

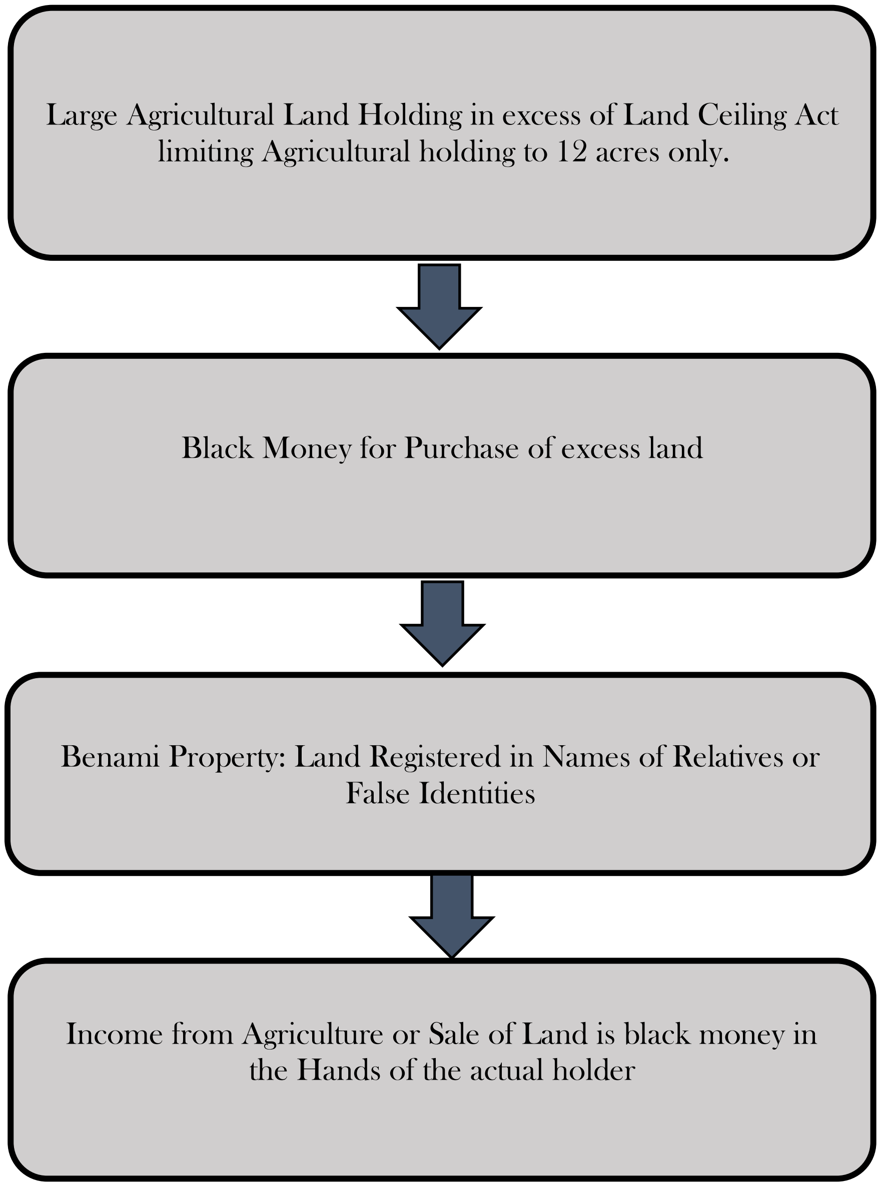

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Figure 5. 3 *Need and generation of Black money for Benami Properties*

5.5.7 Hindu Undivided Family (HUF)

According to Income Tax Act 1961, a Hindu Undivided Family (HUF) is an artificial legal person for purposes of tax assessment. It is independent and separate from its individual constituent members who can be assessed independently for their personal income. HUF comes into being not by registration, but by status of a family that traces its origins to a single ancestor. It traditionally consisted of only adult male members having the status of coparceners, but now also includes adult girls of the family. It is headed by one person; usually eldest male member of the Hindu family who is called the *Karta* or manager. The HUF can hold properties and earn and invest in its name. It is assessed as an entity or 'person' under section 2(31) of the Income-tax Act, 1961, independently for its holdings and incomes. The family as classified by the HUF is perpetual as long as any descendants exist.

Incomes of individual members can be disguised as HUF incomes and investments made by individual members from their black money can be disguised as holdings of the HUF. This notes diversion of income, as well as assets in the name of HUF possibly resulting in it being used as a device for money laundering for instance, a HUF has ownership of agricultural land, and a government official is a member of the HUF. He shows his earnings from corruption as agricultural income from land holdings of the HUF. This misreporting of his illegal income and laundering it in one step as agricultural income is tax free in India. Further, as HUF is an independent entity for tax purposes, it has available to it all deductions available to an individual for purposes of computing tax liability.[41]
Also, HUF can be used to book family expenses and also redistribute income as a gift to the

[41] See https://www.incometaxindia.gov.in/Pages/i-am/huf.aspx

members of the HUF. It can make investment in insurance, financial markets etc. favouring its members, but accounted for tax purposes in its name. A person can be a member of more than one HUF. For example, A is member of his father's HUF. On marriage he can set up his own HUF, of which he is a member and also *Karta* i.e. manager. Thus, to set up an HUF for tax purposes, the following steps are needed.

1. Obtain PAN registration in HUF name. This is income tax identity.
2. Open Bank or Demat account in name of HUF.
3. Transfer property to HUF or divert income to HUF. The HUF can receive gifts also.
4. File separate income tax return.

While this mechanism is very common, it can only be availed of by *Hindus* in India. After liberalisation, there has been no change to the laws concerning HUF. However, due to ease in maintaining accounts, with the use of computerised accounting and increased levels of exemptions; available for a taxable entity, coupled with overall growth in incomes, more Hindus are taking advantage of tax breaks available through HUF since liberalisation (personal communication, December 27, 2018). It may be noted that except for diversion of income or expenses, advantages under HUF are perfectly legal.

Examining this mechanism, I find that it largely falls under H2, but there is an impact of H3 due to convergence in technology.

5.5.8 Shell Companies or *Jamakharchi* Entities

Shell companies obscure ownership and allow beneficiaries to hide their identity. Shell companies are dormant incorporations, as they have no assets and perform no business operations. The term 'Shell Company' is not defined under the Companies Act, 2013 (Singh, 2017a). Strictly speaking shell companies are not illegal in India. However, they can be brought under the scanner under three separate laws; The Companies Act, 2013, the Benami Transaction (Prohibition) Amendment Act 2016, The Prevention of Money Laundering Act. Certain characteristic features of shell companies include, immoderate leveraging, cyclic transactions lacking ostensible business activity or motive and the disproportionate or majority ownership of shares by other companies.

The history of widespread use of shell companies can be traced to the 1980s in India coinciding with declaration of several relaxations in policy related to funding of corporates from the share market (TJN, 2020). Recently, the city of Kolkata has gained notoriety as the hub of shell companies. According to Acharya (2017), "Kolkata has turned out to be India's own tax haven". Unsurprisingly, out of the 331 companies declared shell or *jamakharchi* companies by the SEBI, about 145 companies are registered in Kolkata. As per an Income Tax official, who spoke to 'live mint', a popular business news publication on condition of anonymity, these *jamakharchi* companies are used for money laundering and tax evasion (Majumdar, 2017). Another Income Tax officer contends that, "Almost 90 per cent of shell companies are in Kolkata" (Acharya, 2017). A lawyer who chose to remain unnamed called Kolkata the "Mecca of parallel banking" where traders find an "efficient ecosystem" to trade in shell companies and manage tax liabilities on capital gains (Majumdar, 2017). These shell companies are supported by availability of professionals, who with their established network, support the activities of these shell companies (Acharya, 2019). These professionally include, mainly chartered accountants and entry operators. According to an Income Tax official, "The effective tax rate is around 24 per cent, hence, for earned capital of Rs. 1 crore, one pays Rs. 24 lakh as tax. In Kolkata, one pays Rs 50,000-70,000 to the entry operator to form a shell company through a structured transaction and save on taxes" (Acharya, 2017). A comprehensive analysis of the entry business in India has been covered in the next chapter, as entry operators form an integral part of the money laundering and de-laundering ecosystem in India).

5.5.8.11 Cracking the Shell

In 2014, the central government created a task force to prevent the formation of shell companies, under an anti-corruption drive against paper companies, to unearth undisclosed assets and black money. This task force, known as the SIT, which I have mentioned earlier), in its 3rd report, proposed an urgent crackdown, i.e. the discovery followed by de-registration of such companies. According to TJN (2020), "To anyone familiar with the operations of such companies, sifting out such companies is comparable to finding a needle in a hay stack". Nevertheless, in 2017, the Securities and Exchange Board of India placed trading restrictions against nearly 2 lakh shell companies, as a part of the mounting political pressure on the Narendra Modi led government to implement its 2014 electoral promises on the resolve against black money in India (TJN, 2020).

With the expansion of equity markets, increase in size of stock exchange and increase in size of market, the number of shell companies have proliferated since liberalisation. With the rise in computerisation of banking and accounts since the 1980s, the setting up and management of shell companies has become a highly automated process, making management of a large number of companies feasible. Technology also helps in maintaining interrelationship of accounting entries in geographically dispersed locations. For this reason, on the matrix of my hypothesis, this mechanism falls predominantly under H3 and partially under H1.

5.5.9 Misuse of Tax Exemption to Registered Political parties

India has gradually transformed from a one-party democracy to a multi-party democracy. A unique feature of this transformation has been the record rise in the number of registered political parties which has increased more than 30 times, since the first elections were fought in 1952 in India. As per statistics of the Election Commission of India (ECI), about 53 parties had contested in 1952. Under the Representation of People's Act (RoPA), more than 2500 political parties are currently registered with the Election Commission of India (ECI). Out of these, only 8 parties are recognised as national parties, and 40 as state parties under the Election Symbols (Reservation and Allotment) Order, 1968 issued by the ECI under Article 324 of the Constitution. As per estimates, about 70-80 per cent of these registered political parties have never participated in any elections. In the 2009 elections, it was observed that out of the 1000 political parties registered, only about 32 per cent contested in the elections (ECI, 2014; Chaudhary and Kumar, 2017). Similarly, in the 2014 elections out of the 1698 registered parties, only 464 i.e. 25 per cent participated in the democratic process (Centre for Media Studies, 2019). This development is rather intriguing for observers of the democratic polity in India. What is the reason for forming and registering a political party with no intention to fight an election?

The answer lies in Section 13A of the Income Tax Act, according to which a political party that is registered under RoPA becomes eligible to receive incomes by way of donations, contributions, interest, rent, etc., entirely exempt from income tax. This law requires that in case the party has received contributions above Rs 20,000 from any person(s) in a year, then it is obliged to file an annual statement of such donations in Form 24A with the ECI, providing the name, address and the PAN of the donor(s), and the mode (cash/cheque) of the donation. In case a political party has not received any contribution over Rs 20,000, then this requirement is waived (ECI, 2014). It must be noted that once a political party files the statement in Form 24A with the ECI, the exemption from Income Tax under Section 13A is automatic. Contributions made by companies within the limits of Section 293A of the Companies Act, to political parties are also eligible for full deduction under Section 80GGB and 80GGC of the Income Tax Act in the case of the donors. This exemption has been widely exploited to convert black money to white money through these non-functional/dormant registered political parties. The former Chief Election Commissioner S. Quraishi said , "*a recent law that exempted donations to political parties from Income Tax for the payers and the payee, has caused a spurt in the formation of new political parties.*" (Indian Express, 2011). The last few elections have exposed the lack of a stringent mechanism to ensure compliance with the requirement for filing Form 24A with the ECI.

The ECI has been unsuccessful in ensuring the filing of annual income by political parties. It has also failed in ensuring that these documents are filed correctly. For this reason, the ECI has very limited powers to de-register a political party.

As per an interview with the spokesperson of a national political party in India, "*due to lack of any law regulating political parties in India, unscrupulous businessmen take advantage of tax incentives for political party activity under the income tax act to set up political parties merely for the purpose of avoiding tax by diverting funds to political parties and using them for their own expenses*" (personal communication, October 27, 2017). Further he said "*the rapid growth of a number of registered political parties has happened since liberalisation due to the increase of money in the economy*" (personal communication, October 27, 2017).

However, it must be recognised that some growth is attributable to deepening democracy and the desire for representation by fringe groups. This is reflected in the fragmentation of political parties on grounds of caste, religion, demand for state autonomy, region and identity politics. While these forces have resulted in the formation of many political parties on ideological grounds, these parties constitute the 30 per cent of the registered political parties that contest elections to represent their respective faction. The rest of the parties never fight any election and exist to facilitate the laundering of black money for politicians and businessmen.

5.5.9.1 Electoral Trusts

Section 2 (22AAA) of the Income Tax Act defines electoral trusts as a trust approved by the Board in accordance with the scheme made in this regard by the central government. Section 13B has been inserted in the Income Tax Act by Finance (No. 2) Act 2009, with effect from April 1, 2010. According to this amendment, the contributions received by an electoral trust should not be included in its taxable income, when such electoral trust distributes to any political party registered under RoPA, 95 per cent of the aggregate donations received by it during the year, it functions in accordance with the rules made by the Central Government.

Discussion with ECI officials brought out that no scheme for electoral trusts has yet been framed by the central government. Apparently, no notification has been issued by the CBDT also so far approving any electoral trust as required by Section 2 (22AAA). However, information obtained and released by ADR shows that several electoral trusts have come into existence, and are now making large contributions to political parties. They include trusts like the General Electoral Trust, the Public and Political Awareness Trust, Bharti Electoral Trust, Electoral Trust, Harmony Electoral Trust, Satya Electoral Trust, Chowgule Charitable Trust, and the Corporate Electoral Trust. Perhaps these Trusts are claiming exemption under the general provisions of Sections 11 to 13 of the Income Tax Act in the absence of approval under Section 2 (22AAA) has not been done (Jaswal, 2019).

As a part of liberalisation, there was no change in tax treatment policy of political parties. The marked increase in the number of registered political parties can at best be understood as an unintended consequence of the growth in the size of the economy. Majority of these parties did not participate in the elections and were set up as vehicles for tax evasion and money laundering. On the matrix of my hypothesis, this mechanism falls under H2 for this reason.

5.5.10 Illegal Mining and Export

Mining is one of the core sectors that drive the economy. In this section, I have highlighted the possible malpractices associated with illegal mining in India that lead to money laundering. These malpractices have been well documented in the Justice Santosh Hegde report (2008) made on the reference of the government of Karnataka under section 7(2-A) of the Karnataka Lokayukta Act, 1984 . Some common malpractices in the mining sector, for the purpose of tax evasion includes mining without mining license, over mining, theft of holograms, inflation of expenses, mining without mining plans, under reporting of ore extraction, illegal transportation using photocopies of dispatch permits and under invoicing of sale prices (Lahiri-Dutt, 2007). These activities result in generation of profit which is then utilised for personal benefit and payoffs to different players involved in these corrupt practices (Hegde, 2011). As per Dutt (2007), *"...around 70-80 million tons of coal is produced in India annually in addition to the official production figure of about 350 million tones. This illegal coal – black, invisible and underground in every sense of these terms – forms a part of an economy that has intricate networks and complex linkages going deep into every aspect of life in the coal producing regions of India*" (Lahiri-Dutt, 2007, p. 58).

Illegal mining resulting in export of the ore is a rampant mechanism of money laundering in the minerals and mining sector in India. This is particularly true of Coal and Iron Ore mining activities in India. The Mines and Minerals (Regulation and Development (MMRD) Act of 1957 is the principal legislation governing exploration and mining. Also, the Indian Mines Act of 1952 is primarily meant for labour welfare and safety and health issues. The report of the Karnataka Lokyukta (2008) unearthed a large racket of illegal mining of iron ore and its subsequent export. The report also stated that there was rampant misuse of Mining Leases (ML) across the country (Hegde, 2011). As per the report, the Bellary region, a district in the south Indian state of Karnataka, was particularly prone to such malpractices and illegal activities. Also, the loss to the exchequer due to illegal mining in the last four years was calculated to be approximately Rs 16,085 crores. According to the report, the encroachment of government land in the Bellary region was documented to be as large as 1114 hectares (Hegde, 2011). Under the Export and Import Policy 2004-2009, foreign direct investment (FDI) in the mining sector has fully opened i.e. up to 100 per cent. Due to this development, FDI in the mining sector has seen a steady increase since 2006-07.

5.5.10.1 Under invoicing of Export of Iron Ore

The Lokayukta report mentions an interesting case, in which a well-known mining company in Karnataka was caught under-invoicing its exports to one of its sister concerns in Singapore. To this end, an existing private company that was registered in Singapore, was acquired in

2007 after making various re-appointments and changes in senior management staff. This company, whose activities were restricted to the entertainment, food, and beverages industry, was re-named through a Special Resolution. Its objective was changed to general wholesale trade, which comprised of both exports and imports. A holding company was set up in the tax haven of Isle of Man on 21 December 2007, after one of the directors of the Indian mining company was made the Director of the company in Singapore. Soon after, one share of the company based in Singapore was transferred in favour of the holding company at the Isle of Man. On 9th June 2009, this share was transferred to a company situated in the British Virgin Islands, another well-known tax haven. The report documents that in the years 2007-08 and 2008-09, the Indian mining company exported 8.09 lakh metric tonne (MT) of iron ore to its sister company in Singapore. The origin of this iron ore was obfuscated and was shown from ports in Karnataka. Furthermore, the report goes on to reveal a whopping figure of Rs 215,12 crores as the amount of under invoicing of iron ore for the years 2007-08 and 2008-09. Finally, the report suspects that the foreign exchange generated, might be parked in banks in these tax havens (Hegde, 2011).

In Section 28 of the report titled 'Collapse of administrative and governance system', the Lokayukta states that:

"*In Hospet-Sandar-Bellary (BHS) sector, there are unaccounted mushrooming of registered and unregistered iron ore traders. Since last 2 to 3 years, it is observed that, due to a big margin of profit in this illegal trade, a mafia type of operation have started with the full connivance and support of Politicians, Officials of the Department of Police, RTO, Mines, Forest, Revenue, Commercial Taxes, KSCB, Labour, Weight and Measurement department and others*". Also, the report highlights information procured through Director of Income Tax, Bangalore. The Director revealed the various bribes paid, on different dates, to officials of departments to procure undue favours. This information had been consolidated on a pen drive seized by them from a person of interest. It revealed that titled under the head of 'department expenses', Rs 2.46 crore had been paid as bribes to 617 officials (Hegde, 2011). These officials belonged to varied ranks in different departments in the districts of Bellary, Chitradurga, Bangalore, and other districts in the same region. The high-ranking officials are paid large amounts of money, while lower level officials are paid small amounts at regular intervals. Their compensation is commensurate with the level of aid they provide in the act of illegal mining. It could range from regulatory oversight such as no checking of overloading of trucks for transportation of material; excessive extraction which is more than the permitted quantity; allowing transportation without paying of royalty, to non-payment of taxes such as royalty and forest development tax. Additionally, the report states, *"One of the main reasons for explosive illegal iron ore mining during 2009-10 was posting of favoured officials at strategic posts of Police, Mines, Forests, Revenue and other departments. Because of this, a fearless atmosphere prevailed in Bellary district. Law of the land was seemed to have been suspended and oral whip was used to keep silent. Consequently, administration has allowed looting of natural resources, in this case, iron ore, which continued without any opposition. Huge bribes were paid. Mafia type operations were the routine practices of the day."*

The Mining sector in India has traditionally been heavily regulated. Though there were private mine owners before independence, since independence the mining sector in India was nationalised. Since liberalisation in 1991, private players were allowed into mining through a National Mineral Policy which was announced in 1993. As per Lekha Chakraborty (2014), "The effect of liberalisation on the mining sector can be observed from the steady rise in the share of private sector in the aggregate value of minerals produced in India (Chakraborty, 2014, p. 10). As per the Indian Bureau of Mines data (2007), the share of public sector in the total value of mineral production has declined from 91.19 per cent in 1988-89 to 74.61 per cent in the year 2004-05" (Chakraborty, 2014).

However even today, the process of mining in the formal sector; officially with proper permits and licenses is very expensive as compared to unofficial mining. Unofficial mining has two components, first; siphoning the product from official mines and second; digging product unofficially and illegally from unlicensed mines i.e. tracts of land which may be privately owned but are unregulated due to political pressure and bureaucratic corruption (Lahiri-Dutt, 2007). Cost of extracting the ore in such mines is negligible as no duties, royalties or staff benefits are to be paid. The differential in the cost of transport for mined produce for local destinations and for purposes of export is very high. Illegally mined product is transported by trains using their preferential pricing for transportation to sites near local ports. An interview with the former director of NMDC (National Mineral development corporation), one of the biggest mining companies and PSU's (Public Sector Undertaking) in India, revealed a noteworthy example. He told me that illegally mined iron ore is sent from the state of Karnataka to Goa, and then exported as local iron ore or Goanese iron Ore (which cannot possibly have yielded that ore), exported to China. Further he said, "the entire transaction works on political and bureaucratic favours and cash transactions but revenue streams in as white income with tax benefits" (Former Director, NMDC, personal communication, August 7, 2018).

Another example of illegal mining comes from the state of Meghalaya in the north east part of India. This example is based on my interview with a current minister in the Meghalaya state government. According to the Minister,

"*Rat hole mining is an example of black money being generated and laundered by taking advantage of tax laws and mining laws as applicable to tribals in Meghalaya. Unlike the rest of India, coal mines in Meghalaya are privately owned and there has been a tax exemption for these individuals from income tax. In Jaintya hills, where most mines are located, the owners themselves get illegal mining done on their land. They extract coal by unscientific and rudimentary methods. This is popularly termed as 'rat hole mining' where burrows are dug into the ground to extract coal. This is extremely dangerous and completely illegal. This coal is then smuggled across the international border to Bangladesh. The income generated is misreported as agricultural or some other income and as there is little or no scrutiny from tax authorities because there is exemption on income for tribals of the region*" (personal communication, October 18, 2017).

In this case, it is the laxity of government in enforcing laws that allows laundering of large amounts of money. A major reason for this can be attributed to the fact that politicians are also mine owners. This can be seen in net worth of tribals which is indicated when tribals stand for elections and must legally declare their net worth which is often in hundreds of crores. On 8 November 2018, a prominent women's rights and environmental activist, Agnes Kharshiing, and her aides, Amita Sangma and Emiki Kurbah, were attacked by a group of 30-40 people in the East Jaintia hills, a coal-rich district in Meghalaya, India. Ms. Kharshiing is known for her activism against illegal mining. The attack occurred while she and her aides were taking photos of coal-mining activities in the area. The day before, Ms. Kharshiing had filed a complaint regarding trucks transporting coal in the region. Civil society and activists' groups warn that this attack demonstrates the emergence of a "coal mafia" in the state, with some expressing concern about impunity for this and similar attacks. Approximately one month later, at least 14 miners were trapped in an illegal "rat-hole" mine operating in the same district. These types of mines are known for their dangerous working conditions (BHRC, 2018). In April 2014, the National Green Tribunal ordered the suspension of all rat-hole coal mining in Meghalaya; however, it has allowed the transport of already-mined coal until 31 January 2019 (Majaw, 2015). The ongoing permissibility of transportation means that rat-hole mining continues in the region, often by minor workers who are hired for their small size and ability to fit in narrow tunnels.

As far as rat hole mining and smuggling to Bangladesh is concerned, there is no direct impact of economic liberalisation. However, in the case of iron ore, which is sourced from illegal mines in Karnataka, transported to Goa and misrepresented to having been sourced from Goan mines for export to China, one can safely assume is a direct consequence of liberalisation i.e. H1.

5.5.11 Banking

Banks have a central role to play in curbing money laundering practices. However, they have fallen in practice to become instruments in the money laundering process (Viritha, Mariappan and Venkatachalapathy, 2015). In India, corruption in the financial services sector has been in the media spotlight in recent years. While the government seeks to address issues of debt recovery by way of undertaking an overhaul of existing laws, enforcement actions are bringing to light the corruption in the system and how bank officials have been sanctioning loans to undeserving borrowers which has resulted in unearthing of various bank loan scams (Press Trust of India, 2021a).

A large volume of money laundering activities can be attributed to ignorance of KYC norms or the complicity of bank personnel. As per a sting operation done by *cobrapost.com* (a leading online daily) in New Delhi, the modus operandi of some prominent banks was analysed. It was observed that banks would accept cash from the customers and invest it in the bank's portfolio of insurance products or split that money into diversified portfolios. Many banks were also known to help their customers transfer 'black money' abroad through remittance using 'legal' methods. These methods include using dummy accounts to faceplate the conversion of black money, opening many accounts and closing them at convenience in order to facilitate the investment of black money and withdrawal and using duplicate PAN cards to route the cash transactions into investment (TOI, 2013). Another method that banks use to service their clients is by creating a profile for the client where the client is shown to be engaging in some legitimate business, thereby making his investment legitimate. In some cases, the personal banker would visit the client at his/her residence to take the black money deal forward. In an interview with a senior CA, I came to know that post 2004, this method was increasingly employed by the senior-most members of a national political party to siphon black money abroad (personal communication, June 7, 2018). Other methods include getting demand drafts made for the client either from their bank or from other banks to facilitate investment, without it showing up in the clients account and allotting lockers to their customers for keeping cash pools hidden and secure (Passas, 2005).

The ability of the banks to perform this role was strengthened by the emergence of high-speed data processing and communications between banks, globally. On the matrix of my hypothesis, I find that this mechanism predominantly falls under H3. However, another factor for increase in banks facilitating money laundering can be attributed to higher bank penetration post economic liberalisation. Thus, it partially falls under H1.

