

## 3. India

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### 3.1 BLACK ECONOMY IN INDIA AND TRANSNATIONAL ORGANIZED CRIME: UNDERMINING DEMOCRACY

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#### 1. Definitional aspects

Illegality typically leads to the generation of black incomes. The activities in which black incomes are generated constitute the black economy. Hence, the size of a black economy represents the prevalence of illegality in a country. Illegal acts can be committed either through legal activities or illegal activities. Legal activities are those that are allowed by law (e.g., agriculture, finance, and construction) and produce social “goods.” Incomes from these activities are counted as part of the national income. The implication is that they improve the welfare of the citizens and make society better off.

Illegal activities are not permitted by law (e.g., smuggling, peddling of narcotic drugs, and theft) and are said to produce social “bads,” since they lead to a reduction in the welfare of society, if not also of the individuals indulging in these activities. Incomes from these activities are not counted in national income totals. Such activities are linked to criminal activities of various kinds (see Government of India 2011 for data on crime in India). However, not all crime is linked to generating an income, for example murder or gender violence. Hence, the black economy will not capture such crimes. Furthermore, crime linked to economic activities that generate incomes is often connected with organized crime, whether within countries or across borders – the latter is referred to as transnational organized crime.

The black economy can be understood as broadly reflecting illegality in an economy, even if it does not capture all criminal activities within a society (Kumar

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\* This paper is based on the author's two books, *The Black Economy in India* (1999/2002) and *Indian Economy since Independence: Tracing the Dynamics of Colonial Disruption in Society* (2012).

\*\* CESP, SSS, JNU, India: CESP – Centre for Economic Studies and Planning, SSS – School of Social Sciences, JNU – Jawaharlal Nehru University.

1999). In India, the black economy pervades all sectors of the economy. Elite professions have also been found to be involved in it, for example businessmen, politicians, bureaucrats, police, legal representatives, medical personnel, chartered accountants, and education professionals, among others.

The size of the black economy has been rising since India's independence in 1947. It has been estimated to have increased over the years: it was 4 to 5 percent of GDP in 1955/1956 (Government of India 1956); 7 percent in 1970 (Government of India 1971); 21 percent in 1980/1981 (NIPFP 1985); 40 percent in 1995/1996 (Kumar 1999); per projections by this author, it was 50 percent in 2005/2006. Thus, illegality and crime are constantly on the rise in the country, not only in absolute terms but in relative terms. It has grown from being petty and sporadic to becoming more organized (national and transnational).

Organized crime in India operates within a multitude of areas: illegal forestry and mining; drug trafficking; gun-running; human trafficking; sex trade; illicit liquor making and distribution; encroachment of public land; production of spurious medicines and fake goods; adulteration of food items; malpractices in medical professions, including the sale of blood and organs and other malpractices, such as recycling of hospital waste; *hawala* (an alternative remittance system that operates outside of traditional financing structures); flight of capital; illegal financing of trade; smuggling of goods, including gold and electronic items; and so on. Underlying these illegalities is the "Triad" of the corrupt businessmen, politicians, and the executive, which is made up of the bureaucracy, the police, and the judiciary.

## 2. Causes, history, and analysis

The black economy and illegality have existed in all societies at some point. In India, it became systematic during World War II, when shortages appeared, especially of essentials. Rationing of food was introduced but there was black marketing. To escape detection, perpetrators bribed the bureaucracy and the police. Inflation led to increases in the prices of property, so that those without property found it difficult to get housing on rent. The government introduced rent control laws, which became a source of corruption in the courts.

The British set up a civil service to administer (keep control of) India. The public servant became the public master with enormous power over the public, and this was used to extract bribes. However, the bulk of the population was poor, self-employed, and worked in agriculture. They had few public dealings, so that the level of corruption and the black economy was small. The civil service was accountable to the colonial masters who were interested in efficient control of the country, so they did not allow corruption to grow. They also paid the civil servants high salaries, as compared to the per capita incomes of locals, and gave them many privileges to lessen the temptation for corruption.

There was a landlord class ruling over the peasantry that extracted rent from the farmers on behalf of the colonial masters. They were a part of the tiny colonial

ruling elite and had substantial powers, which were misused to extract money from the people they ruled. They were a law unto themselves and could extract money from the peasantry.

