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ILLICIT OUTFLOWS AND ECONOMIC GROWTH OF INDIA - POST REFORM PERIOD:1991-2018

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Abstract - This study has been undertaken to examine the magnitude of illicit financial flows from India during the Post-Reform period by using World Bank Residual Model and to interpret the long-term changes because of illicit flows after post liberalization of trade. To study the impact on Income Inequality with increasing trade openness since Liberalization and to capture various issues that underlie the generation of cross border transfers.To study and analyze how the �after-effects� of reform, specifically economic growth and income distribution, and increasing trade openness relate to illicit flows, we have found statistical correlation between different variables.

keywords - Illicit outflows,Illicit Trade,illicit economy,world bank residual model,illegal money,capital flight,High net worth individuals

INTRODUCTION

Illicit financial flows, in economics terms are illegal forms of capital flight that occur when money is illegally earned, transferred, or spent.Illicit outpourings strain hard currency savings and reduction in tax collection, adversely affecting India's poor and broadening income gaps prompting to Inequality. If India would have stayed away from the capital trip over such a long stretch, it would have empowered the nation to either contract less debt or pay off the existing obligation at the time.A nation that is still struggling to kill poverty with a deficiency of capital comparative to its development necessities can sick bear to lose funds of such magnitude. Therefore there's a need to look at the volume of unlawful money related streams from India, breaking down the drivers and dynamics of these flows with regards to far-going change.

Illicit trade operates on a vast scale and unprecedented pace, making it increasingly challenging to tackle. There are multiple initiatives and organizations, as well as public and private initiatives, dedicated to combating one or several aspects of illicit trade, but this is not a fight that can be won unilaterally. To achieve success, a global and multidisciplinary approach is needed in which the knowledge, expertise and experiences of various actors can be tapped into and shared.[1]

Illicit funds can be money from evasion of taxes or capital controls, bribes and kickbacks, or proceeds of crimes like human and antiquities trafficking. We care about illicit funds because they are a drain on the economy that, in many ways, perpetuates poverty and inequality worldwide (World Economic Forum, 2015).These illicit financial flows strip resources from developing countries that could be used to finance much-needed public services, from security and justice to basic social services such as health and education, weakening their financial systems and economic potential.

[1] "State of the Illicit Economy Briefing Papers - Weforum - World ...." http://www3.weforum.org/docs/WEF_State_of_the_Illicit_Economy_2015_2.pdf. Accessed 18 Apr. 2020.

Because of the existence of the black money in Indian economy, the per capita income of the people has not been growing in line with the other advanced countries despite the liberal measures taken by the government of India since early 1990s(Kavita Rani, 2014).India ranks fourth in black money outflows with a whopping USD 51 billion siphoned out of the country per annum between 2004-2013, a US-based think-tank's report said today.Alone, India has lost approximately $125 billion in illegal money. A has revealed that the black money even exceeds 10% of our Gross Domestic Product(Kavita Rani, 2014).Also,Sustainable Development Goals (SDGs) calls on countries to significantly reduce illicit financial flows by 2030.

OBJECTIVES

1.To capture the interaction of economic, structural, and governance issues that underlie the generation and cross border transfer of illicit capital.
2.To examine the magnitude of illicit financial flows from India during the Post-Reform period.
3.To Interpret the long-term changes because of illicit flows after post liberalization of trade.

METHODOLOGY

WORLD BANK RESIDUAL MODEL

The model was provided in the Kar and Cartwright-Smith (henceforth KC) study

- Use of World Residual Model adjusted for Gross Trade Misinvoicing for studying the illicit financial flows-
- Sources of funds = Increases in net external indebtedness of the public sector and the net inflow of foreign direct investment.
  Uses of funds = financing the current account deficit and additions to reserves.
- Illicit outflows prevail when the source of funds surpass the uses of funds.
- Therefore for Illicit outflows we have, Source of Funds - Use of Funds

$$A = (\Delta \text{ External Debt} + \text{FDI}) – (\text{CA Balance} + \Delta \text{ Reserves})$$

- Trend Lines and Correlation study has been done using MS Excel

- To study and analyze how the "after-effects" of reform, specifically economic growth and income distribution, and increasing trade openness relate to illicit flows, we have found statistical correlation between different variables.

DATA SOURCES

Secondary data used from International Financial Statistics online database, Reserve Bank of India database and Income Inequality Database.

RATIONALE OF THE STUDY

The rationale for the study is to assess the magnitude of Illicit trade and its impact on Income Inequality with increasing trade openness since Liberalisation and to capture various issues that underlie the generation of cross border transfers.

LIMITATIONS

The model is based on official statistics which is unable to estimate others activities and transfers of capital including trafficking of humans,smuggling, sex trade and few more.Therefore this leads to difficulty in measuring illicit outflows. Also there's incompleteness in adjustment of estimates for Trade misinvoicing.