5.5.12 Misuse of Tax Exemptions for North Eastern States

In this section, I will describe a mechanism of money laundering that is unique to a specific region of India i.e. the seven North Eastern states. According to section 10(26) of the Income Tax Act, a person belonging to a Scheduled Tribe residing in any region identified in the Sixth Schedule of the Constitution is exempted from paying income tax on any earnings that accrues from any source in the area or state specified. As per the sixth schedule, certain resident tribes of North east India, like the *Nagas* and *Garos* are exempt from paying income tax. Under Section 10 (26), the tribals of five north-eastern states - Tripura, Manipur, Mizoram, Nagaland and Arunachal Pradesh - are fully exempted from tax of the Income Tax Act, 1961. Tribals within areas of district councils constituted under the sixth schedule of the Constitution are also free from tax liability. They are entitled to claim exemption from tax in respect of income from any source arising therein, and income by way of dividend or interest on securities.

Evidently, this exemption is being misused, nowadays, to convert black into white money. Accounts of tribals are used by contractors and businessmen from regions outside the North-Eastern states, for the conduct of their businesses. For a certain commission, contracts are drawn up in the name of a local. As a result, the businessmen who are rank outsiders and have little to do with the region, are able to launder what would otherwise be their taxable income.

During an interview on 10 October 2017, with a prominent politician from the North-East India, I noted the following remark, "*There is so much talk of tackling black money these days. However, practically speaking the economy works quite well even in black transactions. Let me tell you about some facts closer to home i.e. the North East. Here, and I can safely say this about my own constituency, people don't file returns. Since we (tribal) are exempt from taxation, people don't feel the need to file returns. They don't even bother to take the exemption certificate as a tribal. If I speak of India though, I believe and it is common knowledge, even amidst policy makers that most black money is deployed and generated in the real estate and jewellery sector in India*". During the interview he kept calling his own state and its neighbouring states a tax haven. To clarify, I asked him the following question: '*So, you are saying the north eastern states are a tax haven nation within the Indian nation?*'

His response was as follows: "*For sure north east is a tax haven, because it is a tax exempted zone, we have porous borders, china as a neighbour; this is compounded by infiltration of drugs, and presence of precious minerals. All tribal areas whether rich or poor are exempt from tax. Why not tax the rich tribals? The Border Security Force (BSF), The Indian Army, The Assam rifles are a huge part of the system on the border. Why do you think Manipur doesn't allow the armed forces special privileges act to be revoked? This is a critical point and they are a very important part of the channel; lot of bullets being supplied to the insurgents in the North East had BSF stamps on them. So the Indian North-East is a very opportunistic area for absorbing, channelling and bringing it back"* (personal communication, 10 October, 2017). My question on preferred jurisdictions for sending black money abroad got the following response from a senior chartered accountant: I was told that, "*Let me tell you within India, certain jurisdictions are tax exempt such as Arunchanal Pradesh, Meghalaya and Nagaland. Often, money would be routed through residents of these states in benami transaction for deployment anywhere else in India, for procurement of property or investment in projects" (personal communication, December 16, 2017).* As a response, I asked him'. So, you are saying there are domestic tax havens in the country?' He responded confidently by sayin*g, "Yes, of course. But only for the tribals who hold this privilege".*

Under the matrix of my hypothesis, this mechanism falls under H2.

5.5.13 Using the Lottery system

Historically, there were agencies in India that track the winners of the lottery. The winners were people who mostly belong to the rural informal sector in India. The winner of the lottery was given the equivalent of the amount of the prize money on the winning ticket. These persons were often afraid of dealing with paperwork and agreed to exchange their lottery tickets for cash readily. The main incentive was immediate availability of prize money & no associated inquiry as to source of funds.

Till the late 1980s, lottery tickets in India were mostly on bearer basis, there was no registration. This was mostly used by bureaucrats in the name of their relatives or middlemen in proceeds of corruption and deal making. This has actually decreased post liberalisation, since before liberalisation, the quantum of money that required adjustment was much lower. A lottery ticket can cover much less of the required adjustment (personal communication, June 29, 2018). Due to this, there is a reverse relationship between the mechanism of lottery & economic liberalisation.

In the next section, I review a list of other mechanisms in the typologies of money laundering.

5.5.14 Other Mechanisms of Money Laundering

In this section, I review a list of other mechanisms in the typologies of money laundering in table 5.1. These mechanisms; which I have classified as 'other' were not the mechanisms that I gathered or verified through empirical research. However, these mechanisms were discovered by me through secondary desk research and I believe make my typologies of money laundering in India more comprehensive and exhaustive.

S.no	Mechanism of Money Laundering	Description of Mechanism
1.	**International Bank, through its domestic affiliate**	In this technique, illicit funds are first placed abroad as collateral in a bank, which instructs its local branch to extend a loan. The amount lent by the local branch is linked to the value of the security with the foreign bank.
2.	**Buying Passports from Select Countries**	The key element in this technique is the misrepresentation of the price of the good or service to transfer additional value between the importer and exporter. Many countries such as Bangladesh, Belize, Cape Verde, and Peru have a long-standing practice of selling their passports. These passports are

		most easily acquired via brokerage firms that advertise regularly in publications such as 'the economist'. Once the tax-exempt account is opened money is deposited by wire or by regular bank.
3.	**Financing Regular Bills and Living Expenses**	This technique could manifest itself in various forms. One of the most common methods is when a credit card is issued by a foreign bank. The issuing bank pays the balance due on the card out of the money kept abroad. These cards ensure confidentiality and can be used on ATM's as well. Similarly, some banks issue anonymous debit/credit cards without asking for any ID proof where a non- resident Indian can fill up whatever fictitious name, he/she desires to put as the cardholder's name. No information is required from the cardholder as credit is already secured. Another common technique is use of anonymous cash cards which are sourced offshore where the ATM account is kept separate from the offshore account. This account is periodically credited by the offshore account free of any electronic link.
4.	**Hiring Offshore Firms**	Foreign Bank opens a Payable Through Account, i.e. a correspondent master account with a bank in the host country .Since the account is legal in the foreign country, a quick look would only reveal the name of the correspondent bank as a beneficiary. This account allows clients to draw checks on it despite having a paper trail.
5.	**Through Nominees and Relatives Overseas**	Expenses can be incurred from money sent to relatives abroad. Sometimes, the launderer first smuggles money abroad, and then have a relation or friend bring it back as a part of a claim to landed immigrant status
6.	**Bogus Capital gains on options trading**	This technique is extremely difficult to detect as regular transactions on the securities market with low to moderate gains are less likely to come under the purview of the Security and Exchanges Board in India. The technique is to buy and sell a commodity, currency, option or stock back and forth between domestic and foreign firms. This ensures that the offshore company records a capital loss and domestic company a capital gain, especially when the offshore company is a tax haven or incorporated in a country with secrecy laws such as Switzerland.
7.	**Compensation for a lost or hijacked cargo**	This technique is mostly employed in alliance with offshore insurance companies. Primarily these are bogus deals to launder money related to insurance scams
8.	**Back to Back certificate of deposits**	The launderer gives money to the company arranging the loan. The company deposits it in a bank in the firm's own name, receiving from the bank a deposit. The company then issues its certificate of deposit on behalf of the launderer, which provides

		an extra layer of confidentiality because the clients name does not appear on the bank's books

Table 5. 1 *The Other Typologies of Money Laundering*

Source: (Passas, 2005)

5.6 Summary of Testing the Hypothesis H1, H2, H3

On the matrix of my hypothesis H1, H2 and H3, I tested the ten mechanisms or typologies of money laundering in India, which I discovered; through my primary and secondary research. I provide the results of my findings in table 5.2

S.no	Mechanism of Money Laundering	Impact of Liberalisation as under H1, H2, H3
1.	**Capital Flight from India**	
1.1	Capital Parked Outside the Geographical bounds of the country	H1
1.2	Round Tripping	H1
1.3	Trade Misinvoicing	H2 & H3
2	**Obfuscating time, place and origin of product**	
2.1	Antiques and Artefacts	H2
2.2	Rare Animals, Birds and Forest Produce	H3
2.3	Mislabeling Owing to Product Classification	H1

3.	**Misuse of Tax Exemption on Agricultural Income**	H2
4.	**Hindu Undivided Family (HUF)**	H2 & H3 (partially)
5.	**Shell Companies or *Jamakharchi* Companies**	H3 & H1 (partially)
6.	**Misuse of Tax Exemption on registered Political Parties**	H2
7.	**Illegal Mining**	H1 and H2 (partially)
8.	**Banking**	H3 and H1 (partially)
9.	**Misuse of Tax Exemptions on North Eastern States**	H2
10.	**Using the Lottery System**	Inverse Relationship (H3)

Table 5. 2 ***Summary of Results***

5.7 Conclusion

In this chapter, I have attempted to contextualise the mechanisms of money laundering with reference to the Indian economy. Before coming to any conclusion, as to the mechanisms of money laundering, it is essential to understand the structures of i the Indian economy. It is my considered opinion that the Indian economy is not open to easy classification and analysis. It defies a *Two-Value Logic Approach* (TVL), [42] of black and white, legal and illegal, formal and informal (Abd-El-Barr and Al-Noori, 2015). It more closely follows the *Multi-*

[42] TVL denotes a propositional calculus, which consists of two discrete values (Abd-El-Barr and Al-Noori, 2015).

Valued Logic Approach (MVL), [43] which has white and black, with all kinds of shades of grey in between. Thus, the economy in India is best described as constantly intersecting between formal, informal and black economy.

I found that black money in India is not a static hoard in the hands of the persons holding it. The layers and segments of the Indian economy provide enough opportunities to deploy it productively, in both- the pre-reform and the post reform period. The need for laundering money in India did not arise from the need to bring it back into the economy. Instead it emanated from the holder's requirement for making investments or purchase large-ticket assets or make large investments for business, which were visible to the authorities. Thus, for this purpose, the holder required accounted for or white money. In many cases, the loan entry in the accounts kept alive the possibility of reversing these borrowings and generating black money as and when required. This kept alive the possibility of reversing these borrowings and generating black money from white later. The consequential discovery was that the Indian economy required not just laundering but also de-laundering of money. I examine this concept in great detail in the following chapter (see Chapter VI).

[43] MVL denotes a propositional calculus, which consists of more than two truth values (Abd-El-Barr and Al-Noori, 2015)

Chapter 6

Unique feature of Indian Economy: *De-laundering*

Chapter VI

A Unique Feature of the Indian Economy: De-Laundering

6.0 Introduction

In chapter III, I have analysed and established how the formal economy, the informal economy and the black economy function in an interdependent manner in India. This is evidenced by the constant movement of money from one sector of the economy to the other. As stated in the previous chapter, this inter-play allows owners of ill-gotten wealth to deploy it fruitfully, as it provides opportunities for consumption in the black and informal economy. This interplay also provides opportunities for the conversion of funds from one type of economy to another. This chapter looks at an atypical feature of the Indian economy wherein the money from the formal economy i.e. 'white money' is often converted into funds for the unaccounted economy known as 'black money'. As I have explained in this chapter, this system also makes it possible to change black money to white money reversing the process. This cycle continues so on and so forth. I have termed this laundering and de-laundering.

In this chapter, I examine the contours of the 'de-laundering' cycle as this is a term coined by me and is unique to this study. Thus, this chapter analyses the demand for black money and its generation; met through mechanisms which are institutions in their own right; straddling formal, informal and black economy. In previous chapters (see chapter IV), I have explained the evolutionary aspect of the informal economy that provided the historical antecedent to contemporary money laundering, as it exists in India today. The previous chapter (chapter V) traces the link between businessmen including real estate players, politicians and bureaucrats in the deployment of black/illicit or unaccounted wealth in political party funding and election finance.

6.1 What is De-laundering?

I define de-laundering as the conversion of legal tax-paid money i.e. white money into unaccounted money i.e. black money. Thus, the act of meeting illegal demands, using money from legitimate income constitutes an act of de-laundering. De-laundering can be carried out, simply, by withdrawing money from a personal account for paying a bribe or procuring in cash, a service or a product on which tax has not been paid. In practice, a sophisticated system has emerged for paying large amounts of kickbacks, bribes and political contributions by a system of layering and conversion to obfuscate the legitimate origins of the money.

Usually, black money is generated by illegal activity that is criminal in nature or through tax evasion. In India, with the growth of the formal economy and the plugging of loopholes for tax avoidance, there is an emergence of a large number of corporate entities and High Net Worth Individuals (HNI), whose income is predominantly accounted for i.e. it is white money. However, due to the persistence in the overall economy of systemic requirements for meeting demands from officials for bribes, speed money, procurement of land (black money component) and convenience payments to politicians and senior bureaucrats, there is a regular need for black money. Thus, the fact that the formal economy needs to support many heads of expenditure, which clearly fall in the black sector of the economy, there is a systemic demand for converting white money to black money to meet demands of these heads which are placed as liabilities on corporate entities and HNIs.

This black money needs to be generated by these entities by some mechanism that will pass the scrutiny of government tax audit, which all players in the formal economy compulsorily face. There are two main mechanisms to accomplish this task. Firstly, this can be accomplished by false billing or misinvoicing which is a globally established mechanism for making unaccounted payments to third parties. The second mechanism is by using a system of 'book entries'. The term 'book entry' has been taken from references made to this term by several business persons, finance professionals, chartered accountants and lawyers interviewed by me. In the following section, I examine the process of de-laundering with an emphasis on the 'book entry system' in India.

6.2 The process of De-laundering

As discussed above, there are two kinds of transactions associated with the continuous process of de-laundering:

1. Misinvoicing
2. Book Entry System

I discuss these two kinds of transactions in the following two sections.

6.2.1 Misinvoicing

A corporate entity or HNI can generate black money by accounting for cash withdrawn by recording false 'expenses'. For this purpose, a large number of transactions have to be recorded. As of today, no single transaction can be above Rs. 10,000/- in cash as per the latest Section 40A(3) and Section 40A(2) of Income Tax Act under the Finance Act, 2017. In a move to disincentivise cash transactions, this move reduced the threshold of cash payment for an individual transaction from twenty thousand rupees to ten thousand rupees in a single day; i.e. "any payment in cash above ten thousand rupees to a person in a day, shall not be allowed as deduction in the computation of income from 'Profits and Gains from Business or Profession' (Tax Guru, 2017). Thus, misinvoicing is often implemented by using the services of book entry operators. This is covered in section 6.3.2 after I provide an introduction to the 'book entry system' in India. Misinvoicing under trade has been covered in the previous chapter in section 5.5.4.

6.2.2 Book Entry System

The book entry system follows modern practices of double-entry bookkeeping to utilise a chain of interdependent transactions to disguise the movement of money. These entities have no real business except to make available their books for entries of a series of transactions. The persons controlling these shell companies record multiple entries based on small individual deposits in the name of a large number of persons who have no taxable income and thus do not have to report their income. This can also be compared to smurfing as related to the first step in the process of money laundering i.e. placement, specifically spread over several small transactions. Such persons are often members of the rural population and these depositors are difficult to trace, as they are widely spread and can legitimately claim not to be subject to tax liability as per IT Act. The cumulative impact of these entries is that a string of shell companies have books with credit balances to show. These accounts and shell companies are nurtured over years.

At any point, the balance of credit in these shell company accounts in name of small multiple depositors allows the operators to accommodate :

a. Equivalent black money which on receipt can be instantly parked but will reflect in the name of these individual small depositors. Thus, a facility to park black money is created.
b. The more important opportunity offered by these credit balances is that when large amounts need to be converted from white to black i.e. de-laundering for example by company A, the following set of transactions allows it to convert white money to black i.e. de-launder. Company A who needs black money deposits a

cheque of equivalent amount with shell company S1. Now, S1 breaks this amount and deposits total funds in accounts of say S2, S3 and S4 shell companies. Now, S2, S3 and S4 withdraw cash to retire low value credits in multiple equivalent deposits, held in the name of depositors who are not subject to income tax. This may be thought of as reverse smurfing. This creates an equivalent cash chest of black money, which is handed over to Company A.

In India, the book entry business is critical to laundering and de-laundering unaccounted money. The book entry business is mostly carried out through shell companies that are either trading companies or finance companies on paper. These companies are spread all over India. As a network of interrelated entities, they are conducting multiple transactions of:-

1. Parking black money (see chapter V)
2. Laundering black money (see chapter V)
3. De-laundering white money (this chapter)

The emphasis is on parking and de-laundering. For money laundering, this process is used for the short term or for reversing money de laundering related deposit entry only (personal communication, November 17, 2017). The transaction of money laundering and de-laundering is relatively instantaneous i.e. takes less than 24 hours and can be linked to multiple geographical locations, both for collecting and remitting funds in black or white. The entire exercise is conducted on the basis of confidence and personal integrity of professional accountants involved in this, which provides it with a veneer of protection, acceptability and authenticity. It is noteworthy, that it is through this network that the bulk of the black money remains deployed in the banking network while the black income of some individuals, is parked as white money of other individuals. An interaction with Dr B.B Dutta on 17 July, 2017, revealed that this large pool of money also provides an anchor against severe shocks in the economy. It may be noted that when money was demonetised in 2016, most of the money came back into the banking system, as the mechanism for de-laundering which went into high gear to help return the cash back to the banks. This was possible as the mechanism for de-laundering were already institutionalised.

As per money laundering literature, the process that I am classifying as de-laundering constitutes steps of placement and layering in the cycle of money laundering. However, the differential that I discovered, was that in India there is a huge requirement for black money. This requirement has grown exponentially since liberalisation. In India, there is a continuous demand for black money, which makes de-laundering essential for tax-paying corporate entities. Also, the existence of critical sectors of the economy for structural reasons, continue to operate with a large part of their activities in the black economy. The best example of this is the building and real estate sector. The need to interact with any such sector raises a need for black money and thus, de-laundering.

A large ecosystem has been created where money laundering and de-laundering is a continuous process. It can be perceived as a bank account from which one can withdraw money and hold it in one's hands as black money; to be used for its designated purpose. Alternatively, money can be deposited and considered to be parked, which can be withdrawn by another person as white money to be deployed in the economy. I have explained the process of parking, in great detail, in the previous chapter.

Most extensive and important users of services of book entry operators are corporate entities and HNI's who have large commitments in cash towards political payments, speed money or land acquisition. Figure 6.1 shows the flow of transactions, facilitated by book entry operators to provide black money against deposits of white money into the accounts of multiple shell companies, operated by the book entry operators. It may be noted that white money, that is deposited, is ostensibly used to pay back monies recorded as having been deposited by petty depositors in the books of accounts. These cash withdrawals constitute the black money equivalent of the white money deposited and can then be used by the corporate entity or HNI to meet its black money commitments. These commitments are often very large and could be designated for the purpose of acquiring high-value assets or to meet commitments to pay commissions and speed money towards the funding of political parties.

6.3 The Mechanism of Book Entries

The book entry business is built around the legal differential between income and deposit or advance as treated by the Income Tax Act 1961. As all income is taxable, subject to permissible thresholds and deductions, there is no advantage in transferring funds to another entity, as a charge for service or sale. Monies of such transactions are taxable; both for income tax and GST [44] which was earlier the Sales Tax and then Value Added Tax (VAT) 2005.[45]

[44] On 1 July, 2017, the Indian government replaced the Central and State indirect taxes such as VAT, excise duty and service tax by introducing the Goods and Services Tax (GST).

[45] The Value Added Tax (VAT) replaced the general sales Tax laws on 1st April, 2005. By June 2014, VAT was implemented in all the states and union territories of India barring the states of Pondicherry, Andaman and Nicobar Islands and Lakshadweep Island.

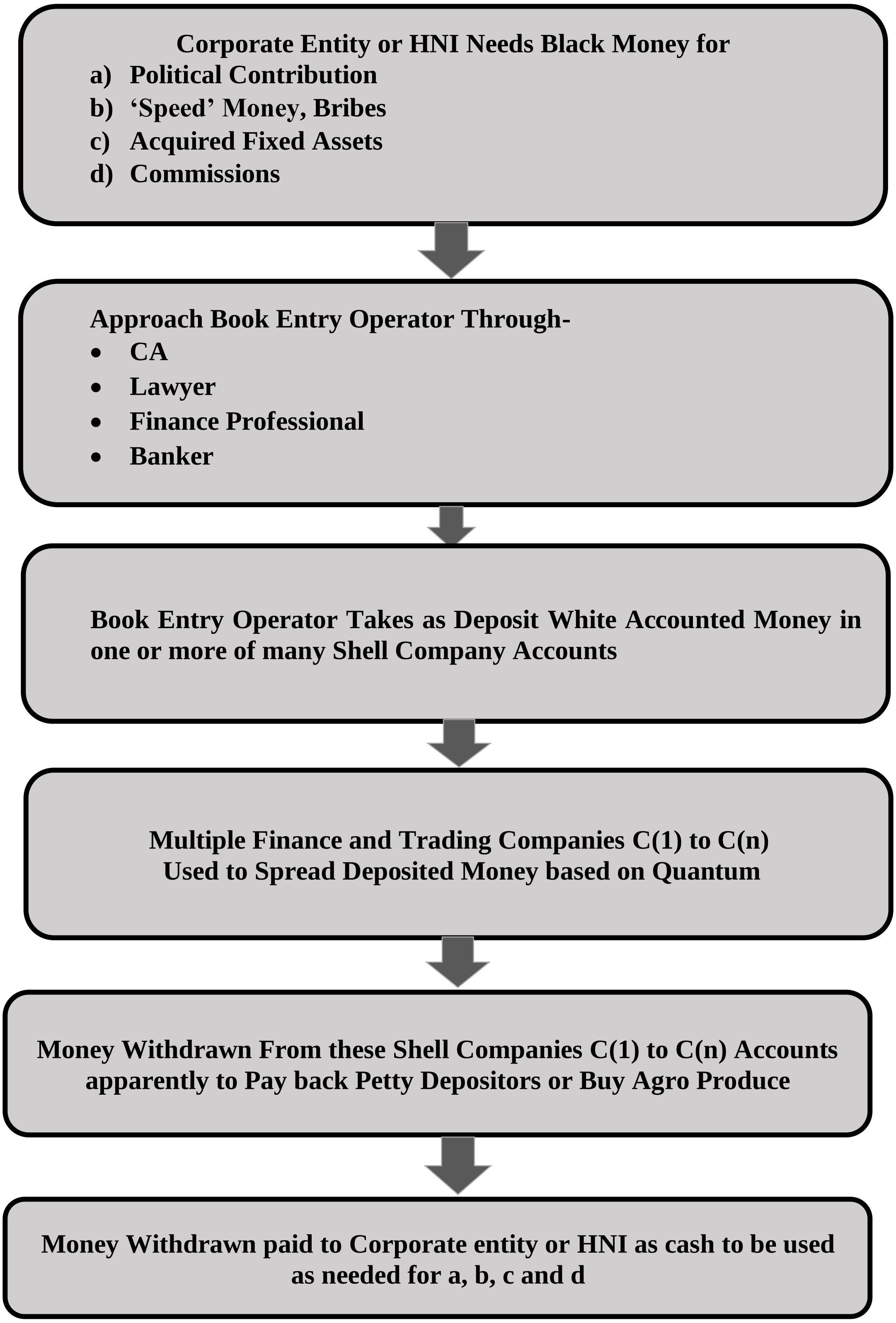

Figure 6. 1 *Money De-laundering through book entry business in India*

Furthermore, in such transactions, a liability is cast upon the seller to deduct tax at the source and report the transaction to the tax authorities. However, monies paid as advance and deposits are both not taxable and are a liability or an asset, which can only be retired in case the advance or deposit is returned or by issuing an invoice for the purchase of goods or property for which advance is made. Unless these reverse entries are affected, the account books of receiving entity will show a credit balance in favour of the party that has given the advance or deposit. The other side of the balance sheet of the company/entity receiving the deposit or advance is that, it now has on its books that much money to give as a loan to someone or withdraw it to retire some liabilities in multiple heads, each being itself of small value. This withdrawal can be in cash also. In which case, the cash withdrawn can be used to retire multiple deposits of less than Rs. 20,000 each, which till 2017 was the limit for cash transaction as per Income Tax Act, 1961. This limit has now been reduced to Rs. 10,000, as already discussed earlier.

The book entry (often only referred to as just 'entry') business in India, operates within a systemic network of entry operators, sub-operators, sub-brokers and their agents controlling large number of bank accounts, registered in the names of their proxies or in the name of companies created by them. Established players in the entry business function through hundreds or thousands of bank accounts. This is necessary to legitimise and authenticate the apparent legitimacy of the entry by keeping each entry either under the threshhold values for cash transactions or by legitimising the series of entries as expalined . Bank accounts are set up in the name of poor persons or persons of no means. These are individuals who are not covered by the Income Tax net i.e. their annual income is less than 2.5 lakh (limit for income tax exemption) rupees or they have agricultural income which is tax-free.

Entry operators set up hundreds of shell companies and their respective bank accounts. Finance professionals controlling these companies are widely networked all over the country through wide area networks (WAN), using the internet. Besides using names of persons in the informal economy; and using their names for cash deposits of less than Rs 20,000, a more sophisticated approach is that a PAN card is obtained in the name of persons whose reported income is below the tax limit as per the Income Tax Act, 1961, and the PAN card is used to open many fake accounts. These individuals or proxies are paid a nominal fee for this service, and in their name, multiple shell companies are set up and run by proxies who are the book entry operators. The modus operandi also includes the procurement of important documents bearing the signature of the proxy individuals, beforehand. These documents include blank cheques, share application forms and letters of authority to avoid future complications. The entry operators themselves avoid signing any documents and bank accounts are under the respective corporate names of the shell companies. This mechanism was explained to me in Delhi by a CA specializing in capital markets with many HNI clients, during an informal interview on 17 January, 2018.

The formation of multiple false accounts aids the creation of multiple layers between the bank account where funds are initially deposited and the end beneficiary. These proxy accounts also serve the purpose of fulfilling several regulatory obligations such as under the Income Tax Act 1961, Companies Act 2013, and the yearly or interim Finance Act etc. As per most chartered accountants, these proxy entities have significant amounts reflected in their balance sheets.

6.3.1. Entries showing receipt of Share Application Money

The Securities and Exchange Board of India (SEBI) has issued guidelines and norms stipulating the maximum percentage of ownership that promoters can have in a listed company, as well as lock-in requirements (SEBI, 2000). [46] Furthermore, SEBI norms have put several restrictions on participating in a public issue. Promoters often apply in a public issue to circumvent SEBI regulations by applying in several names/entities controlled by them. (Varottil, 2015). Such entities may be shell companies.