After independence, a political class came to power and replaced the colonial ruling elite. They started the task of development in a very poor country. They depended on the civil service for governing the country and did not transform it into a public service that was accountable to the people. The political class that emerged from the national freedom movement was democratic in its aspirations, but its members came from the country's elite class and had feudal aspirations. They thought of themselves as rulers and not as representatives of the people.

Consequently, independent India started with high aspirations but a weak democracy because the power was transferred from the colonial masters to a relatively unaccountable political class and a civil service that was accountable mostly to itself. As the democratic restraint of the national movement weakened, the political class became more corrupt. The government of India (1956) talked about the need to keep the black economy in check so that more resources could be raised for development. It found businesses generating black incomes in all sectors of the economy.

The Indian national movement understood that colonial rule was the source both of the poverty and the helplessness of the common man in dealing with their problems of unemployment, illiteracy, and so on. Therefore, it was decided that society as a whole had to overcome these basic problems of the people and the state was given a large role in economic matters. Furthermore, optimal utilization of resources required central planning, which required licensing of capacity in industries. This reinforced the role of the state in the economy.

Due to deindustrialization in India during colonial rule, Indian capitalists were too small to provide capital for the creation of the necessary infrastructure such as transportation and power. They lacked the technology and capital to invest in basic goods like metals and petroleum, or in capital goods manufacturing. The corollary was that a large public sector was needed to support both the growth of the private sector and the planning process. This required the mobilization of savings in a country that was poor. Consequently, consumption had to be restrained through taxation, limiting production, and regarding the import of luxury goods. Imports were limited so as to conserve the foreign exchange required to import capital goods for development. A strategy of import substitution was adopted to boost industry, and high customs duties were introduced for this purpose.

In 1944, the Indian capitalist class drew up a plan of industrialization in post-independence India that contained the above-mentioned elements of policy (Thakurdas 1944). These plans were also incorporated in the industrial policy statements of 1948 and 1956. However, what the capitalists agreed to collectively, they undid through their private actions by fouling up policies through illegality. They cornered licenses by bribing authorities and creating monopolies to corner economic gain. In the various development activities and projects, corruption was

introduced to make extra profits. This was not feasible without the connivance of the politicians and the bureaucracy – so they were drawn into corruption. Luxury goods – or those goods that faced high customs duties – were smuggled in.

As India developed, the size of the middle class increased and shortages of basic goods – like food, scooters, and cement or basic services (telephone and railway reservations) appeared. For each of them waiting lists appeared, and soon thereafter black markets developed. Businesses took advantage of these black markets and this spread corruption to the lower levels of society.

Big business in India realized that manipulating policies required close proximity to political power. It started exercising direct control over the political process by financing political parties and individual candidates for legislatures. It also increasingly interfered in appointments at the senior levels of the bureaucracy in key ministries. The Triad proved useful for this purpose and it was mutually convenient for the three arms of the Triad. The businessmen could manipulate policies, whereas the other two could get the help of businessmen to invest their ill-gotten gains.

Another aspect of colonial rule helped to spread corruption – the policy of divide and rule. The end of colonial rule left behind antagonisms and instability in India's immediate neighborhood, which helped illegality to spread. There have been several wars with Pakistan and continuing communal tension in the country. With China, there have been border disputes and strategic conflicts. These realities have fostered terrorist/separatist movements in India's border states – Kashmir, Punjab, and in the North East. In turn, these areas became sources of smuggling, gun-running, counterfeit currency, human trafficking, the sex trade, and so on.

India has had historically close relations with Nepal and, therefore, open borders. Large-scale poverty in Nepal and Bangladesh has spurred illegal activities in the border areas. The corrupt monarchy in Nepal and the unstable political climate in Bangladesh led to the spread of large-scale corruption. Ethnic problems emerged in Sri Lanka between the dominant Sinhala community and the Tamils concentrated in the north. The Liberation Tigers of Tamil Eelam emerged to fight a civil war over three decades. To finance its activities, it indulged in a wide array of illegalities. Their links with Tamils in India and across the globe helped in the proliferation of illegalities around the world.