DATA ANALYSIS

DISCUSSIONS ON FINDINGS

To study and analyze how the “after-effects” of reform, specifically economic growth and income distribution, and increasing trade openness relate to illicit flows, we have found statistical correlation between different variables.

CORRELATION MATRIX BETWEEN ILLICIT OUTFLOWS, GDP GROWTH RATES, INCOME INEQUALITY AND TRADE OPENNESS-

	ILLICIT OUTFLOWS	INCOME INEQUALITY	TRADE OPENNESS	GDP GROWTH
ILLICIT OUTFLOWS	1	0.7929724196	0.7951008372	0.8717390673
INCOME INEQUALITY	0.7929724196	1	0.9070143146	0.8784323586
TRADE OPENNESS	0.7951000837	0.9070143146	1	0.7370462014
GDP GROWTH	0.8717390673	0.8784323586	0.7370462014	1

- We ran a correlation analysis for the year 2004-2018 between Illicit outflows, Income Inequality, trade openness and GDP growth.Post-reform period led to faster growth of Illicit flows grew faster than before.

- As the size of India’s traded sector increased and also economic reforms led to rising of trade openness in the post-reform period, this seems to have encouraged more trade mispricing, not less.The statistical significance of trade openness to be positively related to trade misinvoicing(Kar, 2010).The results show that reform itself had a negative impact on illicit flows in Post liberalization of trade as trade openness has led to an increase in illicit flows rather than their curtailment

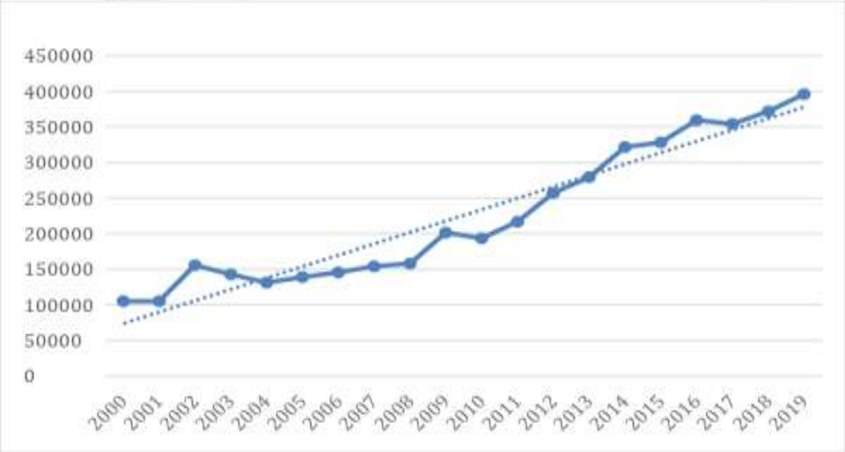
- We see that there exists a positive correlation between illicit outflow, income inequality, trade openness and GDP growth. The strongest correlation exists between income inequality and trade openness.Analysis also shows that more rapid economic growth in the post-reform period has actually led to deterioration in income distribution leading to increased Income Inequality.

- A possible explanation is that worsening income distribution creates many high net-worth individuals (HNWIs) who are the driving force behind illicit flows.

Data presented in Table also show that while economic growth picked up significantly after reform to 6.5 percent per annum on average(World bank data) the faster pace created greater income inequality. From the data, the post-reform period is characterized by a much larger increase in illicit outflows accounting for 59.10% from 2000-2018. It is not just the magnitude of illicit flows that present a challenge for economic development. illicit financial flows cannot be curtailed without the collaborative effort of developing and developed countries.

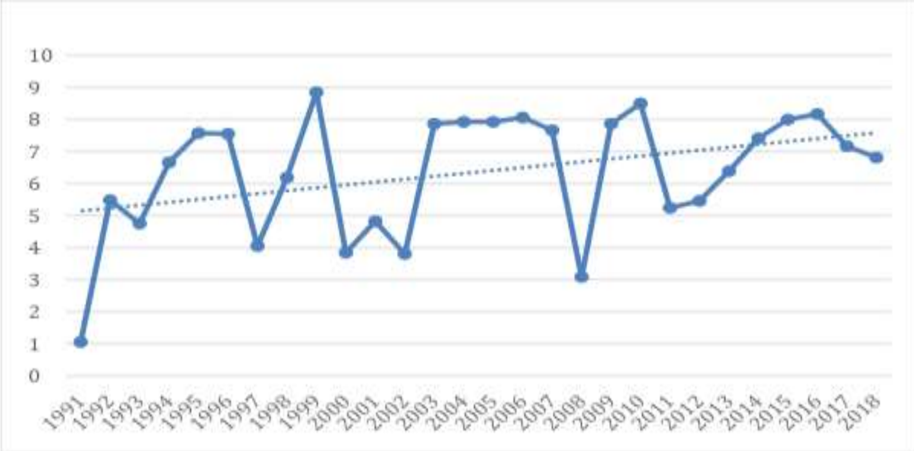
YEARS	GROSS ILLICIT OUTFLOWS (rupee Cr.)
2000	152045
2001	105066
2002	155633
2003	197073
2004	131105
2005	138897
2006	145503
2007	154053
2008	157901
2009	201425
2010	193436
2011	216672
2012	257088
2013	279310
2014	321560
2015	328148
2016	359490
2017	354118
2018	371783