The entry business has acquired a more formal structure over the last two decades, with the practice of purchasing shares through these proxy entities or accounts. The chartered accountants I interviewed, claim to have seen several cases of listed companies, putting their unaccounted or black money into share application money through entry operators.

6.3.2. Entries showing Misinvoicing

[46] "Shareholders in a listed company are classified under two broad categories, i.e. those that belong to the *promoter/promoter group* and those shareholders who are members of the public with no family or formal business ties with the promoter/promoter group" (Varottil, 2015)

In some instances, the book entry operator arranges entries that help the end-user to claim expenditure on false purchases misinvoicing. These purchases could include raw materials, machinery or services. In this process, the entry operator also creates fake bills and receipts as supporting documents to legitimise the entries. The entry operator uses the dummy or proxy entities and accounts; that he has created beforehand to route the cheque payments for these false payments through multiple bank accounts to reach the end beneficiary. This entire exercise constitutes the creation of make-believe documentation to claim false expenses as legitimate and create black money. One case reported by the Income Tax department in India can be quoted here. In this case, the Income Tax department in India exposed the activities of multiple entry providers who confessed to having generated fake receipts of over Rs 500 crores to more than 200 end beneficiaries (Bhalla, 2020).

A recent case, currently being investigated by the Enforcement Directorate (ED) in India is noteworthy in this regard. Mumbai's Md. Farooq alias Farooq Shaikh allegedly ran 160 shell companies duping both public sector and cooperative banks to launder and delaunder thousands of crores which he attained through large scale financial fraud. As per the Central Bureau of Investigation (CBI) and ED in India, Farooq established these false firms at fabricated addresses with dummy directors (Singh, 2018). These dummy directors included names of persons of no means, such as petty buggy and handcart drivers in Mumbai. He carried out his operations from a flat in one of the most crowded parts of the city- *Zaveri Bazaar*, an old bustling market in Mumbai. He is known to have facilitated money laundering through undervaluing imports to escape duty and illicit cash transfers within India and abroad illegally. This is a typical case of money de-laundering by providing cash in exchange for 'false' invoices. The importers and traders who dealt with him are being investigated. What is noteworthy from this case is the role of banks in the public sector as Farooq used more than 160 banks to transfer more than Rs 5,000 crore to overseas destinations through false import documents (Financial Express, 2018).

In another case, told to me by a Mumbai based chartered accountant, "*a private limited company having close ties with a politician in the Indian state of Maharashtra had issued shares to individuals and companies at significantly higher prices (than the actual or market price) and re-purchased them after few months at negligible prices*" (personal communication, August 22, 2017). According to him, this method is rampant among many private companies with deep links to politicians or political parties. One such company that had run into significant losses; claimed to have sold 19000 shares of the face value of Rs 100 to five firms in Kolkata at a premium of Rs 1900 per share (personal communication, August 22, 2017).

6.3.3. Entries showing past holding of family heirlooms

To create an entry of white money, it is shown as having arisen from a sale of gold, jewellery or valuable artifacts devised to have been held as family heirlooms. A chartered accountant from Mumbai, who I interviewed on 5th Octobers 2017, spoke about managing the finances of a former princely estate in India, that ran into relatively difficult times (near bankruptcy) which resulted in the liquidation of their family-land and buildings. This consisted of the realization of a large part of the value in black money, by way of sale proceeds. He explained to me that this large amount of black money was converted to white money through false sale receipts of jewellery and artefacts (personal communication, October 5, 2017). These were obtained from jewellers and antique dealers who were operating through their respective chartered accountants, recording fictitious sales to them. This effectively put more white money in the hands of the seller of the property. Simultaneously, it helped the buyers to justify, artifacts or jewelry already held by them from other dubious means. Needless to say, the financial consultants and chartered accountants make a hefty commission in the process.

6.3.4. Entries consisting of multi-layered transactions

Over the years, entry operators have introduced multiple layers in the transactions between the amount and the end beneficiary. The bogus entities are often private limited companies, which are duly registered under the Companies Act. They maintain their books of accounts, banks accounts, financial statements etc. and file their returns of income tax as well, but have no genuine business. Thus, the basic nature of the transactions remains the same, i.e. cash is first deposited in the bank account of the entity, in the name of widely dispersed non-taxpaying individuals, who in turn, issue a cheque in favour of another shell company controlled and created by the same entry operator or an associate. This goes on till it is given to the final beneficiary as loan/share application money by cheque and deposited into the end beneficiaries account. A well-known case of using such multi-layered transactions is that of stockbroker Ketan Parekh, who made payments of around Rs. 241 Crores to the Madhavpura Central Cooperative Bank through various entities. Investigations by the Mumbai Directorate of Investigation of the Income Tax Department revealed that out of the Rs. 241 crores, over Rs. 180 Crore originated from 130 different bank accounts of Kolkata based entry operators (India Today, 2009). Cash was first deposited in these accounts and then accommodation entries were provided through multiple layers of bank accounts.

Thus, effectively a network of shell companies, ostensibly acting as a money exchange has become part of the Indian financial infrastructure consisting of chartered accountants and entry operators. This exchange provides; at short notice, both black and white money against corresponding entries. In this situation, the system of trust, which has been the underpinning of the *hundi* and hawala system, has played a key role in awarding credibility to the players. For example, when money is converted from white to black, the entry remains standing as white money in the account books of the entity by way of loan or investment. He receives corresponding black money in cash. Now, this entry itself has value, as paying a small commission can reverse this entry. As per a financial consultant in Bangalore, " *These entries are tradable as chartered accountants use existing entries in the system for accommodating demand for laundering and de-laundering so as to retire these entries*. Further, he said, " *You can get as much as 1-3 per cent of the value of the entry, depending on demand*". Multiple such entries and contra entries constitute the ecosystem of the book entry mechanism (personal communication, December 26, 2017).

In the next section, I examine the transactional compulsions for the generation of black money and the need for de-laundering in India.

6.4 Transactional Need for Black Money and De-laundering

It is important to understand that, in economic terms, there is no hard compartmentalisation between black and white economies in India because the money itself is deployed in the economy and is not idle. So, while in the accounts of an individual person there may be quantities of money held as tax-unpaid cash. The same money as it is deployed is productive and has a velocity of money as it participates in economic activity- black, informal or formal. To better understand this, it was pointed out to me by several chartered accountants, that it was impossible to operate in the Indian economy with only black or white money. In fact, as technology and legislation has made escaping from taxes difficult for large corporate entities and HNI's, they have to depend on converting their white money to black money by de-laundering, to meet commitments for which black money is needed. Thus, black money remains an integral part of the economy, even for those entities whose income is entirely accounted for and is in the formal economy.

In the next section, I examine broad categories of economic activity that necessitate this systemic requirement for black money in the Indian economy.

6.4.1 Key Money System or '*Pagri*'

In old-established commercial centres in India, properties are transferred using the 'Key money' system rather than registered sale and purchase agreements. So, on paper, the tenant transfers property to a new tenant and *Key* money grows with the property cost over time. The turnover of the business expected in the premises often bears little relationship to the value of the business activity. The trader looks at key money as an investment, which grows in value over time and saves the trader from a regular outgo of rent. This is black money deployed to save expenditure on rent. According to Appadurai (2000), "The market in "rental" houses is brisk and illegal, involving vast sums of cash, transacted as so-called pagri (key money), which often amounts to more than the market value of the house. The pagri is paid by the new "tenant," who comes in on a much higher rent, and is shared by the landlord and the "selling" tenant who, in fact, is selling his right to stay on distorted rental terms. The landlord seeks the best black money deal, and the buyer pays whatever the market demands" (Appadurai, 2000, p. 639).

Invariably, in old traditional business families, property moves from grandfather to grandson in India, because sons and fathers have considerable coexistence as businessmen together (due to the difference in lifespan). This is a consequence of the Hindu Undivided Family system (HUF). Rural property is bought by non-farmers with the expectation that it will be urbanised, whenever it is, there is a windfall profit and it is tax-exempt since it is agricultural . Also, properties in India and their ownership in cases of commercial properties in old markets, such as old city centres etc. have considerable issues regarding their legal title (Appadurai, 2000). Hence, the person in possession of the property transfers possession against this key money. These amounts are very large and represent substantial costs per unit area. According to a chartered accountant in Delhi, "*Typically this amount could be anywhere between 2 lakhs to 5 lakhs per square foot*" (personal communication, March 13, 2018). The trader requires large amounts of black money to pay this key money to take possession of the property for doing business.

A senior advocate in Guwahati, dealing in property matters gave me an illustration as follows. "*Let us assume that a businessman in the retail sector has decided to set up a business for his son in the same sector. While this may seem odd to a westerner, this practice is relatively common in most Indian business families. His motivation comes from the fact that retail business in established markets of his city requires personal supervision and hand-on management. Moreover, it requires a well-placed outlet. Such established businessmen consider the rental for such an outlet to be a wasteful strain on working capital. Furthermore, such rental requires high levels of accounted money, as rent needs to be paid in accounted money. The alternative, in this case, is for him to buy the property in the area suitable for the proposed outlet. However, he does not have cash; he has gold and miscellaneous properties. He probably purchased these properties in the last forty years of his working life. These properties were strategically purchased in village areas at that time, which were just a few miles away from the city, but are now being sought after by builders to convert to residential properties. He can sell this property at a premium and get 10-50 per cent of the money in white on which there is no tax, since it is agricultural property*" (personal communication, February 16, 2018*)*. Furthermore, he gets a substantial amount of money in an unaccounted form, which is exempt from tax. Using white accounted for money, he has to make deposits with manufacturers and suppliers for products to be stocked in his son's retail outlet. Simultaneously, he uses black money as *Key* money to acquire the property.

6.4.2 'Speed' Money- Bribes and Convenience Payments

According to Mushtaq Khan (2010), developing countries like India are characterised by 'clientelist political settlements'. He defines political settlements as "a combination of power and institutions that is mutually compatible and also sustainable in terms of economic and political viability" (Khan, 2010, p. 4). The nature of political settlements being clientelist is indicative of the critical importance of the power exercised by informal organisations, typically patron-client networks operating within this framework (Khan, 2011). In most developing countries, patron-client networks are active in both formal as well as informal organisations. In India, patron-client networks can operate through formally registered political parties. However, the power distribution among these patron-client networks, even within these formal structures is distributed informally (Khan, 2011).

Patron client exchanges are associated with corruption and rent-seeking. The resources spent within patron-client networks can be classified as variants of rent-seeking. According to Robinson (1998), building distant patron-client relationships leads to the creation of wealth through rent-seeking. This is particularly true in the Indian context, where a distinct network evolved between politicians and bureaucrats on one hand and business and politics on the other; due to the stranglehold of the 'license permit Raj' since independence up to the 1980s. For instance, in a typical patron-client relationship, the businessman would be desirous of obtaining a licence; the bureaucrats would in a position to cause delay or obstructions by demanding bribes or concessions, in order to exercise their power over their clients. Over time, businessmen tried to renegotiate these power structures by pooling their funds towards political lobbies, providing them election funding, rewards and benefits.

The corrupt nexus i.e. 'the triad' of politicians–businessman and bureaucrats has reared its ugly head in the years following the surge in economic growth in the 1980s (Kohli, 2006; Datta, 2011). According to Dutta (2011), "For a state, like India, where wealth is accumulated in a few hands, market forces and the policy of liberalism lend legitimacy to the existence of a lobby or group of individuals. He says, "Typically in a type of governmental state, where there is a loose conglomeration of interests — between different layers of society, there can be existence of various players in the process of an economic transaction—(a) NETA (political leader), (b) BABU (middleman), (c) LALA (corrupt businessman), and (d) DADA (local clientele) and the (e) the emergence of a new class of agents, contracting for business interests of Multinationals. These agents manipulate their roles in different ways—as contractors, commission agents, middleman, as agents of arms dealers — to satisfy their patrons. Modern State or social structures, in a given context, patronize these agents— to promote a type of political or economic ideology (Race/ethnicity/class or separate statehood or Development/Industrialization). Often the state acts as powerbroker — or it may temporarily create a crisis to move away from the existing crisis — political or economic" (Datta, 2011, p. 283).

In a similar vein, Khan (2010) portrays the Indian political economy as a distinctive network of patron-client exchanges, at different levels of economic and political activity. These complex networks have evolved as a consequence of the engagement of political leaders and bureaucrats in different forms of rent distributions through informal channels, more popularly classified as corruption. Khan (2010) contends that corruption is structural in India. Differentiating between petty and high-level corruption, Rose-Ackerman (1999) says, "The former refers to bribes citizens pay to lower-level officials either to speed the delivery of services or to bribe officials to 'bend the rules', while the latter 'involves large sums of money with multinational corporations frequently making the payoffs" (Rose-Ackerman and Lagunes, 2002, p. 23). The term speed money is associated with the former in most literature on corruption. It may be understood that in India, speed money is given to the official to incentivise the official or bureaucrat to quicken the process of a service that would anyway be provided to them in due course. These bribes are paid to receive legitimate services in a more efficient manner. Thus, critical points of interaction between the state and the citizen require that the wheels of state machinery be 'greased'. For this reason, everyone who has anything to do with services provided by the state needs speed money. I interviewed many builders and real estate developers in Navi Mumbai who kept using the term 'Speed Money' as a blanket term for all bribes and commissions they had to pay in cash or in black money, at almost every stage of the real estate or housing project, in order to get things done without too many obstructions (which are otherwise the right of the citizen/entity). For instance, it is well known that if one were to apply for a driving license, chances of getting the license are minimal unless approached through a middleman or facilitator who would charge a small commission for this service (Vikram, 2013).

Corruption tends to multiply if there is a public perception that corruption is widespread. Gunar Myrdal (1968) documented his interaction with Nehru regarding corruption who recalls it by quoting Nehru who said, "Merely shouting from house tops that everybody is corrupt creates an atmosphere of corruption. People feel they live in a climate of corruption and get corrupted themselves" (Myrdal, 1968, pp. 408-09). This statement holds true for the last seventy years of India being constituted into an independent democratic republic. The cycle of corruption reinforces itself in various ways (Myrdal, 1968, 2017). Large projects and day-to-day living in India require interpretation of rules and regulations by the bureaucracy in a constructive manner to facilitate day-to-day living, conducting businesses, logistics as well as specific projects. For this purpose, there are several small to large convenience payments that have to be made to authorities or authorised functionaries. This can be as minor as keeping the premises around you clean, which is a task assigned to a municipal corporation or may be assigned to a private party. In either case, to get an expected level of service, a small convenience payment may be called for. This becomes a huge amount when you multiply it by the number of entities who are making these payments.

Considering another example quoted from an interview with a lawyer proficient in infrastructure litigation; "*in a highway contract, there is a need for a change of alignments due to the imperatives of topology. This, if carried out as per the bureaucratic norms may delay the entire project and open the contractor to liability or penalties; as even the question of deciding whether this change was needed or not, is in the hands of the bureaucracy. In such cases, large convenience payments may be called for. These payments are built into the cost of the project. Also, such convenience payments may amount to five per cent of the entire project cost*" (personal communication, January 12, 2018).

Another example that I consider is from the logistics and transport sector. According to XXX, the managing director of a leading Indian logistics company, "*currently, we are operating with more than 350 trucks that move between and within cities in north India regularly. I make monthly or often weekly convenience payments to traffic police officers in each respective city where our network of supply chain is spread, to avoid prolonged stoppage from our warehouses to the ultimate vendors. This stoppage can arise out of supposed 'routine inspections' and inventory checking by the traffic police, particularly at Indian state borders. This stoppage can cause a lot of delay to my clients and disrupt my supply chain".* She further described to me how this corruption is institutionalised, "there is a password which is generated weekly or daily, like *Kauwa* (crow), *Tota* (parrot), *Ghulam* (jack) or *Tiranga* (Tricolour), to name a few common ones by the concerned officials of the traffic police in India. This code is sent to the broker who coordinates between different logistics companies and the traffic police. This codeword is given to the driver by his supervisor as obtained from thebroker to be provided to the traffic police personnel at the checkpoints. This is an indication for the traffic police personnel to let the truck(s) through without any prolonged intensive checks as the 'dues' have been received. (personal communication, March 18, 2018).

Considering the large network of roads in India and large-scale dependence on trucks for the movement of goods, logistics companies who are getting income for billing their clients need to build these 'out of pocket' expenses into their costs. These bribes and convenience payments constitute black money from white income and the conversion is reflected in the books by false billing in the books of account of the companies.

6.4.3 Political Contributions

While India's transition from a single dominant party system to a highly fragmented multi-party system has been studied, little attention has been accorded to the economic consequences of this development (Pelizzo, 2010). This wave of deepening of democracy has been concomitant with significant challenges. In the case of India, this wave of democratisation has led to increased political fragmentation and has been widely debated in Indian political discourse. The political landscape has been fragmented by fault lines based on the emergence of micro minorities that coalesce around linguistic, caste, regional, economic and religious identities. To seek and remain in power, political leadership encourages these fault lines, while seeking to promote the interests of a few minorities. The rules of 'first past the post system' of electoral politics make it possibly become a minister. Thus, the leader needs to buy and retain his vote share for which he needs black money. Thus, political party fragmentation entails significant economic costs (Uppal and Bhaskaran, 2014). Furthermore, the converging forces of globalisation, urbanisation and liberalisation coupled with rapid economic growth, has led to an increase in consumerism which has, in turn, raised the aspirations and expectations of the people (Johnson, 2005; Ganguly-Scrase and Scrase, 2008; Mathur, 2010; Säävälä, 2012). These factors have altered the necessary amount spent on elections and very large amounts of money are now required to motivate the different categories of voters in their favour (Centre for Media Studies, 2019). Large population, geographical spread and widespread differences between regions have resulted in large infrastructure requirements to sustain political parties. These factors have converged to create large financial demands on political parties to run political parties, on a daily basis. From various accounts, I have concluded that this need for making political contributions is the predominant driver for corruption and the need for black money in India, due to its preeminent importance. The next chapter is devoted to the analysis of the increasing requirement of black money for political party management and election expenses (see chapter VII).

6.4.4 Capitation fee for admission to educational institutions

Culturally, Indians attach a very high value to higher education. This social phenomenon has historical roots and can best be explained through the concept of Sanskritisation. The concept of Sanskritisation was made popular in the 1950s by Indian sociologist M.N. Srinivas. This pertains to the process by which at the time people belonging from the so-called lower castes and tribes sought out upward mobility within the society by emulating the practices, habits, and rituals of the so-called upper castes. In the Indian context, given the superior positions of Brahmins in the Indian caste system, this process was also known as Brahmanisation . Members of lower castes adopted brahminical practices such as learning, acquisition of knowledge, vegetarianism, practising religious rituals, adopting other practices mentioned in brahminical religious texts etc. (Shah, 2019). Over time, the relevance of the caste system in modern-day India while still present has still diluted to an extent and other dominant cultural influences have entered the domain. Since the advent of globalisation and the creation of a large educated middle class, the west has become a dominant influence due to its cultural, political and economic reach in the world. Therefore, this process of Sanskiritisation in the modern day can be extended to include other dominant classes including the west. In order to emulate and adopt the practices of western modernity, as well as the dominant english speaking elite in India, higher education has gained traction amongst status-conscious Indians. The value attached to higher education and the lack of adequate seats in most universities has facilitated malpractices such as levying of capitation fee by the university administration to gain unaccounted amounts from students, over and above the actual fees for admission. Other factors such as India's demographic dividend and rising urbanisation have also led to the sustenance of this social phenomenon.

There has been an increasing demand for quality educational institutions in India due to a large young population,[47] growing middle class and unprecedented urbanisation since liberalization (Pritam, 2019). Since economic liberalisation, the Indian state has identified a shortage of inadequate resources to cater to the demand-pull for higher education and has allowed private

[47] As of 2017, India had more than 50 per cent of its population below the age of 25 and more than 65 per cent below the age of 35, as per data by Ministry of Statistics and Programme Implementation, Government of India (Social Statistics Division)

players in the education sector (Batra, 2014; Barbhuiya, 2020). Due to this, the education sector has undergone a massive transformation in the last two decades (Arunachalam, 2010; Thakran and Sharma, 2016; Rajkhowa, 2017). While primary and secondary education was open to private players earlier, higher education was closed to them. To enable private players in higher education, most state legislatures passed private university bills under the rules of the Higher Education Commission of India (HECI), which enabled them to permit private players to set-up educational institutions.

Government land is allotted at fixed concessional rates for setting up private universities. In 2012, the Union Agricultural Minister Mr. Sharad Pawar said, "Giving land to set up educational institutes is a long tradition in the state and the country. For setting up such institutes, it is necessary that the land is given at lower rates than the market price. If the government decides on giving properties at market rates, it would be impossible to start an educational institute" (Times of India, 2012). The private entity setting up the university started this venture with two specific motivations. One, the university was expected to be a venture to generate funds and give return to the person starting the university. However, these expectations of return were circumscribed by the fact that, legally, all units have to be a non-profit organization (NPO) i.e. any proceeds of operations resulting in any surplus cannot be distributed amongst the promoters and can only be utilised to further the objects of the organisation, as per the Income Tax Act, 1961. Thus, perforce any desire to generate benefit or profit had to be done by creating mechanisms of generating unaccounted or black money. The university contracts out several services, including those of health and catering, through which, the management keeps its own share in the form of unaccounted returns in cash by inflating the expenses. Many of these universities have tied up with foreign universities to send students for a second degree or further education and they get a commission from the foreign university on the fees paid by the student.

The second motivation for setting up educational institutions is to deploy the 2 per cent social benefit prescribed under the Corporate Social Responsibility (CSR) legislation, which is to be compulsorily spent by corporates under section 135 of Indian Companies Act, 2013.[48] According to a CA in Delhi, "*Corporates have often used this money, which runs into large*

[48] After United Kingdom, India is one of the few countries in the world that has made Corporate Social Responsibility (CSR) mandatory by law. Under the Companies Act, 2013 (Companies Act) in 2014.

amounts, to set up institutions which consume the CSR budget through over-invoicing of contracts, and generates black money in their hands" (personal communication, December 12, 2017).

In the next section, I consider other factors that have converged to create a demand for black money and de-laundering since liberalisation.

6.5 Convergence of Factors affecting De-laundering since Liberalisation

Economic liberalisation in India, which actually started in the 1980s, did not result merely from government change in policy but was a result of the convergence of factors including deepening of democracy, the rapid proliferation of political parties, along with liberal policy initiatives by the state (Rodrik; Dani and Subramania; Arvind, 2005; Kohli, 2006; Agarwal and Whalley, 2015; Shah, 2019).

6.5.1 Democratic Decentralisation: Impact of Legislation 73rd and 74th Amendment

In the early 1990s, the Indian economy underwent a series of constitutional reforms, aimed at democratic decentralisation in India. Arguments favouring democratic decentralisation are based on the premise that transfer of power to local political bodies would lead to higher levels of accountability (Johnson, 2003).On the other hand, many studies argue that the devolution of power may not guarantee higher accountability or efficiency. These arguments are based on a critique of state-controlled planning (Lal, 2000). According to Hayek (1945), the state governments lack 'time and place knowledge' to effect policies that address the needs of the local population (Wagner, 2005). Moreover, the state authorities; particularly in developing countries, operate through bureaucracy, which has a history of rent-seeking behaviour and inefficient resource allocation (Johnson, 2003). The latter argument holds true for India.

The 73rd and the 74th Constitutional Amendment Acts, 1992,[49] introduced a three-tier self-governing structure in rural (through Panchayats) and urban (through Municipalities) India. However, the amendment left it to the states to form the rules for elections at the village level (Mathew, 2017). The power to allow Panchayats to set spending limits in priority areas such as roads and electricity also rests with the state (Watson, 2017). *Panchayat* elections became highly politicised and therefore very capital intensive in India. This was motivated by the fact that *Panchayats*, as per the new amendment started receiving budgetary funding directly from the centre and thus, became centres for spending. As a result, they distributed opportunity for kickbacks and commissions. Due to this, the requirement for election funding also increased manifold. According to Anuja (2016), "The immediate fallout, apart from a compromised unit of governance, includes debt cycles among contestants and a possible and worrying cycle of quid pro quo kickbacks...Campaigning expenses for the post of *gram pradhan* (panchayat head) can go up to ₹ 60 lakh. Officially, the State Election Commission (SEC) of Uttar Pradesh sets a cap of ₹ 75,000 for a *gram pradhan* candidate, apart from ₹ 75,000 as security deposit and ₹ 300 for filing nomination"(Anuja, 2016, p. 1). In an interview with poll surveys expert, Dr N. Bhaskar Rao (Rao, personal communication, May 5, 2018), I noted the following remark, "*till 1992, political parties were funded by musclemen and moneymen and other regional sectors. Now, they themselves decided to participate in the electoral system resulting in deep-rooted criminalisation of politics. These factors have led to an increase in requirement for political funding and politics has become a very lucrative business, with one of the highest returns on investment*".

As per the recommendations of the *Fourteenth Finance Commission* (2015), the Modi government's decided to triple the funding to local bodies. Recently, some news outlets revealed that the prominent politician Naveen Patnaik[50] of the *Biju Janata Dal (BJD)* was deploying nearly all his party funds in Panchayati Raj Institutions (PRI), under the state budget 2020-21. This move was combined with the transfer of key assets to PRI's. Mohanty (2020), explains this phenomenon numerically. For instance, in 2019-20, 853 *Zilla Parishads* (district councils), were given 23.5 crores in the form of grants from the Central and State Finance Commission. In 2020-21, this amount would grow 13 times to almost 315 crores. This move, also called the PRI empowerment plan, has gathered immense criticism from the political rival Congress party who

[49] These Acts were enacted as the Constitution (73rd Amendment) Act, 1992 on April 24, 1993 and the Constitution (74th Amendment) Act, 1992 on June 1, 1993

[50] He is the current Chief minister of the state of Odisha (since 2000)

has alleged that the next election between Congress and BJD will be between black money and the Congress (Mohanty, 2020).