Growing illegality in India was also linked to the oil crisis and the sharp increase in the petro goods prices in the 1970s. The sudden wealth in the oil-exporting countries led to large-scale economic activities there, but they lacked the necessary skilled labor (carpenters, plumbers, drivers, teachers, engineers, doctors), which they imported from South Asia on a large scale. These migrants started sending money back home to their families. This encouraged the spread of *hawala* internationally because the *hawala* operators provided cheap services and a premium on the money sent through them. Simultaneously, this service also allowed Indian businesses to send their capital abroad.

In 1991, India changed its policies and made massive concessions to the private sector – whatever it had been demanding in the 1980s was granted. Taxes were reduced, licensing was eliminated, and imports were liberalized, and so on. The role of the public sector and planning was minimized. With the arrival of the World Trade Organization in 1995, there was a further opening up of the economy to foreign trade and capital. The amount of illegality grew, and the nature of the black economy changed – but it grew as well. As the market economy grew, lines ended but money determined who would get what. Anything could be imported, and the private sector was allowed to produce luxury goods. Thus, shortages of telephones, automobiles, televisions, and so on, disappeared, as did the black markets associated with them.

But, as restraints on business declined with the weakening of the state, business indulged in corruption in an even bigger way. The Triad, already in place, started functioning differently and shared the gains from corruption differently. Many politicians became businessmen – openly or in the name of family members. Businessmen also entered politics in larger numbers. Privatization and the setting up of infrastructure in the private sector (or in public-private partnerships) offered new opportunities for making illegal gains by cornering resources like land, forests, and mines. Greater participation by the private sector since 1991 in the education and health sectors has created enormous opportunities to indulge in illegalities. The number of scams and the amount of money involved per scam has grown exponentially since the 1990s (Kumar 2012).

In brief, systematic illegality and corruption in the country has its roots in big business and the Triad it created. This has led to the emergence of organized crime in the country. The problems fostered at the borders by the neighbors and the *hawala* system enabling the flight of capital have strengthened the linkage between local illegality and transnational crime. Finally, the indiscriminate opening up of the economy in 1991 has led to a further spread of illegality and crime.

### **3. Forms, cases, and interfaces of Indian illegality**

For the black economy to be 50 percent of GDP, as is currently the case, it has to be both systematic and systemic. Laws have to be systematically violated so that those in charge of maintaining the law of the land have to be a party to the violation of the law. For a consideration they will look the other way while businesses commit illegal activities. Take, for instance, the way the police and the judiciary in India function.

Illegalities are to be checked by the police, and the persons committing the illegal action should be brought to justice through the courts. In India, presently there are 40 million cases in the courts and they go on for years or decades (sometimes more than 30 years). The time in prison for many under trials is longer than any sentence they might have to serve if they are convicted for the crimes they

were supposed to have committed. Thus, in many jails, there are more inmates under trial than people who have been convicted.

The delays are due to the widespread corruption in the courts and the non-accountability of the judges. Judges postpone hearing cases for frivolous reasons. The legal profession is also interested in such delays, since they collect fees on the basis of the number of appearances in court. Often, in routine cases, – in which a decision should come in less than a year – procedures drag on for more than five years. This leads to a fivefold increase in the number of cases pending. The pressure on the judges also increases. They may have to go through 50 cases in a six-hour working day, meaning that they have an average of seven minutes per case. Each case may come up for a hearing after a few months and the judge must refresh her memory, thereby taking up precious time and often resulting in mistakes.

To smooth the work of the courts, a bribe might be paid. For instance, a court bailiff may charge a party between INR 1,000 (US\$20) to INR 25,000 (\$500) for having a property vacated by the losing party. The local police, who are required to accompany the court bailiff, charges separately. For the inspection of files, filing papers, and so on, an underhand payment to the clerks may be required. Judges have also been caught letting one of the parties to a case see whether the judgment suits their need. One cannot publicly talk about these matters due to the fear of being hauled up for “contempt of court.”

The poor are mostly unable to approach the courts, since filing cases is expensive and the laws are so opaque that often the poor, who are not very literate, do not understand their complexity. Even if they do go to court against a stronger party, the latter is able to bribe their way through the court and delay or subvert justice. Often there is a nexus between the judges and the lawyers. The well-off party hires a lawyer who is able to manipulate the legal system and who can fix a case to appear before a judge of choice. To minimize this kind of manipulation, the judge in a case is often changed. This has created its own problems, sometimes resulting in situations where up to eight judges hear a case over a two-and-a-half-year period. This means each of the judges is unfamiliar with the case and often postpones the case on frivolous grounds.