TREND ANALYSIS



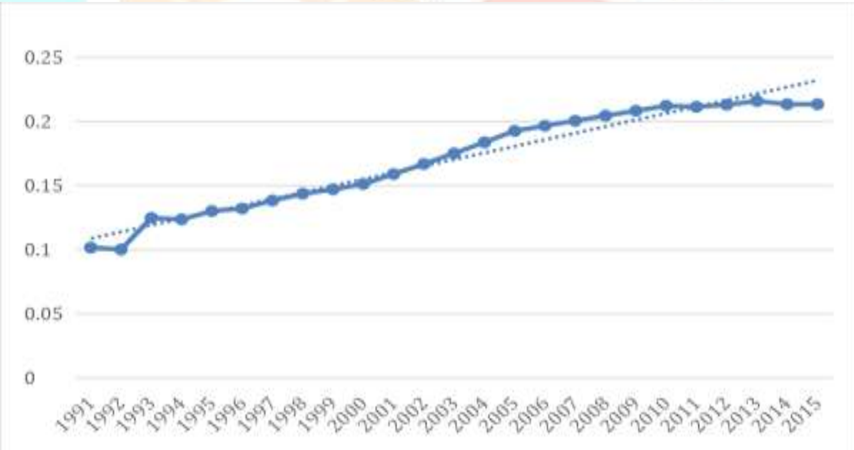
Gross Illicit Outflows

From the above diagram, we see an overall rise in the Gross Illicit Outflows from the country. Since 2000, the gross illicit outflow has been generally increasing and the fall has been very minuscule. Thus we can say that the gross illicit outflow has only been increasing.



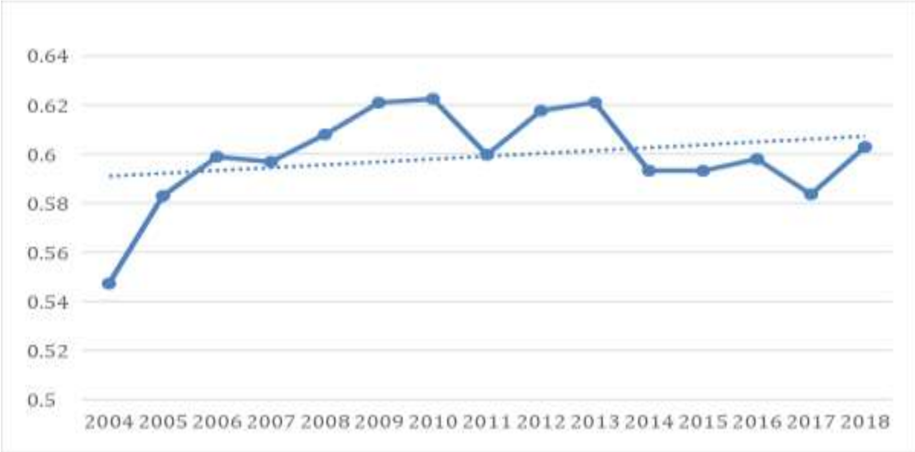
GDP growth rates

From the above graph we can see an overall rising trend in the GDP growth rates in the country since 1991 to 2018. We see a massive rise in the GDP growth in the country since liberalisation. We see a sudden dip in 1997 however it was followed by a rise again in 1998. The biggest fall has been in the year 2008 as the GDP fell to its highest level since 1991. This fall was due to the economic crisis of 2008 but was excellently mitigated within the year 2009. Since then the GDP has again fallen in 2011 however, we see a moderately rising trend since 2012 with a fall since 2017. However, the overall trend has been a rising one.



Income inequality

From the above diagram, we get to see a rising trend in the Income inequality of people. We see that there has been a constant rise in the income inequality of people since liberalisation and we thus conclude that 'the rich are getting richer while the poor are getting poorer'. However, we do have a slight fall in income inequality since 2014, however this is very minuscule in comparison to the general rising trend in the country.



Trade openness

From the above diagram we can see that there is a positive trend in the trade openness. There has been a significant rise in the openness of trade since the year 2004 and has had a growing trend since 2010. However there was a small fall in the year 2011, but it continued to rise despite some fall in recent years, it has however been showing an upwards movement in 2018.