6.5.2 Liberalisation was not 'Market Friendly' but instead 'Business Friendly'

Several authors have contended that the widely held date for opening up of Indian markets from 1991 is contrary to fact, as growth in the period prior to this decade exceeded the growth during the period subsequent to big bang liberalisation (Delong, 2001; Williamson and Zagha, 2002; Rodrik; Dani and Subramania; Arvind, 2005; Kohli, 2006). This growth was a result of policy initiatives resulting in public issues by corporate entities and the opening up of several sectors of the economy to the private sector. During this period, growth can largely be attributed to a close nexus between some business families and the political party in power. An example of this is the astonishing growth of the biggest business group in India, the *Ambanis*. It was reported that Reliance Industries headed by Dhirubhai Ambani grew at a staggering 1,100 per cent (Piramal, 1996). Another sector, which grew during this period was the IT sector, due to the twin factors of non-interference by the government and zero tax on foreign income (Guha-Khasnobis, Kanbur and Ostrom, 2005). During this period, a symbiotic relationship was set up between some business families and the political party in power, resulting in a series of policy initiatives that benefitted these families in the coming decades.

Liberalisation resulted in the growth of the economy and the setting up of large infrastructure and capital-intensive projects. This period was also marked by rapid growth in the software and services industry in India, which earned large amounts of foreign exchange and was marked by 100 per cent tax exemption of foreign income (Bhatnagar, 2006). This phase was characterized by the emergence of several new entrepreneurs and traders, who started investing in manufacturing and other capital-intensive businesses, taking advantage of bank finance and institutional support provided by the government. The rapid growth of the economy also resulted in a large requirement of unaccounted funds or black money. According to a CA in Delhi (personal communication, December 12, 2017), "*Post liberalization in India, new projects were set up by entrepreneurs and businessmen. For the purpose of the balance sheet of the enterprise,* *their contribution, had to be in white and accounted for money. The requirement for black money was acute due to the structure of the Indian economy. Individuals and corporate entities with white money were forced to convert white money to black money*". Those who had white money as the only stream of income, which was completely accounted for required black money for 'Speed money', convenience expenses, getting sanction and permission from various government departments. These entities turned to their consultants and chartered accountants to meet this requirement for black money. Thus, a network of chartered accountants and financial operators in the grey areas of the economy was born; and has since transformed into an effective infrastructural instrument for constant conversion of money from black to white and white to black using a network of shell companies.

The rampant corruption in most major growth sectors in India such as real estate, infrastructure, education and agriculture has created a need for major players in these sectors to stock unaccounted funds for meeting the demands for pay-offs at various stages of the business cycle (Riley and Roy, 2016). On their part, the players indulge in corruption by exploiting the anarchic system in dealing with their buyers, who are unaware of the intricacies of these transactions and associated costs. For instance, due to high stamp duties (Alm, Annez and Modi, 2004) and long-term capital gains tax (Sarien and Chawla, 1963), both buyers and sellers have an intrinsic benefit in underreporting the value of the property. and Thus, they prefer to carry out the transaction, in cash at least in part if not fully. These transactions create and meet the demand for black/unaccounted money of the builders who use this cash to buy favour in various stages of the real estate construction process.

6.5.3. Distrust in Government

The interviews with players in different sectors of the economy revealed a recurrent theme of distrust in both the stability of the government and the role of officials. HNI and business families in India have an inherent distrust in government and do not want all their assets to be visible. Through my interviews and informal discussions during my fieldwork in India, I discovered that these entities work on an asset diversification approach by keeping some assets hidden from the prying eyes of the government. Such assets are kept, both; in India and abroad. This provides them with a sense of security as through this approach, they set aside a nest egg to meet uncertainties of the future. The financial efficiency of assets is secondary in this case and anonymity and security is predominant for this purpose. Large amounts of money are converted from white to black and siphoned abroad to tax havens or parked locally (as I have discussed in the previous chapter).

This sense of insecurity has been compounded by erratic government policies in the name of the common good. Political parties who hold the reins of power have amended the Constitution 104 times since it was first enacted in 1950 (Singh, 2020). The effects of these constitutional amendments included dilutions of property rights and the breaking of sovereign promises made to erstwhile rulers. These amendments have been accompanied by incessant structural changes in the Indian economy, such as the sudden nationalisation of banks under the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969. In rural India, land ceiling limits were imposed under the land ceiling legislation in 1972, resulting in insecurity and loss to large landowners. The 44th Constitutional Amendment led to a substantial erosion of the right to property (Singh, 2020). This earlier fundamental right was reduced to Article 300A, which merely prevents the state from alienating anyone's property except by *due process of law* (Sankaranayayanan, 2011). More importantly, the abolition of privy purses in 1971 and the demonetisation of 1978, were put forth as examples by leading business and finance experts during the interviews I conducted, as examples of the propensity of the Indian State to intervene in holding of private wealth in the name of socialism. Jyoti Trehan (2003) traces India's historical link to the global value chain associated with money laundering. Prior to independence, the motivations to siphon money abroad were similar to those today i.e. a distrust of the government and an environment of insecurity pertaining to the future of the economy. While in the 1930s and 1940s, unsure of the future of the country post-independence, Indian royalty and wealthy businessmen transferred money abroad, the volume of these funds greatly increased in the 1960s, right after the abolition of privy purses and the of nationalisation of commercial banks (Trehan, 2003).

6.5.4. Technology

Economic liberalisation was initiated in 1991. This coincidently was synchronised with the growth of the IT and software industry, rapid infrastructure development, urbanization, scaling up of industries due to removal of limits that impaired it by *License-permit Raj* and most importantly, a lower tax regime (Pedersen, 2000; Delong, 2001). The Indian economy underwent a series of reforms in the 1990s and 2000s which led to the reduction of import tariffs to almost zero. The Indian economy adopted global best practices like intellectual property protection, venture capital, permissions for foreign ownership, stock market listing and telecommunications. The challenges faced by major industries under the planned economy soon lost traction. Furthermore, a major development; converging with these policy changes, was the growth in information technology, particularly the Internet. The rise of the internet led to a steep decline in data storage and transmission costs (Dossani, 2005).

Growth in information technology has made it possible to spread large transactions instantly into smaller transactions, and implement a two-way system of entries and contra entries through a network of chartered accountants and entry operators. The system has become so well networked due to the internet and standard accounting practices that white or black money can be instantly laundered or delaundered, with very little waiting time. CA's have pending transactions of their clients i.e. open balances of borrowing or lending which they constantly utilise for balancing entries from entry operators to absorb or release white or black money. This intensive availability of technology also allows hawala operations to be closely correlated, wherever needed.

6.6 Sectoral Examples: Need for black money resulting in a systemic need for De-laundering in the Indian economy

In this section, I take five specific sectoral examples from different sectors of the economy, to better illustrate their respective need for generating black money and thus the need for de-laundering. These sectoral studies, with varied economic ramifications, serve as representative examples to better understand the role played in the economy and the need for de-laundering. The research presented here purposively covers the real estate sector, infrastructure sector, and the education sector. With their different trajectories, each of these sectors represent the reality of black money and money laundering, despite being subject to different state policies, tax regimes as well as administrative regulations. I investigate these directions through juxtaposition or placing side by side, rather than systematic comparative research which would involve matching like for like.

My understanding of unofficial dealings and negotiations between different stakeholders related to real estate, infrastructure, non-profit entities related to education, health and religion is a product of reaching out to key players and leaders in the related segments of the economy. I have interviewed a range of accountants, politicians, land bankers, industrial commercial and residential private infrastructure developers, and lawyers practising in these areas. I have conducted repeat interviews when possible in order to garner trust among my interviewees. I prepared myself thoroughly with the available literature on the subject, before I sought appointments and spent time with key players in the various sectors. Given the sensitivity of the data, most interviewees opened up on the condition of anonymity, particularly vis a vis the specific inputs given by them.

6.6.1 Case I Private Sector Infrastructure Project: Hydroelectric power Plant

In 1991, the Indian power sector was opened to private participation (D 'Sa, Murthy and Reddy, 1999). This move transformed the state-operated, vertically integrated monopoly into a multi-player market-driven sector, which presented attractive opportunities for entrepreneurs to invest in the power sector (Swain, Singh and Kumar, 2004). These reforms were implemented by amending the India Electricity Act, 1940; and the Electricity Supply Act, 1948, to allow entry to private players in the power sector. Thus, private power sector infrastructure projects came about with the 1991 liberalisation of the economy; when in 1991 private players were invited by the Central Government to participate in the generation, transmission, and distribution of power, under a license from the state government.

I am taking the example of a hydroelectric power project in the private sector because this represents a case where humongous amounts of black money is needed at all stages of the project life cycle, while the revenue is exclusively in white from power purchase agreements. I consider the main inflexion points in the life cycle of the project. Private power sector infrastructure projects became possible when in 1991, private players were invited by the Central Government to participate in the generation, transmission and distribution of power under license from the state government. This was done by amending the India Electricity Act 1940 and the Electricity Supply Act 1948 to allow private players to enter the sector. The following may be considered to be the stages in the life cycle of a hydropower project :

1. Pre-Bid invitation
2. Bid invitation
3. PPA negotiation
4. Raising funds and EPC contractor
5. Taking charge of the project and running the same for the agreement period.

Stage I- Pre-Bid invitation

The first step in initiating the project is an invitation by the state government to private players to consider their suitability for granting license for setting up of a hydroelectric power project of say, 100 megawatts capacity. The authority may initiate the project by floating the idea, by way of informal discussion through individual or group meetings with private investors, that the state is thinking of announcing bid invitations for a license. It is also possible that private players who seek such licenses may themselves initiate a discussion with the authorities. In either case, much bargaining happens behind the scenes and the bid document is so prepared that it favours certain bidders, who at this pre-invitation stage itself have made arrangements with authorities to push the deal i.e. the license their way.

A considerable amount of black money is needed to affect such influence. An interview with a financial consultant (personal communication, February 12, 2018) working with large corporations who had participated in such transactions indicated that the initial cost of obtaining the license went up from Rs 1 lakh per MW in 1991 to Rs 15 lakh per MW in 2010, before investors lost interest in these projects, due to high cost of delays, particularly because of roadblocks to environmental clearances. Several businessmen lost large amounts in securing licenses. The pre-bid stage resulted in an agreement between state authorities and promoters on cost per MW that was to be paid on delivery of license. All these transactions are carried out through black money.

Stage 2 – Bid Invitation

This is the stage of formal advertised invitation of interest and processing of received expressions of interest from private parties. At this stage, there is a commitment charge that needs to be met by the private party with whom authorities have reached an agreement to issue the license. This meant that for a 100-Megawatt power project the applicant had to pay upfront Rs. 15 crores for the privilege of obtaining the licenses, as all this money was by way of unofficial payment/bribes. In case the promoter bidder did not have black money, he had to resort to the services of chartered accountants to convert white money to black by purchasing entries. That is, for a small transaction fee, white money would be deposited in the accounts of the company indicated by the accountant/consultant; and in return, that entity would provide equivalent cash to the promoter depositors as unaccounted money in cash. This cash can then be used by the promoter to meet its commitments towards obtaining the license. Typically, these commitments were made to the chief minister of the respective state.

Stage 3- Power Purchase Agreement negotiation

Once the private entity has the license, it can negotiate with the PTC (Power Trading Corporation), a public sector company, for the power purchase agreement. The PTC has been signing power-trading agreements based on levelled tariff per megawatt for the next fifteen years. For obtaining the PPA kickbacks must be provided to the bosses of the central government in the power ministry that controls PTC and PTC officials. This too is based on the megawatt value of the license and must be arranged as black money to be paid as bribes; payable to specified persons at specified locations through *hawala*. An interview with a finance professional revealed "*A wad of money changing hands between the receiver and the entrepreneur/businessman is a figment of television serials and movies; it does not happen in cases of large transactions such as these*" What actually happens is that entities are nominated in India or abroad and money is deposited with these entities. Sometimes, there are religious institutions, non-governmental social organisations or offshore accounts.

Stage 4 – Raising Funds and award of EPC contract

The PPA, once in the hands of the licensee entrepreneur, makes the project bankable as it represents a government booked failure cash stream for the project. The bank issues a comfort letter promising to advance loan to the project once it is ready. At this stage, the bank officials need to be taken care of and again black money is needed against the future projected cash flows on the strength of the PPA with PTC.

An EPC (Engineering Procurement and Construction) contractor is identified and assigned the project based on the banks comfort letter, showing a willingness to finance the project, once ready.

The bank addresses the comfort letter to the EPC contractor. The EPC contractor in connivance with the promoter over invoices the project. With this comfort letter and contract, the EPC contractor activates his own line of funding from the most attractive sources globally to implement the project on a turnkey basis. The contractor in turn is expected to pay a predetermined amount at different stages of the contract to the promoter by way of kickbacks. These amounts are used for political relationship management and for buying back i.e. reversing book entries incurred earlier to generate black money (to pay for the licenses) and squaring the accounts. Thus, by the time the project finally starts only public money by way of banks loan is involved in the project. The entrepreneur has already recovered his investment along with some profit and everybody involved from politician, bureaucrat, banker have made their pot of gold.

Other costs during project execution:

Putting up of the actual project needs large tracts of land and displacement of population and rehabilitation of the same. At this stage, many vested interests spring up in the name of 'citizen groups', threatening to stall the project and demand funds and favours. All these need to be politically managed by promises of subcontracts and funds. Considerable black money is needed for this, besides the official resettlement cost incorporated in the project and deposited with the government for the same purpose.

The EPC contractor, during the erection of the project, as well as during its completion, needs all kinds of approvals and sanctions All these need to be obtained from various authorities and require kickbacks. These kickbacks are met by the EPC contractor by creating its own war-chest of black money.

Once the project is handed over by the EPC contractor, the bank foots the bill for the EPC contract as a loan towards the promoters. At this stage, the bank officials too need to appeased.

Stage 5 - Taking charge of the project and execution of the same for the agreement period

Once the project is up and running it generates saleable power, which is delivered by way of transmission lines, and billing for the same generates revenue. Now, another set of problems for the project managers raise their head in such projects. If the project needs a staff of, say, 100 persons, there is political pressure on the management to employ many more. As this would lead to long term financial commitments in terms of pensions and benefits to employees besides inefficiencies, such employees are taken on the rolls on a contractual basis and are basically political workers of the local political leaders such as the Member of Parliament (MLA). All this money; though paid officially is paid for workers who are doing nothing for the company. So, in a way, it is laundered at the source. This practice is rampant all over India. What is interesting to note is that the main component of the investment of the entrepreneur is this black money that he brings to the table; as everything else is bank financed. To reverse the entries made at the beginning of the project for obtaining black money against white money deposited through finance professionals or accountants, the revenue stream of the project is burdened with false billing or ghost employees to generate black money. This black money is deposited in the account of the entity, which forwarded the original black money to the entity against a deposit. Now, the entity which was holding a deposit from the promoter on its account returns the money and reverses the entry. This completes one cycle of generation of black money and returning the same, backed by a credit entry in a reported account. During the operation of the PPA and the project there remains a constant need for generating black money for meeting expenses towards what can best be termed as meeting nuisance value. This could be in the name of public and pressure groups or a result of political rivalry around the site of the project.

Thus, post-liberalisation, I find that despite a rise in the setting up of large projects in the infrastructure sector, the sector continues to follow the traditional Indian model of the pre-reform *licence-permit raj.* The practice of funding businesses with public money with zero or little investment of the entrepreneur by the time the project goes on stream continues till date. It is also clear from this example that corruption enables and drives the project and is not a direct hindrance. But for corruption, enabling the entrepreneur/promoter to set up the project at no cost, there would be no interest in pushing for the project. I conclude that even after liberalisation, there is a lack of a level playing field for promoters and entrepreneurs to enter the infrastructure business. State policies in awarding licenses perpetuate 'the triad' i.e. the political-businessman-bureaucrat nexus in India.

6.6.2 Case II Real Estate Project

The number of primary players in the real estate sector have substantially increased in the last few decades (Morris, 2010). The primary players not only include the contractors, builders and developers but also include the investors and consultancy firms in the real estate sector. These investors in real estate projects could be traders or speculators, outright buyers, project financiers, real estate funds, property agents, brokers, underwriters and real estate investment trusts. The consultancy firms in the real estate sector could include players working as project managers, property managers or Consultants providing technical expertise about the real estate project to a builder-developer or owner.

Large-scale urbanisation has created an increasing demand for the real estate sector, both for housing and urban infrastructure in India. It is estimated that at the present rate of growth (2 per cent annually) the real estate market size is expected to reach US $180 billion by 2020; and more than 850 million people will inhabit Indian cities by the year 2050 (CBDT, 2012). As per the United Nations, India has the highest rate of change in the urban population among the emerging market economies, particularly the BRIC nations. This increasing urban population is leading to the large-scale conversion of agricultural land for the construction of residential and commercial buildings. Towns and cities in close proximity to financial centres (such as Delhi and Mumbai) have seen a rampant increase in land rates owing to the conversion of agricultural tracts for the creation of urban dwellings. Prime examples of these include cities like Ghaziabad, Navi Mumbai, Chinchwad, Zirakpur, Mani Majra, Noida, Sohna and Gurgaon. This has given rise to the business of 'Land Aggregation', and the creation of land banks by real estate dealers through front companies.

The real estate sector also employs a significant portion of the Indian working population (both migrant rural and urban) due to its backward and forward linkages to other sectors mainly housing and construction & their ancillary industries such as cement, steel, brick and building material. As per a survey conducted by the consultancy firm KPMG, about 32 per cent of respondents voted the real estate sector as the most corrupt sector in India. When I cited this number to the builders I interviewed during my fieldwork in Navi Mumbai, more than 90 per cent of them were underwhelmed by the percentage. They believe the percentage to be much higher owing to multiple approval requirements from various agencies at different stages of a construction project (see next section for stages).

During my interviews, a property developer in Navi Mumbai told me that his work required him to collect more than 50 approvals to start constructing a property (personal communication, August 27, 2017). Technically i.e. as per declared government policy, these approvals can be sought within a period of three to four months. In practice though, they can take anywhere between 1-4 years and add more than 20 per cent to the project cost (personal communication, August 27, 2017).

There are various stages in the pre-construction phase of a real estate project in India. These include site investigation and soil testing, the appointment of the architect, preparation of the plan and design finalisation. More importantly, these also include obtaining certain clearances from various Municipal Corporations such as sanction of a plan by the municipality concerned and development of a project execution plan. For obtaining all their clearances, black money is needed to be paid to the authorities (personal communication, August 5, 2017).

6.6.2.1 The Affinity of the Real Estate Sector for absorption & demand of Unaccounted Income

The real estate sector has been identified as a prime sector for the generation and investment of unaccounted funds by a report commissioned by the Finance Ministry under the Central Board of Direct Taxes (CBDT) in 2012, in order to identify illicit financial flows from India and abroad. According to this report, real estate is the most suitable asset for the investment of black money, owing to its flexible valuation process, which makes it an ideal vehicle for storing unaccounted or black money in India (CBDT, 2012). The report further observes,

"The availability of urban centres and developed areas critically depends on the policy of the government, as the change of land use and development of infrastructure is largely in its hands. If resources are concentrated on developing infrastructure in select areas, then development accentuates land and property prices in these areas. A master plan of an urban agglomeration is many a time found to be changed and rechanged again. The more developed parts exert a pull on the less developed parts and infuse a push in prices. Such change is at a 'cost' to the developer and paid from the black component of his business" (CBDT, 2012, p. 8). This view is further corroborated by the number of cases registered with the investigative division of the Income Tax Department over the last decade. The real estate sector has recorded the highest number of cases filed under the laws for discovery of black money, tax evasion and money laundering (Ministry of Finance, 2012).

The need for black money in real estate development can be examined through costs that need to be incurred during the life cycle of a real estate project. These include:-

a. Land Notification and De-notification for purpose of development
b. Land Acquisition for purpose of development
c. Pre-Launch
d. Construction Phase and Project Launch
e. Completion and Delivery Phase

Stage 1. Land Notification and De-notification

Under this stage, politicians and officials involved in the decision to notify land for acquisition can pre-acquire land through relatives and dummy entities before such acquisition orders are issued. Once orders are issued that the land is eligible for substantial compensation, those who knew about it stand to claim considerable amounts by way of compensation. Politicians also de-notify lands identified for acquisition in exchange for bribes from builders and developers. Several former Chief Ministers of Karnataka have land notification and denotification cases filed against them. One such instance in Bangalore cost the Karnataka state exchequer around Rs. 5 billion. Even builders testify to the presence of black money and bribes in real estate in India. "This country is rated to be one of the most corrupt nations of the world... the real estate sector is rated to be the biggest contributor to this notoriety," says a report by the Confederation of Real Estate Developers' Associations of India (CREDAI) (The Economic Times, 2016).

Stage 2. Land Acquisition

In the case of outright purchase of land as per Indian laws, the purchaser must pay stamp duty and registration expenses. To avoid this significant outflow at the onset of the project, the Builders and developers often draw up a Development Agreement (DA) with a landowner who dictates that the owner of the land will transfer his interest in the land to the developer or a Nominee in consideration of the owners share in the flat constructed by the developer in order to avoid paying the expenses mentioned earlier. In legal terms, the land can directly be transferred in the name of the purchaser of the property without requiring payment of stamp duty, as well as legal formalities in the transfer of ownership (Ranganathan, 2017).

Similarly, in all other phases, black money is required. Black money is generated by the builder at each stage by selling flats and units with a black and white component. The black component can be as high as 40 per cent.

Stage 3. Obtaining various clearances and permissions from various authorities to apply for sanctioning of plan

Multiple authorities need to provide clearances before a project can be started and all of them need to be incentivised by payments in black money in proportion to the size of the project. All this requires packets of black money at regular intervals.

Stage 4. Construction Phase

In this phase, the builder sells most of the units and finances his construction from sale proceeds. Construction costs are overstated to provide for the black money that is needed in all the phases and any surplus is often used to book more land for the next project. In an interview conducted in Navi Mumbai, a real estate developer responded to my question on the presence of black money in the real estate sector with the following remark, "*we regularly require large amounts of black money to pay for various clearances and permissions. In the life cycle of a project, there are an ungodly amount of hurdles. At every hurdle, we need to grease the wheels of the machinery and for this, we require large amounts of black money. In fact, the common practice for most real estate agents is to take at least half of the payment in cash or black money, as you people call it. This black money is essential for our survival and completion of projects. On an average, we require 30-50 clearances per project. There have been cases where projects have refused to take off and drag on for years when clearances are not obtained in a timely manner. After 21 years in this business, I have a structure in place to tackle these issues. Nevertheless, when dealing with the government, you can never be too prepared"* (personal communication, August 19, 2017). Several other real estate agents, builders and chartered accountants with clients in the real estate sector reiterated a similar viewpoint.

Stage 5. Completion and Delivery Phase

As per the builders I interviewed, even at this stage, several formalities including completion certificate, fire safety etc. are needed. Even delivery to the end-user involves registration of ownership of the unit with the registrar's office. It is safe to assume that for each service that the state delivers, black money is needed as per the builders.

6.6.3 Case III Highway Sector: Yamuna Expressway Delhi-Agra

In this section, I examine a well-documented and judicially reported highway sector project in the PPP (Private Public Partnership) model. In 2003, the Mayawati government decided to develop Agra to international standards by initiating two projects; the Taj corridor project and the Yamuna expressway which was proposed to connect NCR-Delhi to Agra starting in Noida. The entire highway was to be developed as a greenfield project in the state of UP. The Taj corridor project ran into controversy right in the beginning. Since then, Mayawati and her relatives have had to face corruption cases for unaccounted wealth (Tripathy, 2011). The Yamuna expressway was inaugurated in 2012, after several changes of government when Akhilesh Yadav was chief minister. The project was executed mostly during the government of Mayawati when she came back to power. The project was delayed due to land acquisition related litigation for more than two years, missing its original date of completion in 2009. Mayawati was accused of political favouritism in awarding the project to the Jayaprakash group, who set up a SPV (Special purpose vehicle) to set up the project in the name of Jaypee Infratech. Mayawati was severely criticised in the public domain for awarding five parcels of land, in different cities along the 165 kilometer route of the proposed highway, at practically zero cost to Jaypee Infratech in lieu ofa promise for developming housing and other projects to enhance the value of the land in the region.

The project was envisaged as a Public Private Partnership (PPP) project and under the PPP model, tenders were floated which had no mentions of the subsequently allotted land parcels. Furthermore, the Jaypee group which was a known favourite of the CM Mayawati was given a right to collect toll tax for a period of thirty years on the expressway once completed (Achom, 2019). This right awarded by the state government to collect toll tax by Jaypee Infratech made the project bankable. Jaypee Infratech raised funds from the public through equity and banks through loans to fund the project. The project cost was a total of 12000 crores (Zanane, 2012). It may be noted that one of the main raw material going into the construction was cement and

Jayaprakash group was one of the largest cement producers in North India. Thus, he would benefit greatly from the captive demand for the cement and infrastructure development for the five parcels of real estate awarded to them. In one of the parcels, a Formula One car racing circuit was made by the Jayaprakash group (Rajput, 2019). Figure 6.2 shows the relationships between different players in this project and the need and generation of black money. The fact that huge amounts of black money was generated from this project can be confirmed from several legal cases of corruption that were filed related to this project against the CM Mayawati and concerned bureaucrats. I briefly discuss some of these.

1. Garland Controversy

In 2010, the then Chief Minister of Uttar Pradesh (India's most populous state), faced immense public criticism over a massive Rs.1000 note garland, presented to her during a political rally in Lucknow to commemorate 25 years of her party, the BSP. An iconic leader of the Dalits or (formerly called "Untouchables") caste in India. Mayawati's garland, weighing 65 kg and measuring 30 feet in length, kicked up a huge political storm in the Parliament. The rival Congress Party criticised this outright display of opulence and demanded a Central Bureau of Investigation (CBI) Inquiry in the matter. Digvijay Singh, a prominent BJP politician also criticised her distasteful conduct and blatant display of wealth. He said that she was no longer a daughter of the impoverished Dalits but a daughter of wealth (Thakur, 2010). Mayawati, unperturbed by such criticism accepted a similar garland, just two days after this incident. An officer of the income tax department probed the multicore rupee note garland that Mayawati displayed. The giant garland was estimated to be worth between 22. 5 crores, consisting of 1000-rupee notes sewed together (Outlook India, 2010). As per some political analysts, her adoring party workers and impoverished followers admire her blatant display of opulence to them as it signifies a rise in the collective power of Dalits as a community (The Hindu, 2010).