Powerful persons in politics, business, organized crime, etc., can get cases against themselves spoilt by the prosecution. This is done at the initial stage of investigation, when crucial evidence is misplaced or not presented carefully so that the case fails in the court. Thus, these people do not even need to use corruption in the courts to obtain favorable decisions. Judges have often commented on the poor preparation of cases by the police. The powerful are known to influence witnesses to change their testimony. Threats – coupled with inordinate delays (the witnesses also forget what they had seen or heard) – lead to the spoiling of cases against powerful people.

The result is that the members of the Triad have contempt for the law and violate it with impunity. In India, laws on paper differ substantially from how they are implemented due to the judicial delays and manipulations by those in power. For

instance, there are laws against child labor, but these are circumvented in large parts of the country, including in the cities. In such violations, the police play an important part.

Illegality flourishes because the police connives in it. They collect a weekly or monthly sum (*hafta*) to allow the illegal activities to continue. This money is collected from beggars in the streets, street vendors, encroachers on public land, businessmen, sex workers, car thieves, pickpockets, those doing illegal construction, and other kinds of illegal activities. The post of head of a police station (called *thana*) is auctioned. This person sets targets for the collection of money for each of the “beat” constables. The more the commercial activity or the higher the level of illegality in the jurisdiction of a police station, the more money is collected. The money is then shared right up to the top (political bosses) (Kumar 1999). At every level, half the money collected is kept and the rest is passed on. Since the pyramid narrows steeply, a lot of money goes up to the few at the top.

The *hafta* from illegal activities is also collected by the local municipal officers and the local politicians. Thus, a substantial part of the earnings of a poor person is siphoned away by these officials and the politicians. The *hafta* results in linkages between the criminals and the officials. For instance, the pickpocket gets protection from the police and no new pickpocket can encroach on their territory. Organized crime is part of this payment of *hafta* and it flourishes because of the official protection it receives.

In India, since land in urban areas is expensive, relative to per capita incomes, a large number of people migrating annually to the cities cannot afford any kind of formal housing. So the migrants either become homeless and sleep under overpasses, bridges, etc.; or they encroach on public land with the connivance of the police and local politicians; or they crowd into existing slums, most of which have various degrees of illegality associated with them. Thus, with the illegal tenure of their shelter, they tend to fall into the grip of criminals. Since they need income, the family members at times get into illegal work, like bootlegging, sex trade, and so on. Organized crime uses these migrants’ insecure tenure of shelter and their poverty to recruit them for illegal work.

In private professional educational institutions, weak students pay for admissions (called capitation fees). In case of medical education, the capitation fee can be up to \$100,000. The situation is similar in the case of engineering, management, and other professional courses. These institutions are often run by politicians and businessmen. On the pretext of providing social service, these institutions are allotted land at low prices and granted concessions. The involvement of politicians guarantees quick government approvals.

Software and information-related services have experienced a boom in India since the mid 1990s. These lend themselves to under- and over-invoicing and, therefore, to the flight of capital from the country. During the dot-com boom, many fake companies floated initial public offerings on the stock market and then disappeared with the public’s money. The recent scandal involving Satyam Computer

Services (see box on the next page) is instructive in learning about the various kinds of illegalities that such software companies can indulge in: under-invoicing; registering in tax havens; creating fictitious employment records; diverting funds to other companies owned by the same owner; funding politicians; buying real estate; and so on.

As already mentioned, *hawala* is a reality in India. It is not regulated by the Central Bank. It is used to transfer funds within the country and outside of it. Since it deals purely in cash, large sums of money are moved from the premises where *hawala* operates. The police and the intelligence agencies know of these places, but they do not act because of the high-level political protection available to the *hawala* operators. The top politicians in power also know of them, since they use this channel, but they do not act against these *hawala* operators out of self-interest. Thus, what is known privately is not known officially. The *hawala* channels are used by organized crime units to transfer money around the country and outside of it. Terrorists, drug dealers, and others use these channels because of the anonymity they provide.

In summary, due to existence of the Triad, all kinds of illegal activities and crime flourish in India. The common man is helpless in the face of these powerful people.