CONCLUSIONS

- The inflows indicated by the World Bank Residual model whether adjusted for trade misinvoicing or not, are also unrecorded and therefore cannot be taxed or used by the government for economic development. If the inflows go unrecorded, how can we say those are FDI? Therefore the model of capital flight cannot capture the genuine return of those funds.[2]

- The increase in income disparity means there are a larger number of high net-worth individuals (HNWIs) in India now than ever before. A possible explanation is that worsening income distribution creates many high net-worth individuals (HNWIs) who are the driving force behind illicit flows. Of course, correlation does not imply causation but the relationship between growth, illicit flows, and income inequality should be studied in more depth.[3]

- If flight capital was saved and invested in the domestic economy of the country of origin it would increase income per capita and help to reduce poverty.

SUGGESTIONS

- It seems that trade liberalization has contributed more opportunities to companies to misinvoice trade,therefore economic reform and liberalization need to be in sync with strengthened institutions and better governance if governments want to downsize capital flows. Also need to Strengthen regulatory and legal institutions, and

- The result that faster growth by itself is not plentiful in curbing illicit flows implies that Income redistribution policy measures are needed to inclusive growth so as not to leave the poor behind.

[2] "Dev Kar « Global Financial Integrity." https://gfintegrity.org/staff-member/dev-kar/. Accessed 18 Apr. 2020.
[3] "Dev Kar « Global Financial Integrity." https://gfintegrity.org/staff-member/dev-kar/. Accessed 18 Apr. 2020.

Approaches to problem-solving must come not only from the countries where illicit financial flows originate but also from the recipient countries — offshore financial centres with a high level of financial secrecy.

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APPENDIX

TABLE 1 - TRADE OPENNESS : YEAR 2004-2018

source: key components of B.O.P,Reserve Bank of India database.

YEARS	EXPORTS(f.o.b) Rupee Cr.	IMPORTS(c.i.f) Rupee Cr.	E+I	GDP Rupee Cr.	TRADE OPENNESS(EXP+IMP)/GDP
2004	303915	367301	671216	5480380	0.5472172892
2005	381785	533550	915335	5914614	0.5829013421
2006	465748	695412	1161160	6391375	0.5988942092
2007	582871	862833	1445704	6881007	0.5968254912
2008	668008	1035673	1703681	7093403	0.6079031227
2009	857960	1405409	2263369	7651078	0.620936754
2010	863282	1423248	2286530	8301235	0.6224488636
2011	1165665	1746135	2911800	8736331	0.5996754585
2012	1482517	2394647	3877164	9213017	0.6176285037
2013	1667690	2732146	4399836	9801370	0.6209654178
2014	1931074	2815918	4746992	10527674	0.5932004941
2015	1934210	2820072	4754282	11369493	0.5931646461
2016	1743289	2592820	4336109	12298327	0.5979600605
2017	1878943	2633395	4512338	13179857	0.5835987907
2018	1991436	3023163	5014599	14077586	0.6028723334

TABLE 2 - GDP GROWTH RATE(%) : 1991-2018

YEARS	GDP GROWTH RATES(%)
1991	1.056831433
1992	5.482396022
1993	4.75077622
1994	6.658924067
1995	7.57449184
1996	7.549522249
1997	4.049820849
1998	6.184415821
1999	8.845755561
2000	3.840991157
2001	4.823966264
2002	3.803975321

2003	5.866711192
2004	7.922936613
2005	7.923430621
2006	8.060732573
2007	7.660815065
2008	3.08669806
2009	7.861888833
2010	8.497584702
2011	5.241344743
2012	5.456358951
2013	6.386106401
2014	7.410227605
2015	7.996253786
2016	8.169526505
2017	7.167888861
2018	6.811369326

Source:

World Bank national accounts data, and OECD National Accounts

TABLE 3 - INCOME INEQUALITY : 1991-2015

YEARS	INCOME INEQUALITY(TOP 1%)
1991	0.1016
1992	0.1001
1993	0.1247
1994	0.1236
1995	0.1301
1996	0.1321
1997	0.1383
1998	0.1436
1999	0.147
2000	0.1512
2001	0.15889999
2002	0.16680001
2003	0.1710969702
2004	0.1837
2005	0.1926
2006	0.19660001

2007	0.2005
2008	0.2045
2009	0.20829999
2010	0.2122
2011	0.2114
2012	0.213
2013	0.2159
2014	0.21340001
2015	0.21340001

source:Income Inequality Database

TABLE 4 : GROSS ILLICIT OUTFLOWS CALCULATED WITH THE HELP OF WORLD BANK RESIDUAL MODEL : 2000-2018

YEARS	GROSS ILLICIT OUTFLOWS (rupee Cr.)
2000	152045
2001	105066
2002	155633
2003	197073
2004	131105
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