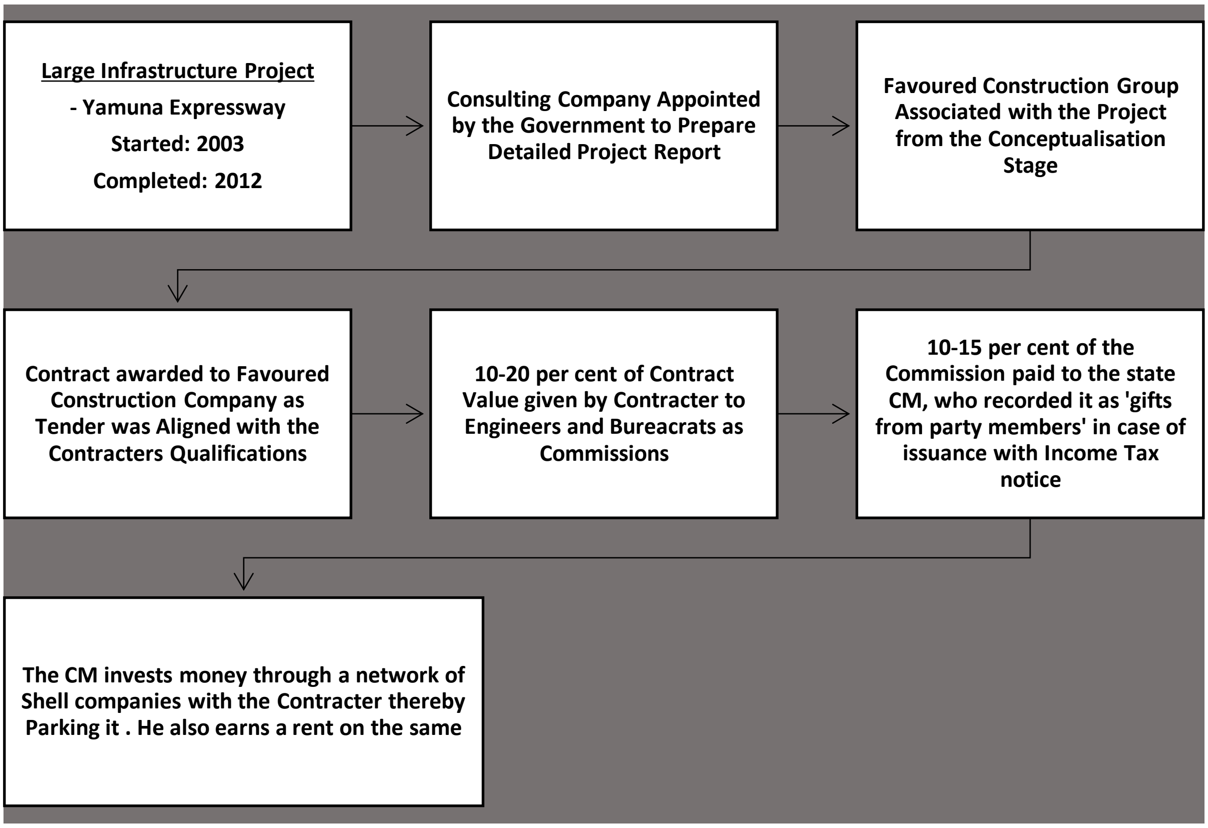

Figure 6. 2 *Need for Black Money in an Infrastructure Project*

2. CBI probe into Yamuna expressway scam against CEO and 20 others

In 2014, the CBI conducted an enquiry of Rs 84.49 crores against the acquisition of 57.15 acres of land in seven villages along the Yamuna expressway. The police alleged that the CEO Mr. Gupta entered into a criminal conspiracy with his associates and family members to purchase the land from farmers at a cheaper rate and then take advantage of land acquisition to seek higher compensation (Rajput, 2019)

3. Yamuna Expressway under CAG enquiry

In December 2019, the CAG (Comptroller and Auditor General) enquired into financial anomalies between the land acquisition rate paid by the state and the rate at which the land was sold to the private builders. Several senior bureaucrats were transferred as a result of this enquiry. The allegation was that Jayprakash Group had been allotted land at a rate much less than the officially determined amount. In fact, subsequent to the allotment of land parcels to the Jayaprakash Group, 1000 acres was repossessed by YEIDA (Yamuna Expressway Industrial Development Authority.

6.6.4 Case IV Educational Institution: as a Non-Profit Organisation (NPO)

Over the last two decades, many large corporate houses in India have set up large institutional entities in three areas. These are education, healthcare and religious institutions (Aithal and Kumar, 2016). Barring few exceptions, all these entities are run as profit centres. The discussion below is focused on education and also healthcare, as in most of the healthcare institutions of these large business groups, education is also imparted at one level or another.

The Indian education system is currently the second largest in the world (after China) (Panjwani, 2014). Historically, education has been a priority sector for the country, with the government and non-profit sector (NPO) sector being the primary providers of the same. The legislative framework in India classifies the formal education sector as a 'charitable activity', covered under the concurrent list of the Indian constitution (Rajkhowa, 2017). However, this position has seen a major paradigm shift in the last 25-30 years, as accelerated economic growth coupled with the rise of India as a knowledge-based economy has led to expansion in job opportunities. This has led to heightened demand for quality education, especially in the higher education sector. As per the All India data on private final consumption expenditure, the rate of growth on education expenditure is higher than private final consumption expenditure, in totality (Kumar and Pant, 2014). This is suggestive of the premium Indians place on education and indicated their willingness and ability to spend large amounts of money for the same.

These trends have led to the emergence of the Indian education sector as a major investment destination for private players in the economy. As a consequence, the private sector has grown substantially in higher and technical education sectors. This is apparent from the mushrooming of several new private universities and deemed universities (about 130 approximately) in recent years (Kumar and Pant, 2014). A report by KPMG (2011,) acknowledges that the expansion in higher education in India in the last two decades has been spearheaded by the private sector. As per the report, the private sector accounts for more than 33 per cent of overall enrolment; with almost 80 per cent of enrolment in vocational education. Despite these developments, the MHRD (Ministry of Human Resource Development) announced in their annual report 2010-11, that the gross enrolment ratio in higher education in India remained below 15 per cent. In order to fulfil the obligations of the government under the Right to Education (RTE) programme to bring the enrolment rate to 30 per cent, there was a need to set up at least 40,000 more colleges in India. This highlights the need for the emergence of an unregulated and non-formal private education segment in the education sector to secure higher education for the major demographic dividend in India. Thus, the once predominantly state-funded sector, higher education in India has now seen the emergence of a large number of private players. According to Ernst & Young (2011), as of 2006, the unaided private sector participation in higher education constitutes over 52 per cent of total enrolment in the Indian higher education sector. Thus, there has been an increasing demand for educational institutions in India, which has seen unprecedented urbanisation since liberalisation. Also, the Indian state realised that it did not have adequate resources and allowed private players to come into the sector particularly in the field of higher education, which was close to private players in most states of the countries. Hence, most states passed private university bills, which enabled them to give permissions to private players to start educational institutions. Land rates were fixed at a substantial discount to commercial rates for such private universities. The private entity setting up the university did so with two specific motivations. Firstly, the university was expected to be a venture to generate funds and give returns to the person starting the university. However, these expectations of return were circumscribed by the fact that all educational institutions in India are legally required to be non-profit organisations. Under Section 2(15) of the Income Tax Act, the term 'charitable purpose' is inclusive of the activities of the education sector. Thus, this law provides the entities involved in educational activities the provision of exemption from income tax. This exemption is subject to certain approvals and conditions outlined in Section 10(23C) and Section 12AA such as the condition that the entity has to apply 85 per cent of its income to educational activities. Entities are very ingenious in making sure their accounts reflect this, no matter what their actual activities constitute. Thus, perforce any desire to generate benefit or profit had to be done by creating mechanisms of generating unaccounted money. Also, the university contracts out several services including those of health services, catering in which the management keeps its own share in the form of unaccounted returns in cash.

Despite being regulated by both the state and central legal framework, there is a significant unregulated segment in this sector, operating in the form of 'tuition centres', special coaching institutes for competitive entrance exams, pre-schools and vocational training institutes from almost every small town to major city across India. As per a report titled 'Private and Foreign Participation in Higher Education' by PWC (2010), the unregulated activities in the education sector, there are a large number of lucrative opportunities for providing various educational services such as coaching for entrance exams, vocational training and skill enhancement under a Public Private Partnership (PPP) arrangement. The persistently high demand for seats in these institutes owing to India's young demographic make these institutes lucrative profit-making ventures but are not subject to regulation. Thus, the education sector in India can be classified into two sectors; the regulated sector and the unregulated sector. The regulated sector in India includes schools and higher educational institutes, which include technical, non-technical and medical higher education.

A useful step in curbing this trend might be to provide a more distinct definition of the phrase 'charitable purpose' within the definition of education given the paradigm shift this sector has witnessed in the last two decades. Such educational institutions are created and operated to generate black money for the promoter group. These institutions are created as independent corporate entities using the provisions of the income tax act, societies act or company law. Under the Income Tax Act, entities so created can apply for tax exemption for their income. The income of registered societies, companies or trusts are exempt from income tax, as far as they use their income for meeting the objectives of their corporate entity.

Once these income tax exemptions are obtained, the licenses for setting up the educational institution are applied for by the government. Then, the land is procured through the government at concessional rates. Funding is provided to the entity by way of donations helping the corporate group meet the requirements of their CSR responsibility. Secondly, through advances made to the institution by the promoting the business group and once the institution is set up and operational, a regular cash stream of unaccounted money by way of capitation fees and charges towards miscellaneous activities is created. The education sector is perhaps the most lucrative business in India as the rate of failure is minimum and the rate of return is assured due to the large population and the premium it pays to education.

The entire management of the institution rests with a management body, consisting of prominent social figures, mostly retired bureaucrats, army officers and friends of the corporate promoter. The control on funding and finances is exercised through mid-level managers and accountants of the non-profit entity, who report and work directly for the beneficial promoters. Thus, the entire institution effectively becomes a generator for large amounts of black money, which may be against false billing, conversion of debts forwarded to the non-profit entity through false billing and capitation fees.

6.6.4.1 Inflating regular Expenses

A common malpractice in private education institutes in India is inflating regular expenses. To this end, the management responsible for the trust of the institution have found innovative mechanisms to carry out the same. This mechanism involves, firstly creating a private limited company that owns the land and constructs the building of the institute. Then, this land is leased on a commercial basis to the school management who are responsible for the daily affairs of the institution. Another common practice at this stage is for the school to sign a contract with a private company that would be responsible for the day-to-day running of the school, under the terms of the contract. The company would be entitled to a share in the fees earned by the school and would provide the necessary capital, workforce and technical equipment, as and when required by the school.

In the last three decades, many distinguished private schools in metropolitan cities in India, have been established by eminent business houses. Another recent trend that has emerged is the taking over of schools being run by old existing trusts, by new management. Due to this, the ownership and management of the trust change hands. An interview with the treasurer of a national party who is also a private investor revealed that, "*In order to complete this process, black money is required, as this transaction is largely unreported in order to avoid tax liability. Often, this transaction would be carried out mostly in cash.* (personal communication, November 17, 2017).

Reverse entries or advances given can be easily made by showing donations from miscellaneous persons of small denominations to the entity and paying itself back by reversing the loan entry. Thus, an entire system of laundering and de-laundering becomes captive under the promoter business group.

6.7 Conclusion

Laundering and De-laundering have become an essential feature of the Indian economic system. The book entry system which facilitates the movement of funds works both ways and thus aids in supporting the cyclical nature of laundering and delaundeering. While liberalisation is not the reason for this unique cyclical nature, economic growth has facilitated institutionalisation of the same and has had a huge multiplier effect. Liberalisation opened the Indian economy to new sources of finance capital both from private and foreign investors. To understand the effects of liberalisation on the Indian entrepreneurial process, it helps to visualise these cases individually, as a series of interconnected markets for building-related products and services. Each of these interconnected markets consists of buyers and sellers who have grown over the last thirty years, especially since liberalisation. While I established that mechanisms of money laundering are not a direct consequence of economic liberalisation, it would also not be entirely correct to state that mechanisms of money laundering were facilitated by the opening up of the economy. It would be more accurate to say that liberalisation facilitated the incredible increase in quantum of money supply, number of players and a need for deployment of this money supply. The existing institutions necessitated the laundering of this fresh quantum of money into both black and white money. Thus, liberalisation created a need and increase in the incidence of laundering, as well as de-laundering. The opening up of the economy merely made the mechanisms of laundering an institutional and systemic reality, constantly evolving with the unfolding of increasing level of openness bridging the gap between the formal and informal sector.

The socio-economic structural reality of the Indian economy demonstrates an inherent demand for conversion and laundering of money and re-converting it into unaccounted money i.e. bringing it into the institutional framework and then De-laundering it. With the opening up of the economy to private players and foreign investors, the quantum and velocity of the total money in the system has gone up and therefore the inter-convertibility has gone up. Thus, the Laundering and De-laundering of money has evolved as an economic tool for perpetuation and parking of black money, necessitated by political, administrative and bureaucratic corruption. However, this corruption is institutionalised through political agency. I explore this in the context of election finance in the next chapter (see chapter VII)

Chapter 7

Election Funding in India: Growth and Institutionalisation of Infrastructure for Money Laundering and De-laundering

Chapter VII

Election Funding in India: Growth and Institutionalisation of Infrastructure for Money Laundering and De-laundering

"It is common knowledge that black money is used in elections. In private conversations after elections, when we (Election Commission) cannot do any more harm, politicians tell us what they really spent. We do everything we can to catch them. We keep track of the money flow and have seized crores of rupees during elections in the past. It does act as a deterrent. But they are always ahead of us and find some new modus operandi to circulate the money."

\- SY Quraishi, Chief Election Commissioner

7.0 Introduction

This chapter analyses the contours of electoral funding in India, and its propensity for absorbing large amounts of black money. Money is needed regularly for managing and running political parties and for funding specific elections. This incessant need for funding is the foremost cause, as identified in this study, for the continued resilience of indigenous, as well as contemporary money laundering and de-laundering mechanisms. Given that politicians are the prime beneficiary of mechanisms that facilitate laundering and de-laundering of huge amounts of money, it is not surprising that till the formation of the Special Investigation Team (SIT on Black money) , there was little political will to tackle the twin issues of black money and money laundering in India.

In order to analyse this lack of political will, as well as establish the causal relationship between election funding and money laundering-de-laundering mechanisms, I examine the role of money in election finance in India. Additionally, I examine the sources of electoral funding as well as players that facilitate the generation and absorption, as well as the further investment of these funds.

The remainder of the paper is organised as follows: In the next section, I begin by analysing the rising cost of elections and the major sources of election funding in India, as well as the drivers of election related expenditures; including the shift toward large contributions from corporate groups and its effect on the nature of selection of nature of candidates for electoral politics in India. Evidence suggests that access to money is fast becoming a requirement for those seeking to get a party nomination and, of course, for actually winning elections. I then briefly review the workings of the alleged nexus between politicians and builders, as a primary mechanism of money laundering through illegal election financing. Lastly, I trace the evolution of India's legal framework concerning political party fundraising and expenditures.

My account and analysis of Indian party funding and electoral expenses using and deploying black money, provided in this chapter, is primarily based on confidential interviews with political party functionaries. These interviews are necessarily confidential because they discuss, among other things, activities that are in breach of the laws and rules. The interviewee may/may not be a beneficiary of such operations. Given the necessarily anecdotal character of the evidence of this study, my findings and conclusions must necessarily be taken as somewhat tentative. Despite this, the interviews are significant; painting a picture of a system in which rules placing restrictions on election funding may actually help fuel corruption and illicit finance in Indian elections. Also, they re-affirm my findings regarding money laundering mechanisms in India, i.e. money laundering can be attributed to structural and institutional failure rather than a macroeconomic policy failure.

7.1 Burgeoning cost of Elections in India

With a population of nearly 1.3 billion, Indian general elections are the world's most humongous exercise in democracy (Sahoo, 2018). In the last general elections, 900 million eligible voters went to cast their vote at more than 1 million polling stations across the country. In fact, the 2019 election has been touted as the world's most expensive election, spread over a span of 75 days. As per a widely circulated report by the Delhi based think tank CMS (Centre for Media Studies) titled *Election Expenditure In 2019 Elections*, Rs 55000 crores or $8 billion was spent, out of which the Modi led BJP spent nearly half and returned to power. As per this report, "In 20 years, involving six elections to Lok Sabha between 1998 and 2019, the election expenditure has gone up by around six times from Rs 9,000 crore to around Rs 55,000 crore" (Centre for Media Studies, 2019).

I interviewed Dr Bhaskar Rao, an expert in poll expenditure and author of the highly circulated report by CMS mentioned earlier. When I asked him about the evolution of the rise in election expenditure since independence, he responded by saying, "*There have been significant changes in this aspect. One macro change is the decline of ideologies. The second is that there is no concept of voluntarism. There is nothing like an ideological cadre. Everything related to campaigning is paid for. Broadly there is no party ideology in any national party in India today, none represents any particular ideology which means there is a blurred difference between the political parties. Also, governments themselves want people to depend on them. The main thrust of the government is to appease people for votes by paying them. Earlier, in the first two-three elections, 1950-55, and then in 1963, the contestants were from the ideological ranks. Aside from the professional shift, the number of political parties has increased. Moreover, reputation has decreased but the grip of parties has increased. Parties have become too powerful. After 1962-79 muffle power was working and not money power i.e. booth capturing. Later on, black money become the mainstay of elections. This unaccounted money has entered in 1979 which became a major source of election funds. The black money ratio has gone from 20-25 per cent to 40-4 per cent in party funding as well as campaign expenditure. Please note that party funding and campaign expenses is different. If I remember correctly, the first one to begin the funding of elections as an industrialist was xxx (name anonymised).. Thus, the first batch of political funding by industrialists was in 1967-72*" (Rao, personal communication, May 5, 2018).

It may be noted that besides general elections referred to above, elections are held for Rajya Sabha, State Assemblies, *Panchayat Raj* organisations and Municipal Corporations. It is thus not surprising that the commonly held belief amongst economists, politicians, academicians, regulators and independent observers of Indian politics is that the cost of contesting an election to an Assembly or Parliament seat has become prohibitive for most Indians. The National Commission to Review the Working of the Constitution, chaired by Justice M.N Venkatachaliah had occasion to review the electoral processes and working of political parties in 2002. B.V Kumar, former Director-General Revenue Intelligence is quoted as under: "Unless you have enormous amounts of money, you can't be a candidate. Many of the industrialists don't just give to one party. Like betting on horses, they hedge their bets, favouring the most likely candidate to win the election. That way, the patronage is done. They always want to be on the winning side. So, political funding is very common. Although, there was a law passed during Rajiv Gandhi's time that stipulated that political funding could be made through cheques. But, very few people or organisations use this route*"*. During an interview with the Spokesperson of a political party in India, I asked him to share his views on the rising cost of an election in India. He said, "*It's a very deplorable situation but the cost is rising because politics is no longer motivated by a public service sentiment. Now it has become extremely profit-oriented and there is a very high rate of return in politics as a business. There is a highly organised system of sharing of commissions between MLA's, MP's for projects in the constituency. There are these MP lead schemes where at 20 per cent kickback to the MP, which is an oft respected figure among political circles, the MP becomes primarily beneficiary. So, it's a very lucrative business. You sell your influence for any amount of money. Earlier MPs used to eat quotas for products in short supply like gas and telephone connections which they used to sell to make money. Besides, they have free travel at great government expense which subsidises their operational cost for activities other than politics. They have free or highly subsidised facility for government accommodation and telephone services. In the name of security, they also often get special treatment, otherwise not available to other citizens*". (personal communication, October 27, 2017)

An autonomous body, the Election Commission of India (ECI) is responsible for administering the election process in India. Although Election laws enforced by the ECI place a ceiling of Rs. 40 lakhs for election to Parliamentary seats, and from amounts ranging from Rs 8-16 lakh for Assembly seats; however, these amounts are widely acknowledged to be farcical. Minhaz Merchant (2012) observes that:

"In the five recent state assembly elections, the Congress and the BJP together fielded over one thousand candidates. According to the Election Commission's unofficial estimates, the average campaign expenditure of the candidate is between Rs 2.5 crore and Rs 5 crore for an Assembly Constituency (official EC cap: Rs 2.5 lakh) and between Rs. 5 crore and Rs 20 crore for a Lok Sabha constituency (official EC cap: Rs 40 lakh). Take the lower end of the EC's estimate of Rs 2.50 crore per Vidhan Sabha candidate. The thousand-plus BJP and Congress candidates thus spent an estimated Rs. 2,500 crores in the space of two months during the five assembly elections this year. The money spent by smaller parties – the BSP, SP and SAD – would take the cash that washed through the electoral system between January and March 2012 to more than Rs 4,000 crore. Add organisational and logistical expenses, and the total annual cost of running a political party like the Congress or the BJP would be well over Rs 5,000 crore each – 10 times the declared expenditure in their audited balance sheets."

The National Commission to Review the Working of the Constitution, chaired by Justice M.N Venkatachaliah had occasion to review the electoral processes and working of political parties in 2002. The foremost problem area identified by it was the high cost of elections and the abuse of money power. The Commission in its report noted that:

"One of the most critical problems in the matter of electoral reforms is the hard reality that for contesting an election one needs large amounts of money. The limits of expenditure described are meaningless and almost never adhered to. As a result, it becomes difficult for the good and honest to enter legislatures. It also creates a high degree of compulsion for corruption in the political arena. This has progressively polluted the entire system. Corruption, because it erodes performance, becomes one of the leading reasons for non-performance and compromised governance in the country. The sources of some of the election funds are believed to be unaccounted criminal money in return for protection, unaccounted funds from business groups who expect a high return on this investment, kickbacks or commissions on contracts, etc. No matter how we look at it, citizens are directly affected because apart from compromised governance, the huge money spent on elections pushes up the cost of everything in the country. It also leads to unbridled corruption, and the consequences of widespread corruption are even more serious than many imagine. Electoral compulsions for funds become the foundation of the whole superstructure of corruption".

To illustrate this phenomenon, E. Sridharan (2014), provides a commentary on results of the National Election Audit (1999), conducted by the Centre for the Study of Developing Societies. In this study, aggregate data relating to candidates in 24 select parliamentary constituencies covering 122 candidates were examined. The study corroborates the extensive spending; much beyond the stipulated election limits, in elections, by a variety of political candidates irrespective of party affiliations. Almost all candidates were found to be spending over five times the expenditure limit. Moreover, the difference between the money spent by the winning candidate and his nearest political rival was not significant. This is indicative of growing competitiveness in the political area, as well as the uncertainty of election results; an important factor that I explore in the next section. It may be noted that individual candidates are expected to spend significant amounts of money on their elections, besides what the party may earmark specifically, for the candidate's constituency and spend on star campaigners and for the election as a whole (Sridharan, 2014).

7.1.1 Rising Political Competition & Electoral Uncertainty

With the rapid rise in India's population (Yang and Dai, 2019), the size of political constituencies has grown. While the median parliamentary constituency in 1952 [51] had fewer than 300,000 voters, today's parliamentary constituencies contain, on an average between 1.5 and 2 million people (Kapur and Vaishnav, 2003). The growth in the size of the electorate over time means that candidates have to spend more money to woo potential supporters. A significant escalation can be seen in the competitiveness of Indian elections. The fall of single-party government led by the Congress party and the rise of coalition governments in India has led to an increase in the number of political parties. As per Sridharan (2009), the number of national parties declined from 8 to 6 between 1989-2004, while the number of state parties increased from 20 to 36 and the number of registered parties doubled from 85 to 173. Competition has also added to electoral uncertainty, meaning that parties find it increasingly difficult to calculate the elasticity of votes to expenditures (Gowda and Sridharan, 2012).

In an article relating to elections to the Pune and Mumbai Municipal Corporations, the Times News Network reported on January 17, 2012, that:

"The road to becoming a Corporator is expensive. According to the Election Commission's observations, a Member of Parliament spends an average of Rs 7-10 crore on a Lok Sabha election, while an MLA spends Rs 2-3 crore on a state assembly election. Corporators are not far behind. In the last civic elections, about 25 Corporators across party lines in Pune spent over Rs 1 crore for civic elections and observers say, the amount will multiply as the city goes to polls in 2011".

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[51] the date of India's first post-independence elections

The decision to devolve funds relating to several social sector welfare schemes directly to the Panchayats has added a new attraction and a competitive element to the elections to these posts. Furthermore, an ominous development has been the rise of the *Panchayati Raj* system in rural India, a 3-tiered system of decentralised governance. The 73rd. and 74th Amendments to the Constitution (1992-1993) formally established this governance structure at the grassroots level, thereby multiplying the demand for election finance manifold. Political parties field candidates' at all three levels, even at the village level, where formal partisan affiliations are prohibited, though regularly brandished.

For this chapter, my research is based on a two-pronged strategy; firstly to confirm findings from secondary research through interviews with players and stakeholders in public law enforcement, politics, business, law and finance. Secondly, it was my objective to seek insights through interviews with senior politicians who have been in power at the national and state level with the status of Cabinet Minister, Chief Minister, MLA, party Spokesperson, party Ideologue, party Treasurer and political party functionaries at various levels (from village Panchayat to national Parliament).