#### **4. Social processes, global economic flows and routes**

Local criminal activities described above have been linked to transnational crimes through terrorism; the printing and circulation of counterfeit currencies; the operation of *hawala*; the production and distribution of narcotic drugs; arms trafficking; and the smuggling of electronic items, gold, and gems. As discussed in section II, in all these cases, the neighboring countries – and at times their secret services – are involved. The income from these activities help finance terrorism and destabilize the nation.

Myanmar has been a closed nation until recently and there has been much ethnic conflict. Thus, it was easy to move narcotic drugs through these territories into India's northeast, where separatist movements were active. Similarly, Bangladesh presents another porous border through which human trafficking has been taking place and where terrorist movements have found sanctuary. They also became conduits for organized crime.

Conflict in Afghanistan since the beginning of the 1970s has led to international rivalries. The Western nations armed the Taliban – fundamentalist Muslims – to fight the Soviet forces that entered Afghanistan to help the left-leaning regime that came to power by dethroning the King. Soon, Afghanistan became the Vietnam of the Soviets and they had to eventually withdraw. But by then, Afghanistan was awash with weapons supplied by the West. Afghanistan was also known for its production of narcotic drugs. When the central power weakened and



Satyam was one of the high-flying software companies of India and an exemplary one, according to the government and the business community. It was controlled by the highly respected Raju family of Andhra Pradesh. In January 2008, Mr. Raju of Satyam, the chairperson, stunned everyone when he admitted to committing massive fraud against the public over the years. Apparently, the company was defrauded of Rs 7,000 crore (\$1.5 billion) but the final tally could be larger. The loss to the shareholders and employees was a multiple of this sum.

Mr. Raju claimed that Satyam was operating with margins of 3 to 4 percent, when for comparable software companies, they were in the range of 25 percent. Was Mr. Raju lying under the auspices of telling the truth? The puzzle is that Satyam should have had higher profit margins, but its owner, Mr. Raju, claimed that it had lower margins, thereby willingly implicating himself in fraud. Was he trying to cover up a bigger fraud?

In India, there have been concessions in taxation on profits from exports. So, it may pay to divert profits from a company that is not entitled to tax concessions to another group company that is entitled to tax concessions, and thereby save on tax payments. Mr. Raju was siphoning funds from Satyam to sister companies dealing in real estate.

To take advantage of the provisions for exports, they have to be over-invoiced. Hence, more foreign exchange has to be brought into the country than has been earned. This way, undeclared wealth held outside the country or profits of other companies transferred out of the country through *hawala* are brought back – that is, reverse *hawala*.

Satyam tried to buy its sister companies at high and inflated prices. So, its fictitious bank accounts, worth Rs 7,000 crores, would have been drawn down and money transferred to the owners of the sister companies, that is, to themselves, and then there would have been no one to ask where the money went. So, using book transfers, the earlier siphoning off of funds would have been covered up and the false entries of the bank balances and fixed deposits reversed/set right. Satyam was forced to reverse its decision to buy the sister companies by the investment bankers who approached SEBI (stock exchange regulator) with the story of the non-existent balance in the banks. There was little time to bring back other undeclared funds, and perhaps due to the global crisis of 2008, they became stuck. Since the funds did not exist in the Satyam bank accounts, Mr. Raju had to cover up by saying that the actual profitability of Satyam was lower and that he had been inflating profits for years.

The Satyam affair points to the practices adopted by crooked Indian businesses – siphoning profits, fudging muster rolls, the cozy relations with politicians and bureaucrats, and finally, manipulating bankers, “independent” auditors, and “independent” directors. Mr. Raju’s admission has brought into question the notion of the “respectable” or “honest” businessman.

regional warlords emerged, the Taliban smuggled weapons and narcotic drugs to enrich themselves.

A nexus emerged between the Taliban and the Muslim fundamentalists in Pakistan. This impacted the separatist movement in Kashmir and also became a major source of financing Muslim fundamentalism in India. In the process, India became a route for transnational crime. This was facilitated by a corrupt bureaucracy and police force.

An amnesty was given to smugglers in 1983 so that they could come into the mainstream. But this led to the entry of criminals into politics, or at least their more active participation in politics. Before, they had financed politicians but remained largely in the background. The Triad now had criminals in it – either the businessman or the politician in the Triad had criminal backgrounds. As criminals entered the legislatures, the rule of law weakened. They manipulated the police, the bureaucracy, and the judiciary to get favorable decisions and also interfered more blatantly in decision-making.

Smugglers developed links with organized crime abroad to carry on their activities systematically. These links also required them to be in touch with *hawala* operators, who did not distinguish between clean (but illegal) money and dirty money. So they transferred the money of terrorists just as often as that of businessmen under-reporting exports. In fact, the gold smugglers often needed foreign currency to buy gold for smuggling into India, and they got it from drug rings that needed to send funds to finance their activities in India. Thus, many interlinkages developed.

Smuggling was driven by the chance of making easy money, since custom duties were high for the import of luxury goods, liquor, tobacco products, gold, and gems. It required corrupting the customs officials and the politicians. Airports and ports turned into dens of corruption with all kinds of illegal activities taking place. Very complex importing rules were deliberately set up so that the misclassification of goods and services was possible. The threat of harassment is an important driver for the willingness to bribe the official machinery.

In India, laws on paper differ substantially from the way law is practiced. Being in power implies the ability to offer favors for utilitarian considerations. For instance, traffic rules are violated with impunity, especially by those in power. When the average citizen gets caught, they offer a small bribe to the police to be let off. Hence, traffic on the roads is chaotic. A driving license can be obtained without taking a test. This is symptomatic of the entire gamut of rules and laws in the country. The honest get harassed while the dishonest make money or jump the lines.

It is the Triad of corrupt businessmen, politicians and the executive that has facilitated systematic illegality in the country, and as it has strengthened over time, illegality has spread. The citizen is not able to resist it individually and is more willing to offer bribes and commit illegal acts. The Triad takes advantage of this by pushing for more illegality. In the process, people have moved from collec-

tive action to individual action and weakened democracy in the country. With the Triad operating unhindered, international organized crime gangs have also found it easy to penetrate into India and set up operations.

## **5. Consequences for victims – outlook and impacts on the rule of law**

The consequences of the growing black economy have been that development has been set back due to widespread policy failure. Kumar (2005) shows that the Indian economy has been losing 5 percent of its annual growth rate since the mid-1970s due to the growing black economy. Otherwise, by today, the Indian economy could have become the second largest in the world. Income distribution is highly skewed against the poor, and this is having an adverse social impact. India has the largest number of the poor people in the world as well as malnourished children and women, illiterate people, and sick people.

The state is considered to be weak and unable to carry out its mandate. The institutions of democracy (e.g., legislature, judiciary) have been weakened due to all of this, and there is a feeling that the nation lacks social justice. Thus, today, every section of society is trying to gain something at the expense of others. This has resulted in massive conflicts in society and often chaotic conditions. The political structures are badly fragmented, meaning there are a few hundred political parties, each jostling for its space and share of power, which is exercised not for the national good but for the section it represents. Thus, faith in the nation has weakened.

The poor face a criminal environment and live insecure lives. Their children often engage in various kinds of illegal activities and get into drugs, smoking, and other addictive behaviors. Women engage in other kinds of illegal activities and have to bear a double burden of taking care of the home as well as working outside.

The black economy leads to both higher costs of production with lower quality and to environmental damage. Thus, the rate of inflation is higher than it need be and health costs rise due to increased levels of disease and low capacities to fight them. Corruption in the medical profession adds to health costs, and as a result, the poor often fall below the poverty line when treating a major illness in the family.

Tackling the black economy is the key to making a dent in crime, whether national or transnational. Since India's independence, dozens of committees and commissions have looked into the problem of the black economy (and its various aspects) all around the country. They have made thousands of suggestions and hundreds have been implemented: reducing tax rates; reducing controls and regulations; demonetization of high denomination currency; voluntary disclosure schemes; bearer bond schemes; acquisition of undervalued property; and so on. There are already enough laws to check corruption; the problem is that they are not being implemented. Intelligence about organized crime exists, but no action is taken since top businessmen and politicians are involved. The problem, therefore,

is not a technical one, and the size of the black economy has increased in spite of the steps taken to check its growth. The issue is one of political will, which is non-existent.

It is crucial to have political movements wanting to strengthen democracy and bring about accountability among the members of the Triad. Movements on the right to information, judicial accountability, the right to education, the right to food, and the right to housing are all needed to strengthen democracy and bring about accountability in the political process. Movements centered around these issues have emerged in the last two decades and they may eventually change things for the better.

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