The picture that emerges from distilling and coalescing the views and insights of these senior persons, obtained from their interviews is not available from secondary research, but in my view has a higher level of credibility, as these persons have shaped the direction of the Indian political economy and continue to do so. Further, these insights go into explaining the very crucial aspects of cycles of money laundering and the core understanding of why it is so pervasive. In light of these insights, I find that much of the established research is somewhat incomplete in the picture it presents. While most of the secondary research is directed at classifying and describing the phenomena; it underestimates the role of individuals and the public. It has generated detailed analysis, which is discussed below, but the analysis uses convenient lynchpins to hang different models of politics-corruption-money laundering matrix and the regulation under which it operates by labelling both money and politics as dirty.

7.1.2 Incidence of Black Money in Electoral Funding

In India, black money is almost synonymous with elections and political parties. There is little to no transparency, and all the stakeholders make sure that political parties continue to escape any form of scrutiny. Therefore it comes as no surprise that statistically, in India, one of the biggest recipients and facilitators of black money are the political parties and their gargantuan election campaigns. Ironically, in the last national election in India, the election campaigns were primarily centred on the issues of black money stashed abroad and widespread political corruption. Nevertheless, the political discourse did not address the problems regarding black money in India, especially during elections and in the functioning of political parties. Sridharan notes the powerful nexus between political parties and black money in India: “Parties in India raise money for election and inter-election purposes through private donations, the bulk of which are believed to be unaccounted for despite recent incentives for transparency in the Election and Other Related Laws (Amendment) Act of 2003, which introduced tax-deductibility for political donations against receipts. While parties are tax-exempt, they have to file income tax returns. However, these declarations are thought to be understatements” (Sridharan, 2014).

The Election Commission of India reported that during the *Lok Sabha* 2014 elections, around Rs 300 crores (INR 3 billion) of unaccounted cash and more than 17,000 kg of drugs and a massive amount of liquor, arms etc. were seized. As per most economists, this is a conservative estimate of the actual amount of illegal and illicit funds utilised during the elections. As one scholar has noted, this reality is often referred to as the “rule of ten”—the idea that actual election expenditures are ten times the reported amounts. Furthermore, both empirical and anecdotal data on India’s political finance indicate that a large portion i.e. 75-80 per cent of political funding is generated from illicit sources.

7.1.3 Role of Public: Public Allegiance up for Sale

The senior-most political leaders that I interviewed, held that the people at large are also responsible for making unrealistic demands from them against a commitment for their votes and these politicians considered themselves to be victims of unbridled cartelised demands of the voters for favours, both in cash and kind. A family with 5-10 voters in several North Eastern states assembly constituencies routinely expects to be given a car, while someone with 2-3 voters expects a motorcycle. I was told that the situation has reached such proportions that voters give undertakings on non-judicial stamp paper which isnormally used for entering into legally binding contracts, by way of commitment for casting the desired vote and acknowledging the receipt of funds. It is well known that in the South Indian State of Tamil Nadu, cash would be slipped under the door of voter's houses just before the polling date, to influence voters. Thus, what used to be earlier an invitefor parties to offer food and drinks to voters during elections, has become a bunch of offerings of gifts and favours. Voters "shop around" for extracting the best deal from the candidates till the last moment before voting. The term "shop around" was mentioned by leading Indian politicians, who I interviewed. This includes a former speaker of *Lok Sabha*, a current Chief Minister from the North East, a former Cabinet Minister from the North East, President of a ruling regional party and the Treasurer of a ruling regional party.

According to the national spokesperson of a national party, "*Today, in Indian elections, public allegiance is up for sale. The highest bidder gets maximum votes. The negotiations for this are done in a very businesslike fashion representing a clutch of votes in any specific Indian constituency*"(personal communication, October 27, 2017). The implication of this is that money, invested by some leader for elections is first converted from white to black and then vice versa. As per a former cabinet minister from the North East in India, the election funding cycle is as follows, "*money is collected all year round through commissions, kickbacks and illegal means and parked through money laundering. Then, when needed, converted to black by de-laundering - distributed to voters, who again convert it to white"*. He furthers added, "*If you look at the economy, white is converted to black then converted to white again. Where is the Black money that you speak of??" This logic is not as unusual as it appears at first glance. The cash money taken by voters is invariably used to buy something, which returns the money to the white economy* (personal communication, October 18, 2017).

7.2 Election Funding in India

By definition, election funding is the provision of money to facilitate or influence the choice of voters in favour of a person or a group of persons by the process of voting. Over the last decade, The Association for Democratic Reforms (ADR), a non-profit organisation working in the area of electoral reforms, has been a keen observer of the financial matters of political parties. Under the RTI (Right to Information) Act, it procures and documents important information regarding party funding, as well as a declaration of income, by the party's income returns statements.[52] The examination of incomes reported reveals the various nomenclatures ascribed to such incomes by political parties. It has been observed that there are no standardised terms used to classify sources of funding by political parties. Terms are used arbitrarily, often, lacking any uniform classification. For example, donations received by political parties are also shown as contributions, or sale of coupons, or membership fees, or levy, or election funds. In the next section, I identify the various sources of election funding available to a political party in India.

I was repeatedly told by several political leaders including Members of Parliament (MP) and members of state legislatures that elections for them meant a trigger to collect black money, as without it winning an election was not possible. In fact, I was told by a former Finance minister of a State, that the need for black money for elections is the single biggest reason for perpetuating the cycle of corruption and generation of black money. A former Member of Parliament told me that the government was the biggest buyer and the biggest spender (personal communication, April 5, 2018). Commissions are to be made and kickbacks to be received for all such government spending and buying. Hence, the stakes are very high to take control of the government exchequer. He told me that politics has become the most lucrative business in India with the highest return on investment (ROI). Hence, there is a rise in competitive spending on elections to woo the voters and gain power. I was told that this government spending feeds the river of black money annually (as elections are being held for some body or the other all through the year). As the economy is growing, this too is growing and a river of black money has been generated. I asked a Spokesperson of a political in Indian, '*Could you elaborate on how politics*

[52] the Right to Information Act, 2005 see https://rti.gov.in/rti-act.pdf

has become a lucrative business?' He responded by telling me that in India, politics had the highest ROI.. Further, he said,

"*Politicians carry out this business by representing vested groups and charge money to promote those vested interests. This can be done in three ways:-*

1. *By persuading their cases with government and influential decision-makers. For instance, a government official seeking a transfer, a citizen seeking favours from public administration in a criminal matter (seeking leniency), regularisation of property holding, regularising some irregularity in which the citizen or corporate has indulged, getting compensation in the name of calamity.*
2. *By creating public pressure. For instance, there may be a vested interest against building a particular dam in the constituency. As the Member of Legislative Assembly (MLA), I can collect people and marshal support against that.*
3. *By asking questions in the Parliament or respective Legislative Assembly to influence policy and create favourable or block unfavourable legislation of some motivated, vested interest. For example, an internal study done in Lok Sabha in the 1990s showed that a large number of MPs were asking questions that favoured one particular industrial group which I will not name. This group has since then become India's largest industrial group. Also, in many cases, the political entity himself is actually the real owner of vast land banks and holds tremendous leverage amidst any developer due to his holdings"* (personal communication, October 27, 2018)

7.2.1 Sources of Election Funding

Where do the political parties get their funds from to manage their affairs and participate in elections? An analysis of their Income Tax returns and statements filed with the Election Commission (EC) shows that even the sources for the money declared to have been reviewed are mostly opaque. As of today, political parties are not required to reveal the name of individuals or organisations giving less than Rs. 20, 000. As a result, about 74 per cent of the funds cannot be traced and are from 'unknown' sources. This becomes very relevant in the light of recent events when the National Political Parties were brought under the Right to Information Act (RTI), 2015 by a Chambers of Indian Commerce (CIC) ruling. There is an ongoing public debate on this issue. Unfortunately, full transparency is not possible under the current laws, and it is only the RTI that can keep citizens somewhat partly informed. The Supreme Court has been particularly worried about this issue and had time and again passed rulings on this. When asked about the linkage between money laundering and election funding, Dr Bhaskar Rao said, " *The linkage is very much and obviously there for sure. The election process in India is one major outlet of money laundering but obviously, money laundering has other dimensions. One known obvious outlet is elections. Launderers are happiest and most secure by buying political power. It is a good "investment". This man xxx in Goa is notorious for this. Some years ago, I have interviewed him in Goa. He said, "I steal from the rich and pay the poor, I'm Robinhood." It is rumoured that he was with the Russian mafia. He was known to be using gold and hawala transactions to deploy his ill-gotten wealth. He was the power behind the then Chief Minister (CM) in Goa, who I will not name. This is how money laundering is employed as a tool by politicians. His earlier modus operandi is a common tool of money laundering in India even today, i.e. by donations through churches. While Earlier he would donate to religious organisations, then he started re-routing funds to political parties perhaps owing to having higher returns and being a better investment.*"(Rao, personal communication, May 5, 2018).

The Supreme Court in *Common Cause (A Registered Society) v. Union of India and others [1996] 222 ITR 260 (SC)* dealt with election expenses incurred by political parties and submission of return and the scope of Article 324 of the Constitution, where it was contended that the cumulative effect of the three statutory provisions, namely, Section 293A of the Companies Act, 1956, Section 13A of the Income Tax Act, 1961 and Section 77 of the Representation of the People Act, 1951, is to bring transparency in the election funding and people of India must know the source of expenditure incurred by the political parties and by the candidates in the process of election. It was contended that elections in the country are fought with the help of money power which is gathered from the black source, and once elected to power, it becomes easy to collect tons of black money, which is used for retaining power and for re-election and that this vicious circle has totally polluted the essential democracy in the country (Indian Kanoon, 2018). The Court held that the purity of election is fundamental to democracy and the Commission can ask the candidates about the expenditure incurred by the candidates and by a political party and for this purpose. [See: Union of India v. PUDR AIR 2002 SC 2112]. The Court in the aforementioned Common Cause case also held:-

"...*The political parties in their quest for power spend more than one thousand crores of rupees on the General Election (Parliament alone), yet nobody accounts for the bulk of the money so* *spent, and there is no accountability anywhere. Nobody discloses the source of the money. There are no proper accounts and no audit. From where does the money come, nobody knows? In a democracy where the rule of law prevails, this type of naked display of black money, by violating the mandatory provisions of law, cannot be permitted."*

Also in the case of *State of Uttar Pradesh vs. Raj Narain* and Others. [1975] 3 SCR 333, the Constitution Bench of the Supreme Court of India considered a question- whether privilege can be claimed by the Government of Uttar Pradesh under Section 123 of the Evidence Act, in respect of what has been described, to be the 'Blue Book' which contain security protocols to be followed such as the President, Vice President and PM. This was summoned from the Government of Uttar Pradesh and certain documents from the Superintendent of Police, Rae Bareli, Uttar Pradesh. The Supreme Court, in this case, held that "the right to know, which is derived from the concept of freedom of speech, though not absolute, is a factor which should make one wary, when secrecy is claimed for transactions which can, at any rate, have no repercussion on public security" (Ray, 1975). The Supreme Court went on to lay down that:

"*In a government of responsibility like ours, where all the agents of the public must be responsible for their conduct, there can be but few secrets. The people of this country have a right to know every public act, everything that is done in a public way, by their public functionaries. They are entitled to know the particulars of every public transaction in all its bearing....*".

For the purpose of this study, I have identified seven sources of election funding, fertilising and cross-fertilising the electoral process. For each, I explore the '3 W's' of election finance: *from where*, *to whom* and *for what*, to better understand its nature and complexity.

1. *State Funding*

First, for the purpose of conducting of elections, the state is the single largest source, as it fully underwrites the entire cost of the machinery it employs and deploys for conducting the process of elections. It has been further argued that the state must also provide funding to individual candidates and maintenance of political parties to support their respective cases in front of the people.

The state is expected to use its financial resources to develop, provide and sustain an environment conducive to free and fair elections, besides maintaining an administrative apparatus to prepare for and to conduct elections. In reality, the state tends to go beyond its mandate by doing all that it can to tilt the balance in favour of its favourite sons and daughters as candidates. The state can dispense support by allocating or withholding resources. State-owned media might influence elections by allocating preferential timings to one or the other candidate. Other standard methods of spending state funds to influence the electorate in favour of a candidate are motivated announcements for setting up of projects and indication of planned investments, allocation or withholding of security forces to enable or dissuade voting by particular segments of the voters and, allocation of contracts and licenses as favours in order to influence voting.

2. Candidates Own Funding

Secondly, the candidates invariably have to mobilise their own resources also for meeting full or part of their election expenses, depending on their party alliances and financial support base. The individual candidate is expected to deploy funds raised, to connect with the voter and implement strategies that educate the voter, promote ideology, win over fence-sitters and in general promote his self-interest by fair means. The truth, in reality, is that funds are mostly used to run down opponents by fair and foul means, gain leverage vis-a-vis big power brokers to lock in vote banks and cater to criminal forces to garner votes. A relatively new trend by candidates is to use election funds to prepare for the future, by saving a significant chunk to develop a nest egg. So even if they lose an election, they have something left to fall back on to help survive and fight another day .

3. Party Funding

Thirdly, we have party funding, which cannot be limited only to the direct cost of the elections but must cover fixed costs that the party has to incur to protect its long and short-term interests in a region. This must include the cost of the upkeep of the well-oiled party machinery whose main objective is to come to power through elections.

4. Corporate Funding

The fourth source is corporate funding. Corporates provide resources to 'candidates both regarding infrastructure support and cash on quid pro quo basis or worse against specific grants or promises of grants of favours. Parties in power are thus able to mobilise a larger quantum of funds from the corporate world. There is scant ideological underpinning for the relationship between political parties and captains of industry in India. Post-election relationships with the government may help influence other corporates to join hands as partners for joint ventures or keep permissions pending to disallow entry by potential competitors. Good political connectivity is also known to help in raising investments. Such connectivity may also be used by less scrupulous captains of industry to circumvent the executive and the judiciary, whenever and wherever possible to their advantage.

5. Foreign Funding

As the sixth source of funding, we have organs of foreign governments and various organisations affiliated with international movements. Funding from ideology and shared policy is often the cause for such support. This has historically been more apparent in the case of left parties. Funding for elections is often provided by international bodies and foreign state-owned organisations to influence the post-election power structure. International religious affiliations play a significant role in mobilising funds for elections in the country and such funding often comes through dubious channels such as 'hawala'. It is interesting to note that during elections, the rupee strengthens on international currency markets, as different international interest groups pump rupees into the election process.

The objective of international donors is to promote their ideology, which may be some form of capitalism or socialism, concern for gender or particular age group of the population, animal rights, environment or just everyday religious beliefs. International players would also like to use their leverage to influence trade policies and secure trade to benefit their citizens. At worse, such funding is used not only to influence national policy but also to dictate it.

6. Individual donations

Some HNIs, for their own reasons, may help in funding the electoral candidates. Sometimes one may find an individual funding an election for ideological reasons. More commonly one finds criminals, tax evaders or persons who can otherwise benefit from the largesse of elected candidates, funding their present or future benefactors

7. Syndicated Funding

The seventh source of funding is the syndicates of bodies having common interests. Such interest may be legal, extra-legal or even plain illegal. Such groupings find it economical and more manageable to support and promote the electoral interests of candidates they feel would help further the syndicate's cause. Again ideology has little role to play. This segment is best represented by business cartels trying to promote their legitimate agenda; but often, in reality, reduced to their seeking policies to garner undue and monopolistic advantages. It is shared interests that make sugar, tobacco and the build-up of the mafia as leading financiers of the democratic process in India.

The purpose of corporate and syndicated donors in funding elections is mostly, economic. They use the mechanism to hedge political risks, get leverage to enhance their business and increase their sphere of influence.

7.2.2 Problems in election funding

There are several problems in the process of election funding. These can best be studied from the viewpoints of a. the candidates b. fund providers and c. opinion leaders in society.

From the candidate's standpoint; the funds available for elections are inadequate, because amongst other things the constituencies are relatively large, and the cost of support systems to maintain the momentum of one's candidature over the length and breadth of the constituency proves to be very expensive. There are irregular intervals between elections, throwing all fiscal planning astray. There is a lack of inner-party democracy, and a system has evolved where candidates with financial muscle and criminal backgrounds, push aside more deserving candidates from within political parties in the race for party tickets. Polarisation exists on caste and religious lines, giving rise to petty 'leaders' who for consideration of one kind or another allocate votes under their control. The inadequate infrastructure to facilitate election further increases the direct cost. Except for candidates in power and those belonging to large parties or those with strong financial backgrounds, it is challenging to mobilise funds.

From the funding providers viewpoint, there is an excessive demand for funding. This happens because, in the absence of ideology, the need for resources brings all parties and candidates to all credible and potential donors. Hence, several donors end up having to fund more than one party or candidate. Failure of governance at all levels and absence of working systems dictate a need for political patronage for anyone with 'larger' interests and reluctant donors are caught in the web of election funding. The necessity of reliable links with parties in power and the dictates of political risk management require multiple investments.

The opinion leaders' viewpoint, as can be gauged from media reports, is that the elections are becoming too expensive and the politician-criminal nexus is multiplying. Soft money is fuelling criminal influence in elections, and money power has become the deciding factor in determining the fate of a candidate. Crucial social and economic burning issues, along with law and order are marginalised for short-term electoral gain. Even well-intentioned policies fail as firmness in policy implementation is sacrificed to curry favour to attain and sustain power. This results in giving undue leverage to persons who are inefficient and incompetent in the business of legislation and governance - the purpose for which candidates are elected. Power brokers, number makers and small selfish groups coalesced around a mesh of self-serving interests get to run the country and State legislatures, resulting in the downward spiralling of the quality of governance (Suri, 2005).

In fact, too little money is spent on the election process at all levels. This contradiction is apparent when one considers that as per evidence, not all the money collected in the name of elections is indeed used in elections. It is well known that not enough money is spent on preparing the voter for the election; either by state or political parties and hence when elections come, a hammering approach is used to buy short-term loyalties. Money is deployed with expectations of specific short-term gains. Further, the 'winning horse syndrome' ensures uneven funding of candidates, as everyone wants to bet on the apparent winning horse. It is also important to emphasise that perceptions of what is too much with reference to the funding of our opinion leaders; are distorted. Society perhaps expects too much for too little from politicians. In effect, it gets what it pays for. Politics must emphasise ideology, policy and programming. Mechanisms to encourage this must be demanded, encouraged and implemented by opinion leaders and they should become more proactive and curtail their role as reactionary critics.

In a democracy, election funding ideally, must come from the people by a transparent mechanism to the political party for running the political party, as well as election funding. However, with the setting in of various malpractices and emergence of an electoral cycle which has resulted in a constant election calendar all year round, instead of the constitutional intent of elections to be held once in five years. This has happened due to the fact that elections in different states at the national level, municipal corporations, and other elected bodies, have all got desynchronised. The primary source of election funding was political parties who took funds from different sources. However, now the primary source of funds to be collected is funds raised by individuals who are in positions of power, within those political parties at a national or regional level. During elections, they generate funds from their own resources with a clear understanding that they would be collecting by way of kickbacks, and collection of favours, multiple of what they have invested. Thus, Indian politics today has several billionaires who pump money into elections for their own seat of power, with a clear objective of generating more money for themselves in return. Due to this constant need, black money is needed consistently.

It is important to note that the key insight that I gathered from these interviews was that, it is the role of the public and individual leaders commanding major segments of the economy that together are responsible. Together they generate demand for black money and this continuous demand is met by a carefully nurtured ecosystem, which works like a money exchange and performs several functions simultaneously. The system on one hand meets the continuous demand for black money. On the other hand, it seamlessly converts money, raised from commissions, kickbacks etc., to legitimate accounts, so that this money may remain deployed in the economy working hard to beat inflation and generate income. When needed, drawings in either black or white money are made possible. The process is so well institutionalised now, that drawings are nearly instantaneous and can even be made by depending on discounting on potential future cash flows. As per a former Treasurer of a leading regional political party in India, "*This happens through political friends in power, standing guarantee for a political person seeking the funds*" (personal communication, September 2, 2017).

7.3 Patterns of Political Accumulation- Alleged Nexus between Politicians and Real Estate in India

Indian political discourse is indicative of a nexus between politicians, bureaucrats and real estate agents in India. Kapur and Vaishnav (2011) examine one of the major channels of illicit campaign finance in India; the real estate sector. They begin their argument on the premise that politicians and builders engage in a quid pro quo. In this three-step process, politicians park their illicit assets with builders for two reasons; firstly, to avoid public scrutiny, and secondly as a pragmatic investment option. During election times, the builders are tasked with re-routing these funds to politicians for election finance. Builders are dependent on political leadership for discretionary policy favours. An interview with a former treasurer of a national political party supports this claim. He said, “Interpretation of bylaws related to land development such as interpretation of Floor Area Ratio (FAR) can result in much more saleable sq. square area footage in the same”. Thus, an observable finding could be the demand for cement, the primary raw material used in the real estate sector. This demand should contract during elections when builders route funds to election campaigns. I have already mentioned how *hawala* is used efficiently by real estate agents and politicians to deploy money to various, often remote, geographical locations during election time.

According to Vaishnav (2003), “There are three basic stages. In the first stage, politicians accumulate resources while in office. Although the salaries for MLAs and Members of Parliament (MPs) are modest, studies have shown that the asset holdings of many elected politicians are often disproportionately large. Estimating the financial rewards to office is a difficult enterprise due to the variety of ways politicians can hide their assets from public scrutiny...once politicians accumulate assets, they require a place to invest these assets where they can avoid public scrutiny, while earning a decent return. Because land is a valuable commodity and India’s real estate industry is booming as the size of the middle class expands, many politicians are thought to deposit a portion of their assets with real estate developers" (Kapur and Vaishnav, 2003, p. 9).

Using state-wise data of the monthly consumption of cement during the period of past elections in 17 major states, spread across fifteen years and five parliamentary elections, Milan and Vaishnav (2011) analysed whether fluctuations in construction activity are linked to the electoral cycle. The authors found a major drop in cement consumption during the four-week campaign period in assembly polls. It was also observed that the decline in cement consumption was higher in the urban areas, as compared to the rural areas. Also, this decline was accelerated when national and state election dates coincided. Their research provides substantial evidence that cement consumption does exhibit a political business cycle that corroborates their hypothesis (Vaishnav, 2011). Moreover, in the last twenty years, India has generated a clutch of highly influential political families, in different Indian states with considerable accumulated wealth including Land Banks. These families are themselves Land Banks and thus active players in the real estate market, and their ability to influence policy can affect the evaluation of land in any given area. A CA in Mumbai explained this process to me. He said, "*For instance, in the late 1990s, the Bangalore airport was planned and finally made faraway from the main city of Bangalore. It was constructed at this location, primarlily, to benefit a particular political family by triggering an increase in land value in the vicinity*" (personal communication, October 5, 2017). I interviewed a treasurer of a political party in Delhi who can be quoted here. He said, "*In many case,s the political entity himself is actually the real owner of vast land banks and holds tremendous leverage amidst any developer due to his holdings*" (personal communication, September 2, 2017)

On being questioned about the nexus between real estate and politicians in India, a former Speaker of *Lok Sabha* during an interview told me:
"*You have an incomplete picture. There is a third player in this nexus- the Mafia who in the beginning was the prime mover of the relationship between the local politician and the property developer. Later, there was a morphing of roles and a situation came whereby the property developer may only be a front for the mafia.*" He further explained that "*The relationship had multiple benefits for the three players. For the property developer, it gave access to political patronage allowing for change for lands use and sanctions related to development and property. For the mafia, it gave a legitimate front business where he could park money. To the politician, it allowed for drawing upon funds when needed and parking them when not needed. While the property developer acted as the executor in the transaction, the mafia gave protection and the politician provided support through favourable legislation; and interpretation of rules and regulations along with the support of the local government machinery. Thus, the third players*

support the nexus between the two. Today the situation is that the erstwhile mafia has taken on the role of the politician with the developer being a family member or front". (Former Member Lok Sabha, personal communication, January 14, 2018). He gave examples of several major states in India, where the ruling politicians were effectively playing this role. He added that the reason for this is the fact that the three roles are synergistic and represent forward and backward integration in business terms. He pointed this out to be the situation in the states of Uttar Pradesh, Maharashtra, Karnataka, Haryana. He further added commenting on the politicians in India, "*Earlier they were satisfied with just speed money and convenience payments. Now, they want a share in the business, legal and illegal*" (Former Member Lok Sabha, personal communication, January 14, 2018). Corroborating this fact, an interview with a former Chief Minister in a state in the North East of India revealed to me that his predecessor had signed an agreement with a well-known builder of the region which confirmed that he would be guaranteed a bag of money per every bag of cement produced by the factory (Former Chief Minister, personal communication, January 17, 2018). Thus, due to the constant requirement of funds, politicians now want to become stakeholders and not just recipients of a lump-sum amount of black money.

7.4. Political Selection: Criminalisation in Politics

In recent years, perhaps one of the most oft-quoted statistics on Indian politics is that one-quarter of its Members of Parliament (MPs) face pending criminal charges (Chaudhary and Kumar, 2017). This fact about Indian politics has been highlighted by academics, civil society and Indian as well as international media. The statistics among elected state legislators, though less discussed, are of a similar magnitude.

The nexus between crime and politics is not a new phenomenon, on the contrary, it has been an issue facing the Indian state since its first post-independence election in 1952 (Vaishnav, 2011). In the initial years of the post-colonial period, many politicians were suspected of having links to criminals, gangs and other illicit networks. However, it has been observed that there has been a qualitative change in the 1970s, as criminals actively joined politics, no more content to concede the spotlight to party bosses. A government-sponsored commission which culminated in the Vohra Committee Report in 1995 concluded that earlier, "the criminal was only content to playing second fiddle to the politician to enable him to win the election and in turn to get protection from him. The roles have now reversed. It is the politician now, who seeks protection from the criminals. The latter seek direct access to power and become legislators and ministers"

The commission concluded:

"The nexus between the criminal gangs, police, bureaucracy and politicians has come out clearly in various parts of the country… those gangs enjoy the patronage of local-level politicians, cutting across party lines and the protection of government functionaries. Some political leaders become the leaders of these gangs…and…get them elected to Local bodies, State Assemblies and the National Parliament. Resultantly, such elements have acquired considerable political clout".

It can be safely deduced that the patronage of criminals by political parties as opposed to just traditional politicians has become deeply entrenched into the fabric of India's democracy.

7.5 The Evolution of Party and Election Financing Regulation in India

This section outlines the evolution of India's election finance regulatory regime over the past several decades, with special emphasis on developments that have shaped the system, as it currently exists. For the purposes of this analysis, political finance encompasses both election campaign finance and the finances needed by parties to run their organisations between elections. According to Sridharan and Vaishnav (2016), India has had two distinct political finance regimes. The first one spans the period between 1947–2003, which saw candidate expenditure skyrocketing, party funding through private donations, and lack of transparency. The second period spanning the decade since 2003, was marked by a partial presence of transparency through the Right to Information Act, coupled with civil society and media pressures buttressed by supportive judicial rulings. For the purpose of brevity and to decipher each milestone in the political finance regime, I have further divided this period into the following milestone years/decades in the history of Indian political finance - i) The early years ii) 1969 iii) the 1970s and 1980s iv) the 1990s v)1990-2003 . The decade following the year 2003 was characterised by many effective steps aimed towards transparency and fairness in the political finance of India

(Gowda and Sridharan, 2012). Unfortunately, despite various efforts and the implementation of multiple suggestions by committees set up by the government of India, the majority of political funding is still largely opaque. The chief regulatory actor, i.e. the Election Commission of India (ECI) remains hamstrung by inadequate authority to fulfil its mandate. While transparency underlying political finance has seen some improvement post-economic liberalisation in the past decade, even after two decades, the state retains vast discretionary authority in the Indian economy. According to Kapur, Sridharan and Vaishnav (2018), "First, political contributions must be fully transparent… Second, candidate spending limits should be relaxed, or eliminated entirely, but only in exchange for strict disclosure requirements and enhanced enforcement…Third, party accounts must be subject to independent scrutiny.
Fourth, the current distinction, whereby there are limits on candidates' expenditures but not on that of political parties, should be abolished…Finally, only if the above preconditions on transparency and enforcement are fulfilled, should public financing be contemplated. In the absence of such complementary reforms, there would be nothing to stop politicians and parties from having their cake and eating it too — a condition that they have become all too accustomed to" (Kapur, Sridharan and Vaishnav, 2018).

7.5.1 The Early years 1947-1969: Strict Limits on candidate spending

Before independence in 1947, the leaders of the Indian National Congress were dependent on voluntary contributions made by individuals, as well as common citizens, as the main source of election funding. Corporate donations to political parties were legally subject to some restrictions but had to be declared clearly in accounts of the company. Despite this, before gaining independence, election costs were kept to a bare minimum with most of the campaigning done on a voluntary basis. However, the cost of elections began to rise with the creation of more electoral districts with increasing population, as well as the introduction of Universal Adult Franchise (Malik, 1989). Thus, it was only natural for the newly formed Indian state to enact new laws and regulations to deal with Electoral Politics and Finance.

The Representation of the People Act (RPA) of 1951, for instance, was the first regulation to be adopted to overcome various issues in conducting elections and introduced limits on the amount that could be spent on election campaigns (Ramadevi, 2000). RPA (1951) imposed strict limits on candidate spending. While candidates risked disqualification for exceeding limits on paper, legal ambiguities and the absence of effective monitoring capacity, undermined these restrictions. Also, the law stipulate that third-party expenditures on behalf of candidates must be reported. This opened up a major loophole that was blatantly and regularly exploited. To make up for this development, politicians turned with greater frequency and intensity to big business donors. The shift to corporate funding took place as economic regulation was increasing, with firms accumulating and donating large quantities of "black money" to evade cumbersome tax regulations (Ramadevi, 2000).

From 1948, the supply of black money grew in the broader economy, in parallel with a high-tax, tightly regulated economic policy framework. High tax rates induced many businesses and individuals to evade taxes. This highly regulated economy derisively termed the "license-quota-permit raj," mandated government licenses and permits for all manner of economic activity (Singh, 2002). This gave enormous discretionary authority to bureaucrats and politicians, some of whom could be induced to allocate licenses and permits in exchange for kickbacks. This led to a corrupt fund-raising nexus between business groups and ruling parties in the central and state governments. The subsequent ban on corporate donations, therefore, seems, in retrospect, to have entrenched the influence of business groups over politics in opaque ways.

Discussions about political finance reform began in the context of the debate on black money generation in the 1960s, the nexus between black money and political fundraising being mentioned in the Reports of the Santhanam Committee on Prevention of Corruption (1964) and the Wanchoo Direct Taxes Enquiry Committee (1971) .

7.5.2 Ban on Corporate Donations 1969

In 1969, Prime Minister Gandhi succeeded in getting the Indian Parliament to enact an outright ban of corporate donations to political parties. The ban on corporate donations went hand in hand with a leftward regulatory shift in which the government nationalised banks in 1969 and insurance companies in 1973, and regulated domestic big business (Monopolies and Restrictive

Trade Practices Act 1969) and foreign investors (Foreign Exchange Regulation Act 1973) more tightly (Jha, 2001).

The 1969 ban on corporate donations to political parties was a major milestone in the political finance regime of pre-financial liberalisation in India. The Indian government enforced it without providing a suitable alternative to legitimate funding to replace the lost donations. Thus, the net effect of the ban was the creation of a vacuum that could only be filled by tapping black money and perpetuating a corrupt equilibrium in which bureaucrats and politicians took kickbacks in exchange for the licenses and permits necessary to operate in an increasingly dirigisme economy. Increasing competition between political parties compounded by rising inflation led to an arms race in election spending and the consolidation of an impenetrable, corrupt political finance regime in which ruling parties at the central and state levels that controlled the regulatory levers of power had the advantage in fundraising (Kochanek, 1987).

Moreover, between 1947-1971; there was little surplus money and the government made major capital investments under a planned economy, where the middle class was small and about 80 per cent of the population was residing in rural India. This population was also primarily dependent on agriculture for its subsistence. In this situation, there was a much smaller market economy and the bulk of economic activity existed in the informal economy. Under these circumstances, the black money generated was often stored as cash and also deployed in purchasing land. During this phase, the requirement for political party funding was not much and most of the black money resulted from illegal activities or unreported income, as corruption was not rampant and had not seeped through to middle and senior levels of bureaucracy.

7.5.3 1970s and 1980s: Rising Cost of Elections and Political Competition

This phase of the Indian economy was marked by two important events; the first oil shock (1973-74) and the 1971 war with Pakistan for the liberation of Bangladesh. These events culminated in a sudden rise in prices in India. Also, the negative impact of two decades of economic planning by the state and curbing of entrepreneurial energies of the people under the stranglehold of the license permit raj could be felt during this tumultuous period. Speaking of this period in an interview, Dr Pai Panandikar said, "*It is during this period that in a structured manner; Mrs Indira Gandhi (the then Prime Minister) took the decision of raising political funding through commissions from large purchases made by the government; particularly in the defence and oil sector. This decreased the political parties' dependence on corporate funding, which was mostly family-owned. This resulted in political alignments with family businesses. This strategy generated large amounts of money for the purpose of political party funding which had to be constantly parked to be available. When elections came, this money was mostly invested with crony capitalists and resulted in the rapid growth of few new corporate Czars.*

One of the most significant developments in the decade to follow the ban on corporate donations to political parties implemented by Indira Gandhi was the 1974 Supreme Court ruling in *Kanwar Lal Gupta v. Amar Nath Chawla*, which held that party expenditures in support of a candidate would count toward the candidate expenditure ceiling (Kumar, 2002). This ordinance resulted in plugging a major loophole, which allowed political parties to circumvent strict expenditure limits. Soon after this development, the Congress government amending the Representation of People Act in 1975, effectively overriding the Court's decision. The Indian Parliament appended Explanation 1 to Section 77(1) of the RPA, stipulating that party and independent supporter expenditures, not authorised by the candidate would no longer count against the candidate spending limit. This amendment rendered all spending limits farcical and further fuelled party spending arms races (Kumar, 2002).

By 1975, increasing political competition and the demand for election funds increased with the delinking of party spending and candidate spending to calculate campaign expenditure limits (Sridharan E., 1999). Furthermore, this period witnessed electoral spending arms races in which parties tried to outspend each other and to bend voters in their favour by providing them with various sorts of incentives, such as free liquor during election campaigns to mobilise crowds. The fact that corporate donations were illegal compounded by lack of any limit on party spending, appears to have accentuated the slide towards dependence on black money (Gowda, 2012).

Unfortunately, Rajiv Gandhi's attempts to instil more transparency in the political finance regime were not successful in bringing corporate contributions above board. The institutionalised nexus of corruption—a quid pro quo that Kochanek referred to as "briefcase politics"— which was characterised by political favours being traded for donations, largely in black money become so deeply entrenched in Indian politics that re-legalization found no takers. This was further compounded by the secrecy that prevailed under the status quo where companies had little incentive to be transparent given the discretionary powers wielded by the state over the economy. This lack of incentive can be attributed to the possible cost of retribution by politicians or parties that were not given the right amount of funds (Kochanek, 1987).

In 1985, corporate donations to political parties were re-legalised. However, this development had little to no positive effect on reducing the dependence of political parties on black money and the increasing the transparency of political contributions. This could be attributed to a lack of tax incentives for political contributions (Sridharan, 1999). Further, by that time, the system of contributions in black money had become so entrenched, that there was no incentive for business groups to come above board. Businesses had to deal with a range of parties in power in the central and state governments, and with a variety of individual politicians. Therefore, the secrecy of political contributions became imperative, so that those that were not so favoured would not penalise the donor for supporting their political rivals. Since political donations would have to be made public in a company's annual reports (with the potential for adverse reactions from shareholders) and since there were no tax incentives, companies tended to stick to the by-then customary practice of secret political donations.

7.5.4 The 1990s: Call for Political Finance Reform

Large-scale economic reforms in the 1990s have left many areas untouched; it is exactly these areas that have become a source of lucrative rents for politicians and bureaucrats. In these sectors, such as land, natural resources, real estate, mining and defence; politicians are easily able to trade policy and regulatory favours in exchange for monetary payments or in-kind assistance from firms. In fact, in many of these sectors, state-owned enterprises continue to occupy a dominant position in the marketplace— internalising many of the transaction costs inherent in transactions between the state and business) (Sukhtankar and Vaishnav, 2015). Finally, the continued role the state plays in India's economy is not only a cause of India's warped political finance regime, but it is also a consequence of it (Sukhtankar and Vaishnav 2015). The heavy-handed role of the public sector in the economy, not only feeds collusion between business and politicians, but the very transmission belts of political finance serve to entrench those patterns further. The regulatory intensity of the state concerning land, for instance, creates incentives for politicians to extract rents from private sector firms in exchange for permits, licenses, clearances, and so on. Once formed, this equilibrium is hard to break; neither side perceives it is in their best interest to defect from the collusive status quo.

In 1993, the Confederation of Indian Industry (CII) made a call for political finance reform due to increasing number of demands politicians were placing on member companies. The CII suggested that campaign donations be made tax-deductible and that public funding is allowed to lift the burden on industry (Yadav, 1996). Three remarkable developments took place concerning political finance in the year 1996. Firstly, the Supreme Court of India issued a directive to political parties to file annual returns under the Income and Wealth Tax Acts in January to be submitted by 20th February, a directive that had received zero compliance from all political parties since 1979; when they were first exempted from these taxes. The purpose of this ruling was to act as a deterrent for those parties' that had made a practice of ignoring notices from the Income Tax Department (Yadav, 1996).

The second significant development was the Supreme Court's, in the run-up to the general election that year, interpreting Explanation 1 to Section 77(1) of the RPA such that party and candidate expenditure would both count toward the candidate spending limit unless parties filed audited accounts of income and expenses. Combined, with these two rulings political parties were forced to file annual tax returns, including audited statements of income and expenditure. It is another matter though that, the performances were invariably doctored. These developments—combined with higher enforcement initiatives by the Election Commission resulted in relative restraint in campaign spending by parties on behalf of candidates in the 1996 election. The third and final worthwhile development from 1996 was the RPA Amendment Act of July, which limited the election campaign to 14 days from 21 days and raised the candidate spending limit to somewhat more realistic levels, although still far below estimates of actual spending. After two years, a partial state subsidy, i.e. free airtime for seven national and 34 state parties on state-owned television and radio was introduced (Gupta, 2018).

Lastly, the 1999–2002 periods saw three concrete reform proposals put forward. In 1999 Lok Satta, a nongovernmental organisation (NGO), proposed introducing tax-deductibility of corporate and individual donations. In 1999, the 170th Report of the Law Commission recommended the deletion of Explanation 1 (the third-party spending loophole) and making adherence to minimum standards of internal democracy and transparency, a condition for receiving state funding. Finally, in 2002, the National Commission to Review the Working of the Constitution recommended (1) deletion of Explanation 1; and (2) comprehensive transparency measures including the disclosure of financial assets and liabilities by candidates (Gupta, 2018). The commission held that state funding should be deferred until the functioning of political parties is regulated to ensure internal democracy and transparency. While these efforts did not usher in immediate reform, they laid the groundwork for important (albeit partial) reforms enacted in the 2000s.

7.5.5 Post 2003 and Recent Developments: Affidavit Disclosure Regime

The political finance regime in India, since 2003, has witnessed a significant tilt towards increasing the level of transparency in electoral politics. These changes were part of a broader "Right to Information" (RTI) movement pioneered by Indian civil society, which sought to improve the level of transparency in politics and government (Gupta, 2018). Speaking on the issue of future initiatives to curb election expenditure and increase transparency in the electoral process, a BJP Spokesperson from New Delhi made the following remark during an interview conducted by me, "*As a young politician, I'd like to explore whether it would be beneficial to check the veracity of legalising lobbying in India. Give political workers a salary. A political worker who wants candidates to win will ensure that there is an incentive to work. Also, this country is always in election mode so the exchequer is always spending. This country is always in election mode. There should be one nation one election. There's another election in October now. If you manage to organise all these elections together, you will be saving a lot of money*" (personal communication, September 7, 2017). Her views on the idea of 'One Nation One Election' are reflective of Prime Minister Modi's recent call for simultaneous polls in India. Since being re-elected to power in the last elections in 2019, the BJP has been actively pushing for this agenda which entails conducting one massive election at the centre as well as the state level, all at the same time. When I put forth this proposition of 'One Nation One Election' to Dr Bhaskar Rao, he said, "*It is highly impractical for a country of this size. It is dangerous for India as it poses serious ramifications and threatens the country's basic character. Instead of saying this, they* *should reduce the number of political parties. They spend heavily on advertisements on every candidate; full-page advertisements causing crores! If expenditure is your concern then there are other frivolous things that can be avoided. Stop spending on achievement advertisements. Open any newspaper just before or during elections, the front pages of newspapers are filled with colourful advertisements about the achievements of candidates accompanied by large posters of candidates. This move is going to increase the cost of the election process*" (Rao, personal communication, May 5, 2018).

According to Sridharan and Vaishnav (2016), Indian politics has witnessed two critical developments in the regulation of political finance since 2003. The first is the emergence of 100 per cent tax-exempt electoral trusts that can be set up by companies under the 2013 Electoral Trusts Scheme. These trusts enjoy tax exemption provided they disburse 95 per cent of their annual receipts (including surplus brought forward) to political parties. Also, contribution limits on companies rose from 5 per cent of average net profit to 7.5 per cent (averaged over the prior three fiscal years). However, it remains difficult for the ECI to enforce election expenditure rules issued under Article 324 (Sridharan and Vaishnav, 2016).

To conclude, the developments between 2003 and 2008 on the transparency/disclosure front, although partial and undermined by larger political economy shortcomings, in important ways, represent the most significant reforms of political finance India has seen since the system took shape between 1969 and 1975. The role of civil society, aided by India's free media and independent courts helped in instituting reforms, despite resistance by all major parties, with private corporate sector donors comfortable with the status quo, and thus remaining mostly passive.

While the discussion stated above is the established view, what is missing from the analysis is the fact that the funding depends on individuals controlling the party. Often, the individuals contesting the election are paying hefty donations to the party and spending money on the political campaigns themselves. A former Member of Parliament told me, "*In the recent elections held in the five states in India, the person who was elected as the chief minister in one of the states was the person who spent the most from his own kitty. Often chief ministers were appointed on their ability to generate earnings for the party by way of kickbacks etc.*" (Former Member of Parliament, personal communication, April 5, 2018). Thus, most political parties generate money through individuals, rather than through party funding.

7.6 Conclusion

As can be seen from the analysis herein, one conclusion is inescapable. This is the factum of the requirement of large quantities of money being the mainstay of election funding. The interviews also establish a clear nexus between political parties and corporate entities. This nexus helps cycle this money from black to white and vice versa. Thereafter, ill-gotten wealth and kickbacks are used to fund both the expenses of political parties and also help create personal wealth for politicians. The benefit to corporate houses is also twofold. Firstly, this cycle helps facilitate these transactions and make money through them. Secondly, they enjoy political patronage which destroys the level playing field, giving them an upper hand in all government contracts. The proliferation of black money into electoral funding has resulted in a situation, where to stand as a candidate, one needs astronomical sums of money. In the event such a candidate is elected, his focus is to recover such money, and this further exacerbates the problem of money laundering. For instance, in the 2014 national election, 79 per cent of the Congress Party's candidates and 73 per cent of the BJP's candidates had declared assets greater than Rs 10 million ($166,500) (Jaffrelot and Verniers, 2020).

Some parties openly endorse the idea of taking money from candidates in exchange for nominations. The Bahujan Samaj Party (BSP), for instance, has an intricate payment system beginning with mandatory initial payments from aspiring nominees for sending their names to the party president, to a final payment of more than Rs 5 million for an actual nomination. The BSP president, Mayawati, once famously defended the practice, saying: "Since many rich persons were keen to contest on our party ticket, I see nothing wrong in taking some contribution from them" to subsidise candidates from a lower-caste, not unique to India, but it nonetheless has consequences (Pradhan, 2006). The premium that parties place on self-financing candidates has contributed to the influx of candidates with criminal connections into politics, growing links between businessmen and politics, and the perpetuation—and deepening—of dynastic (or family) politics (Vaishnav, 2014). Kapur and Vaishnav (2013) illustrate this equilibrium through an examination of the connections that exist between politicians in India and the construction sector. The authors argue that the former provide policy and regulatory favours in exchange for election finance; an exchange they empirically document through an analysis of business cycles in demand for cement (Kapur and Vaishnav, 2003).

The economy notwithstanding; many of the regulations that have been crafted to govern political finance contain large loopholes that give political actors a wide berth to circumvent the rules. For instance, Explanation 1—which first opened the floodgates to undisclosed, third-party spending on candidates—continues to the present day. Finally, the ECI needs greater enforcement authority, most of which can only come from legislative change, to take action against parties and candidates that defy its orders.

These gaps in ECI's enforcement powers, if left unaddressed, will stymie any future attempts at reform. The ECI possesses constitutional independence and is widely perceived to be one of the more independent election agencies in the world. It is only accountable, at the end of the day, to the judiciary; the government in power does not dictate its mandate, and commissioners can only be removed from their positions via an impeachment process similar to the impeachment process for a justice Supreme Court. The downside to this situation is that the commission's constitutional mandate and enforcement powers, which have been outlined by a subsequent statute, must be revised by the very institution the ECI seeks to control if it gains the power to punish malfeasant candidates. The media, civil society and the judiciary can play a catalytic role, but the commission is bound by the shortcomings in its legislatively enumerated enforcement powers. When asked about whether liberalisation had brought about any direct or indirect change in the electoral process, Dr Bhaskar Rao said something very important. He said, " *Well there are no obvious connections that one can think of but I can safely say that the process of liberalisation implies bringing in equity, here it is the opposite. Barriers to entry are increased and equity is reduced. That is all I will say"* (Rao, personal communication, May 5, 2018).

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Chapter VIII

Conclusion

Chapter VIII

Conclusion

8.0 Overview

As stated in my introduction, my original interest in the mechanisms of money laundering and capital flight began as a desire to find out the effects of economic liberalisation on the black economy in India through mechanisms of money laundering. My preliminary research was focussed on tracing the evolution of black economy in India. Results of the initial enquiry, both through desk research and interviews, led me to understand that for arriving at any meaningful conclusions, my research methodology needed to be inclusive of a *long durée* approach to the Indian financial landscape. Critical to this approach was tracing the origins of indigenous mechanisms of *hundi* and *hawala* including developing an understanding of the working of the Indian economy in relation to the evolution of mechanisms of the money laundering.

My thesis was decided. The primary assertion to be tested was whether complex money laundering mechanisms evolved as a consequence of liberalisation. To sum up the hypothesis:-

> Hypothesis (H1, H2, H3): To test whether there is an unintended or accidental relationship between the advancement of mechanisms of money laundering and economic reforms of 1991.

H1: - The liberalisation of the economy in India has resulted in the emergence of complex money laundering mechanisms; including capital flight to overseas tax heavens. H1 is derived from critical political economy, which suggests that neoliberalism was a smokescreen for advancing the cause of the elite in India.[53]

[53] As per this view, market liberalisation is not *per se* a problem but the manner in which it was left unchecked and seen as a messiah of change and development led to its 'side effects' remaining unchecked.

H2: - There is a partial correlation between economic liberalisation and the emergence of complex money laundering mechanisms. The neoliberal ideology has been a general policy prescription which like liberalism, operated differently due to different pre-existing institutional structures, such as *hundi* and *hawala* in India.

H3:- The emergence of complex money laundering mechanisms was part of a larger shift that included changes in technology, shifts in the international political environment and globalisation. H3 is formulated on the basis that the emergence of money laundering mechanisms was significantly influenced by factors other than liberalisation.

The hypothesis has been formulated to test whether liberalisation led to the growth of mechanisms of money laundering and this can be divided into three aspects; namely *Evolutionary*, *Institutional-Structural* and *Political Agency*.

Firstly, *Evolutionary*; my central research question is essentially the relationship between the mechanisms of money laundering in India operating within the black/informal economy and the structural shifts in the Indian economy. In Chapter IV, I established the existence of money laundering mechanisms in the Indian subcontinent much before the onset of not just liberalisation in the 1990s but even before independence in 1947. Many of these mechanisms such as *hundi* and *hawala* have survived through the passage of time and continue to be in use by businesses in India. This depicts both the robustness of these informal mechanisms in the face of modern banking as well as the position of trust they enjoy among age-old businesses in India, often considered more legitimate and reliable than formal banking channels. Traditional mechanisms of *hawala* and *hundi* are ancient and ingrained in the culture of many communities. It is extremely challenging to make them redundant. Efforts at regulating indigenous financial channels, mostly result in criminalising certain sections of society. This is particularly true in India. More importantly, the role of the parallel economy cannot be rejected as an appendage as it has a critical role in supporting and stabilising the economy. It has a stabilising effect also. The taxation in India has had too many exemptions/ too many levels and multiple authorities resulting in a competitive advantage by merely tax planning which when taken to its zenith results in tax avoidance and tax evasion. Thus, There are primarily four main reasons for the presence of a large informal economy working in tandem and at times more effective than the formal economy; i)element of trust in traditional financial systems due to culture & evolution ii. tax exemptions provided by the state iii)cost-effectiveness and Efficiency i.e. the competitive advantage of black economy in India and lastly, iv) the lack of political will due to need for black money for running political parties and election funding. The first two aspects have been analysed in Chapter IV; the third and fourth aspect has been the subject of analysis in chapter V & VII respectively.

Secondly, I examine the *Institutional-Structural* aspect, where I analyse the institutionalisation of mechanisms of money laundering operating within the Indian ecosystem. I have examined this aspect in chapter V. During the research, it became apparent that there is a mutually symbiotic relationship between the formal Indian economy, legitimate informal economy and illegal black economy in India. The black economy is evolving with the Indian economy, and there is a constant flow from one segment of the economy to another. On a close examination of the black economy in India, I observe that there are interconnections between the unaccounted transactions in particular sectors of the Indian economy such as the real estate sector, gold, and diamond sector and there is a strong demand pull for election funding. Corruption whether in the form of bribes or illegal activities appears to be the sine qua non for the generation and deployment of black money across sectors. However, the black economy in India has grown to a level where it cannot be contained within the problems associated with corruption and often pervades parts of the private sector as well (Kumar, 2005). In fact, the demand for black money is such that it results in a need to convert white money to black i.e. the process of de-laundering, which is a unique contribution of this study.Thus, the socioeconomic structural reality that is India has an inherent demand for conversion and de-laundering of money i.e. re-converting it into black moneyThus, the laundering and de-laundering of money has evolved as an economic tool for perpetuation and parking of black money necessitated by political, administrative and bureaucratic corruption. This is encouraged by the persistent need for black money and over time mechanisms have evolved to give even black money the ability to generate revenue.

Thirdly, I explored the *political agency* and lack of political will, where I examine election funding and socio-political acceptance of mechanisms of money laundering for business activities and electoral practices. I find that a nexus of businessmen, politicians and bureaucrats has matured, despite economic liberalisation in the 1990s and has allowed a few corporate entities and wealthy individuals to reach the top of the global wealth lists, even as the bulk of the population suffers from stagnant and insecure living standards. In fact, I have come to accept the thesis that liberalisation in India was not market-friendly but business-friendly (Dembo and Kochanek, 1975; Rodrik; Dani and Subramania; Arvind, 2005; Kohli, 2006; Agarwal and Whalley, 2015). An essential component of political decision-making, elections and the associated circulation of unaccounted incomes are also analysed in this study. The largely informal cash-based expenditure in the funding of elections makes for an abundant pool within which unaccounted funds may be transferred and withdrawn at convenience (Rao, 2009). The large gap between the disclosed expenditures on elections and the estimated expenditures demonstrates that the funding is most likely from unaccounted sources (Core Committee on electoral reforms, 2010).

8.1 Research Trajectory

My experience, during research for finding tangible conclusions was initially confusing as there were vast differences of opinion between what I gleamed from available academic literature and the information provided to me by actual players and practitioners working on various aspects of the economic activities which were the focus of my study. Two rounds of qualitative fieldwork were conducted between 2017 and 2018. The complexities and intricacies that I discovered pointed me in several directions with reference to the economy and drew me to a more in-depth analysis of sectors in the economy, namely--education, real estate, infrastructure etc. I investigate these directions through juxtaposition or placing them side by side, rather than systematically comparative research which would involve matching like for like (Jacob, 2015). My sources included government documents, policy papers, legislative debates, media resources, judicial documents, NGO literature, locational maps and property title and sale documentation. I have interviewed a range of politicians, bureaucrats, users of land including industrial manufacturers and private infrastructure developers, and lawyers representing these users, NGO activists, real estate developers and their contractors, land brokers and various other middlemen in land related deals including government touts, as also professionals such as chartered accountants, lawyers, journalists and academics. Varied sources have been used to generate open-ended data, or build the argument from the bottom up (Guest et al., 2013).

I had access to a variety of literature on the subject which I studied and this led me to conclude that the Indian economy was not just shocked into an open market economy from a closed planned system in 1991 but had been the subject of economic liberalisation since 1980s itself

(Jenkins, 1999; Kohli, 2006). This opening up of the economy led to growth and development. My meetings with leading businessmen in the field of real estate and senior accountants dealing with all sorts of HNIs, high placed national security professionals, leading bankers, policy economists and above all some of the top leading business family members in India altogether gave me deep insights. The thrust of their argument was that Indian entrepreneurship is exceptionally creative and is very flexible in its approach to the realities of the economic ecosystem around it. I was introduced to the concept of understanding that money was not only laundered in India but because so much black money was needed by the formal sector to meet demands placed on it for black money that there was a constant need of de-laundering. This provided me with a rare peep into the actual working of the Indian economic ecosystem. This laid bare contours of an economy consisting of both reported, i.e. white, unreported, i.e. black; intertwined in a symbiotic relationship requiring a constant flow of funds from one to the other, buffered by a huge informal but legal economy. Thus, the Indian economy does not just create black money that needs to be laundered. It also generates opportunities for black money to be deployed. It also creates a need for white money to be delaundered to meet the institutional, structural necessities of the entrepreneurial process. These contours take shape through various examples I have quoted including corruption and political costs.

I conducted interviews with real estate developers in Navi Mumbai and Delhi, and they revealed several sources of generation of black money in their sector. These sources can be divided into-: *Structural*, *Opportunistic* and *Outright Criminal* sources. The structural sources emanate from exceptions' to regulatory compliances are the focus of this thesis. While these leakages and the black money generated through these leakages have been the norm for conducting business to the extent that it not only offers a competitive advantage to the businessman but it also allows profitability in business, there has been a criminalisation of professionals and professionalization of money laundering. However, many changes are underway. Interviewees revealed that they firmly believed India to be standing at an inflexion point of sorts. Most interviewees admitted that *"things are changing"* and expected to change drastically with rolling in of the Goods and Services Tax (GST), the Real Estate Regulatory Act (RERA) as well as demonetisation. Major structural changes aimed at increasing transparency and reducing the need for cash (mostly black money) is underway. These structural shifts can be divided into various categories such as *political* such as a unified government at the centre after many decades- *strategic* with India emerging as a major engine of growth in Asia, *cultura*l with increasing India's soft power, *demographic* with a largely young population and growing domestic market or International. Some of these include initiatives such as *Make in India* (to boost up investment and entrepreneur growth), *Skill India* (to meet up the for new-generation human capital), *Digital India* (movement towards cashless or less cash economy) along with two major reforms in financial and tax system- demonetization and GST.

In the next section, I summarise my findings succinctly.

8.2 Summary of Findings

The humongous amounts of black money that exist in India is facilitated by a vibrant informal economy for its useful deployment but its sheer size is quite counter intuitive to the generous tax exemptions available. I have come to the conclusion that the large amount of black money that the Indian economy generates is mostly due to two reasons. Firstly, due to a demand pull for meeting political party expenses and election expenditure by politicians. Since the BJP came to power in 2014, it has actively tried to take policy initiatives to dry up the availability of cash to political parties. The government has come up with statutes that bar receiving cash donations by political parties of more than Rs 2000. This was Rs 20000 earlier. For election funding, it has provided for large anonymous electoral bonds to be bought by large donors in favour of the preferred political party. Provisions of allowed cash expenditure under income tax rules too has been made more strict. Cash transactions and withdrawals from banks are also subject to strict KYC norms. Also, during elections, the Election Commission (EC) has roving powers to seize any cash that is caught. All these stringent measures have resulted in drying most political parties of much needed cash and thus affecting their ability to fight elections.

Additionally, I discovered that the reason for the propensity among most Indians to try to hide income and assets from the state could be attributed to their lack of trust in the state. This distrust is borne out of arbitrary governance that India's population faced over centuries and its distrust in the government of the day has not been removed even in its post-independence experience. I discuss that there has been a tilt towards socialism in government policy since independence, a trend that has seen some major changes in the recent past. Moreover, there has been a continuous attempt to indulge in populist policies with scant respect for rights of individuals to property. There has been a lack of focus on creating a stable business-friendly environment.

Sudden and major shifts in policy by the government of India, since independence have been the norm, all in the name of common good.

As mentioned in chapter VI, right to property was a fundamental right under the Indian constitution. In 1978, it was removed as a fundamental right under the 44th amendment to the constitution. This is a prime example of sudden policy shifts by the government. Another instance would be of large land holding being abolished under the land ceiling laws of the 1960s under the abolition of the *Zamindari* system in India. This has led to fragmented land holdings unless one breaks the law one can hold only 12 .5 acres of land. This results in a situation where all land held in excess of 12.5 acres and all income from such excess lands becomes part of the black economy. It also removes any incentive for growth in legitimate farming for individuals. To protect plantations, corporates are allowed large holding but these have been marred by militant labour unions and often run aground.

In addition, I have surmised that there is a weak causal relationship between economic liberalisation in 1991 and mechanisms of money laundering as they exist today. In fact, the propensity to launder black incomes as well the demand for black incomes is much higher in sectors where the regulatory powers of the state are extensive. It is well documented that the real estate sector, NGOs and precious metals are safe havens of black incomes.
Thus, generation of black money and consequent need for money laundering can be attributed to structural and institutional failure rather than a macroeconomic policy failure. (Further comments in chapter IV). Furthermore, the opening up of the economy in 1991 has merely provided opportunities for the capital flight of illicit incomes leading to a further spread of illegality. I find limited evidence through interviews carried out that imprudent macroeconomic policy drove illicit flows from the country. This finding finds support in the findings of the IMF, GFI and Panagariya (2008), who have observed that macroeconomic policies in India have been prudently managed and played a stabilising role.

The primary conclusion I arrived at was that the need for black money is perpetuated mainly by a need for humongous amounts of cash funds required for maintaining political parties and the conduct of elections. This requirement of the political leadership of generating funds by dispensing favours makes it challenging for political leadership to curtail corruption to curtail black money. Laundering and de-laundering of money being cyclical, is intrinsic to the functioning of the Indian economy. While liberalisation is not the reason for this unique cyclical nature, it has facilitated the same and had a huge multiplier effect. Liberalisation opened the Indian economy to new sources of finance capital from private investors and foreign investors. To understand the effects of liberalisation on the Indian entrepreneurial process, it helps to visualise these cases individually as a series of interconnected markets for building related products and services. Each of these interconnected markets consists of buyers and sellers that have grown over the last few decades years, especially since liberalisation. While I establish that mechanisms of money laundering is not a direct consequence of economic liberalisation, it would also not be entirely correct to state that mechanisms of money laundering were facilitated by the opening up of the economy. It would be more accurate to say that liberalisation facilitated the incredible increase in quantum of money supply, number of players and a need for deployment and management of this money supply. The existing institutions in all sectors of the economy necessitated the laundering and de-laundering of this fresh quantum of money into both black and white money. Thus liberalisation created a need and increase in incidence of laundering as well as de-laundering. The opening up of the economy merely made the mechanisms of laundering an institutional and systemic reality, constantly evolving with the unfolding of increasing level of openness bridging the gap between the formal and informal sector.

Several Indian businesses are regular users of *hawala* and associated money remittance mechanisms (such as *hundi* and *angadia*). These businesses take advantage of the mechanisms of as *hundi* and *hawala,* as well as their ability to move funds rapidly and profitably in space and time. Thus, in a highly insecure environment in India, for HNI in terms of security available and competitive advantage that can be derived from the confidential secure movement of resources, it becomes imperative that money movements are done securely and confidentially, away from the prying eyes of the government, criminal threat and/or competitors. A prime example of such businesses can be diamond and jewellery where precious but small packages have to be moved securely over vast distances, real estate where transactions have to be done in great confidence requiring large amounts of money to be delivered in geographical locations quickly once the transaction has been concluded, trading of commodities from sources in countries that require specific kickback such as erstwhile the Soviet Union and now erstwhile Soviet-Bloc countries. Trade mis-invoicing is a prime example of this mechanism. In these situations Trust and security of transaction with speed is critical. These systems over centuries have improved their trust quotient by adapting to the latest technology. For instance, I discovered through my various interviews, how technology; particularly the internet, is extensively used to settle transactions in *hawala*. Hawala is considered so reliable that in case of emergency if large amounts have to be sent from point A to point B, individuals seek out the services of *hawala* operators to remit money. These emergencies include hospitalisation, accident, bail bond.

My research depended heavily on the way the economy in India has played out since liberalisation till now. During the course of my research, the Indian government made an unprecedented move by carrying out a nationwide demonetisation of high-value currency notes. This move has added a further structural phase or inflexion point (in the evolutionary aspect) in my research. Furthermore, the immediate aftermath of the demonetization drive and complementary policy measures (it is still ongoing) have been excluded from analysis but can act as points of relevant future research. The present Prime Minister has taken it upon them to bring much more of the Indian economy into the white economy by way of various incentives and disincentives to reduce cash transactions. Significant reforms in taxation are underway by way of simplification of income tax reporting forms, reduction in harassment of income taxpayers through technology in order to increase compliance. In the case of indirect taxes, which amounted to about 36-37 per cent, is being replaced by a single GST. Proponents of the government policy say that these policies will result in ease of doing business in India and rapid growth of up to 10 per cent per annum. People in the arena of business emphasize the fact that nearly the same amount of cash is back into circulation as was before demagnetisation. They also point out that GST will help big business, but in its present form with multiple slabs, it harms small and medium business and thus will lead to more avoidance at a lower level of the economic parameter. It is my conclusion that the policies will result in an expansion of the economy and can be considered another structural transform. However, it will not result in wiping out the black economy or the processes of laundering and de-laundering. It is my conclusion that these will grow in tandem due to the inherent nature of the Indian economy that is based on a huge Indian population, young working-class and low levels of market penetration for a very large number of goods.

8.3 To Sum Up

The trajectory of my research led me to some specific findings, which I consider to be unique and are the result of my being able to get a glimpse of the actual workings of the mechanisms of money laundering, on ground, by the users. Professionals involved in the money laundering business, from the humble *Angadia* to the highly trained finance experts, chartered accountants and lawyers, all, after initial reluctance gave me to understand some basic truths. These I enumerate in my summation. It cannot be overemphasised by me that the actual beneficiaries of these practices- the bureaucrats, the politicians and the business persons from different sectors of the economy not only reinforced my understanding but simultaneously helping to formulate it.

Firstly, to understand the impact of liberalisation on the Indian economy, I needed to examine the concept as it applied to money laundering mechanisms. While much of the literature spoke of liberalisation as a policy initiative of the 1990s, I came to conclude that:-
a) There was no market-friendly liberalisation of the economy, but business-friendly policies were adapted, which helped some businesses.
b) The roots of liberalisation were deeper and could truly be traced from the 1980s, which showed comparable or better growth of the economy from the 1990s. This finding is consistent with the works of a notable number of scholars of political economy such as Atul Kohli (1980), Rodrik and Subramanian (2004), Harris-White (2003), Rob Jenkins (1999), Bardhan (1998), and Mushtaq Khan (2011).

Secondly, when researching the mechanisms of money laundering, I found that much of the literature used the term *hawala* and *hundi* interchangeably. My interaction with professionals in the businesses quickly led me to understand that in India, these were two completely different instruments. While hundi is a promissory note, hawala is a system of referencing that helps in the identification of the beneficiary of the transaction of money, from a geographically distant point. While hundi literally means a container, hawala, literally, means a reference. Since the 1980s, the hundi has become obsolete due to better penetration of banking while hawala has become ingrained in the system of money laundering and become intertwined with banking and modern accounting practices using technology, particularly the internet. I have termed this new version of *hawala* as *hawala* 2.0.

Thirdly, it was imperative, for this study, that I developed an understanding of the Indian economy if I was to develop any real understanding of the impact of liberalisation on mechanisms of money laundering. Initially, I found the literature very confusing as it equated illegal, untaxed incomes with the informal economy. I was told by leading Indian economists that, in India, the informal economy was not the illegal economy as it was mostly tax-exempt. Most small businesses are legally tax-exempt from taxes that are levied on production or sale, now replaced with GST. Most persons earning wages (Rs 2.5 lakhs per annum) are exempt from income tax. Agricultural income is completely tax exempt and this covers about 60 per cent of India's population. This leaves only 2 per cent of Indians as income tax payees and in as much as 90 per cent of businesses as being tax -forming the informal sector. Thus, the Indian economy consists of three parts, to my understanding, one formal i.e. tax-paying, two, informal i.e. tax-exempt and three black i.e. involved with tax evasion or other criminality. It is important to understand that the formal economy and tax exempt informal economy are both legal and white in nature.

Fourthly, as my research progressed I placed more and more reliance on insights I was getting from my interviews which were providing me with information not available in the literature or public domain. As a result of my interviews with senior political leaders and business persons, I realised that there was little pressure in India to launder black money in terms of economic advantage. There were vast opportunities for investing and safely deploying black money particularly in the real estate sector. The pressure for laundering came from law, if one were to make large expenses such as foreign holidays, expensive cars or buy fixed property, one needed to show tax paid white income. Also, in order to set up projects and access bank funding, the promoter needed to bring to the table his share of funding the project. This had to be in accounted for white money. Various mechanisms or a mix of mechanisms of money laundering were used to convert black money to white money towards meeting the margin money component on behalf of the promoter for a project. Depending on other factors, this was mostly done since liberalisation by the mechanisms discussed under entry business or round tripping.

I further came to understand that even if an individual's or corporate entities' operations and incomes were all in white tax -paid formal economy, one needed large amounts of cash i.e. black money to "get things done". Thus, my fourth nugget of understanding is that in India, there is a constant need for black and white money and while mechanisms of money laundering exist, there is an eco-system created which constantly delaunder money to provide black money for the needs of those whose income is in white but have commitments of demands that can only be met by black money.

Fifthly, while analysing the mechanisms of ML in the background of the concurrent need of black and white money, for economic activity in India, I discovered that traditional systems of money laundering were all being deployed and used actively since liberalisation. The big change or evolution in the mechanisms of money laundering as a result of the convergence of state policies directed towards liberalisation, international move towards globalisation and rapid growth in information technology, all converged to create an eco-system in India akin to a highway where one-way traffic was rushing to launder money, it was moving with equal alacrity in the other direction to delaunder it. This highway was created by a mechanism that is popularly known as the book entry system. This system allows anybody to launder or delaunder money at minimum cost and in shortest time. The evolution of this system has ensured that there is no need to keep idle money, even if it is black. All monies are black or white only in the accounts of the entity, while it may be productively deployed in the overall economy. Thus, the book-entry system, which is the central mechanism linking services of *hawala* and the *Angadias,* along with the facility of modern banking, all marshal together to provide service of money laundering or de-laundering through a network of professionals.

My *Sixth* conclusion does not have to do with the mechanisms of money laundering or the black economy but the core question that raised itself throughout my research as to why India needed so much black money and why was it so difficult to get rid of. I concluded that there is traditionally a pre-existing pool of black money in the Indian economy, resulting from earlier high taxation of as high as 97 per cent and fear of the state in as much as the Indian state successively penalised capital formation by following policies of nationalisation and high taxation. As per my interviews with economists and politicians, I was given a very simple calculation for the generation of black money in the Indian economy every year. I was told that the state's annual spending in the award of contracts and procurement of materials and services formed the annual flow in the river of black money in the Indian economy. Commissions over the years have been as high as 10-30 per cent in all government spending. The question that arose in my mind was - *Why has this level of corruption been allowed to persist?* The answer lies in the high cost of elections and election funding which was estimated for the last general election to be even higher than the US Presidential election.

Finally, I must draw attention to the fact that during the period of my study itself, India has been going through massive changes. These concerned the pertinent fields of economic policy, agricultural policy, taxation, social welfare mechanisms, financial inclusion and the criminal justice system. In this environment of change, it is quite possible that what has been true till now may change in the near future. Large ticket corruption, as per all accounts, has been reduced in India and the government is making serious attempts at reducing the role of money in elections. However, as yet, there is no sign of diminishing in the cost of elections. As mentioned earlier, the last elections of 2019 were the most expensive to date, anywhere in the world. [54] This was five years after the present government had been in power since 2014. The cumulative impact of these policy initiatives may require a serious re-look at my research and conclusions. However, as things stand, India's economic liberalisation has only resulted in the creation of a sophisticated eco-system for laundering and de-laundering of money taking advantage of the convergence of technologies, globalisation and economic liberalisation.

8.4 Recommendations and Areas of Further Research

The trajectory of my research has led me to conclude that more focussed research needs to be done in several areas as several policy initiatives have been taken as corrective measures to make their impact felt in the working of the economy. One of the most important initiatives of the government is setting up of the Jan *Dhan* (bank) accounts for all adult citizens linked to the *Aadhar* cards, reducing dependency for various transactions in cash and encouraging usage of electronic transfer. Setting up of several digital payment platforms and prescribing thresholds for cash transactions for different proposes, including a maximum limit of Rs 2000 for political donations, are all efforts directed at a cash less society by the government. However, it is also a fact that as the economy has grown since demonetisation, cash in the hands of the people of India has doubled to over Rs 19.3 trillion from a low of about Rs 8.9 trillion crores (Press Trust of India, 2018). On the face of it, the policy seems to be having the opposite effect. Further

[54] As per the report on 'Poll Expenditure' by Centre for Media Studies (2019)

research is needed to pinpoint actual reasons for this growth in cash. It needs to be examined whether it is possible that those receiving direct benefits don't really qualify for these and are layering their income from undetected activity in cash with the benefits meant for the poor, old, unemployed or disabled and thus inflating need for cash. Further, it needs to be examined how claimed reduction for corruption in big-ticket government purchases and contracts is going to affect round tripping?

The Indian AML regime is quite stringent. However, till recently, due to lack of convictions or recovery of ill-gotten funds it was felt that it lacks teeth. However, recently several individuals that were caught through its apex body, the Enforcement Directorate (ED has turned the tide slightly. The ED is the lead prosecuting agency against ML since the enactment of the PMLA in 2005. The PMLA became India's passport to join the FATF in 2010. The PMLA lists 28 types of offences that are classified as criminal under this regime. Despite the tough regime it imposes, statistics reveal that in the last 11 years (as of 2019), out of 1326 cases filed under the PMLA, only 173 persons were prosecuted of whom none have been sent to jail as a convict. Thus, there is a problem in enforcement. In June 2017, Hindustan Times a leading daily newspaper in India interviewed ED officials on condition of anonymity. They said that it is difficult for them to make the charges stick as the primary charge sheets are not produced by them but other agencies such as the income tac department and the CBI. He said, "If the judge looks bleakly at the first one, it becomes difficult for us to convince the court that subsequent money laundering charges should stick" (Bhattacharjee, 2016). Thus, despite strict measures the ED has been unsuccessful due to the lack of inter-agency coordination and a lengthy judicial process, till recently. By 2017, the ED discovered suspicious transactions to the tune of rupees 9000 crores. While the figure is significant, it is rather unimpressive when measured against the estimates of the FATF for India i.e. a figure of approximately Rs. 12000 crores (as 2 per cent of GDP for FATF member states as of 2017).

This study recognises CAs, lawyers and financial consultants as key players in the money laundering mechanisms in India. Involvement of such professionals, even in the international context, can be seen from the Panama Papers incident and regular advertisements in international magazines for setting up corporate entities and accounts in tax havens by attorneys and law firms. The involvement of CA's and lawyers has been brought to the attention of the current government due to two recent developments. Firstly, in light of the cases of money laundering through shell companies that were uncovered by the government officials of a 'Joint

Task Force on Shell Companies'. This Task Force was set up in February 2017 by the Prime Minister's office and it disclosed the involvement of CAs and tax consultants as key players in the misuse of shell companies to launder black money (FE Online, 2020). Secondly, as part of the anti-corruption demonetisation drive of the Modi government, various prosecuting agencies conducted searches and unearthed the involvement of lawyers in laundering of black money (Press Trust of India, 2017). The case of Delhi based lawyer Rahul Tandon is an interesting example of this trend. The ED accused Tandon of illegal conversion of Rs. 51 crore of demonetised cash to Rs. 38 crore by laundering the proceeds working closely or with the help of his bank manager, his CA and few entry operators. In the crackdown against shell companies, the ED arrested the famous Axis Bank case in New Delhi, with laundered funds to the tune of Rs. 40 crore (Bhattacharjee, 2016).

CAs and lawyers have used client confidentiality as tool against investigation. Post demonetisation, more and more instances of the involvement of CAs, lawyers, financial and tax consultants in cases of money laundering has led the government to contemplate an amendment to the existing laws. The government has been contemplating making it mandatory for CAs and lawyers to report suspicious transactions under the PMLA. This amendment would be introduced as an exception to the rule of client confidentiality that financial and legal professionals are bound by. The current situation provides them a layer of immunity and exemption from the rule concerning disclosure of information of their client's transactions. According the section 14 of PMLA, reporting entities are accorded immunity against civil and criminal proceedings for providing information required by competent authority. According to section 12 of the PMLA, banks, financial institutions and financial intermediaries are obligated to maintain records for 10 years. Under section 13, the chief of the Financial Intelligence Unit can request these records to be furnished. However, it must be noted that the findings of the FIU have no evidentiary value and have to be proven by enforcement agencies (Pandey, 2017). These enforcement agencies i.e. the ED and the CBI have been working towards catching more CAs and financial intermediaries in suspicious transactions involving money laundering and financial fraud. According to Suresh (2017), "The PMLA stipulates up to seven years in jail and the confiscation of property of those involved in money laundering but that doesn't include chartered accountants. The proposed amendment doesn't make it clear what the punishment would be for CAs. As per an official of the ministry of finance, "the preliminary view is that an amount or asset equal to the laundered amount should be confiscated from the CA as well" (Suresh, 2017). The present Modi government firmly believes that a strict law against the significant player in money laundering will act as a deterrent to professionals and help in the curbing of generation of black money.

Changes made in laws related to election funding, issuance of electoral bonds along with general restrictions on cash transactions in the economy, are all expected to have a major impact on the electoral process and political party management. However, it is too early to study the impact of these changes on the demand for black money. Some time needs to pass before these changes result in significant deviation from present norms of demand for black money and resultant need for money laundering and money de-laundering in the economy.

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Approval Letter from Ethics Committee

Iosif Kovras
Department of International Politics
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City University London
London
EC1V 0HB

30 June 2017

Project Title: Drivers and Dynamics of Money Laundering: The Case of India

Start Date: 30 June 2017
End Date: 30 September 2019
Approval Date: 30 June 2017

Dear Shreeya,

I am writing to you to confirm that the research proposal detailed above has been granted formal approval from the International Politics Ethics Committee.

Please note the following:

Project amendments
You will need to submit an Amendments Form to the Chair/Secretary if you want to make any of the following changes to your research:

(a) Recruit a new category of participants
(b) Change, or add to, the research method employed
(c) Collect additional types of data
(d) Change the researchers involved in the project

Adverse events
You will need to submit an Adverse Events Form to the Chair of the Committee, copied to the Secretary of Senate Research Ethics Committee (Anna.Ramberg.1@city.ac.uk), in the event of any of the following:

(a) Adverse events
(b) Breaches of confidentiality
(c) Safeguarding issues relating to children and vulnerable adults
(d) Incidents that affect the personal safety of a participant or researcher

Issues (a) and (b) should be reported as soon as possible and no later than 5 days after the event. Issues (c) and (d) should be reported immediately. Where appropriate the researcher should also report adverse events to other relevant institutions such as the police or social services.

Should you have any further queries relating to this matter then please do not hesitate to contact me. On behalf of International Politics Ethics Committee I do hope that the project meets with success and many thanks for your patience.

Kind regards

Iosif Kovras
International Politics Ethics Committee

Email: Iosif.Kovras@city.ac.uk
Tel: +44 (0)20 7040 4005

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Annexure I Interview Transcripts (Not to be Published) (Section Deleted)

Disclaimer and Ethical Considerations :

In accordance with City, University of London Guidelines on '*Storage of Data Involving Human Participants*', I have kept the data i.e. interview transcripts, written consent of interviewees in a **fire-proof, password protected safe** in my house in New Delhi. I have ensured that this personal safe cannot be accessed by anyone but me. All other research material is safely stored in my laptop, which is also password protected and cannot be accessed by anyone except me. Nevertheless, I have omitted some information in many interviews, to protect the identity of the interviewee or a third-party involved.

In most of the transcripts, I have anonymised or provided pseudonyms to most interviewees as information was provided to me in **strict confidence**. I have sought **written consent** from my interviewees to use the information provided by them in my study. Unless explicitly agreed, along with written consent, I have anonymised the interviewee. I use actual names, only in cases where the interviewee gave written consent to be quoted and cited as themselves. I have also sought permission from my 42 participants to share the interview transcripts with the examiners of this thesis (as well as my supervisors). Thus, the next section is only for the examiners and is **NOT TO BE PUBLISHED.**

I interviewed 6 categories of participants:

I. Politicians and Political Party Functionaries
2. Chartered Accountants and Financial Consultants
3. Hawala Operators who work as Forex dealers/Money Changers/Imported Goods Dealers
4. Economists and Sectorial Experts
5. Lawyers
6. Real Estate Agents, Builders and Investors in Infrastructure Projects