

Does Black Income Impact Monetary Aggregates, Inflation and Interest Rate in India? An ARDL Analysis with Granger Causality

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Black income is presently the most important economic issue in India. This study demonstrates its macroeconomic impact on base and broad money, currency with the public, interest and inflation rate. Black income is co-integrated with them. The long-run causality between black income and these variables is unidirectional and stable. Black income Granger causes monetary aggregates and nominal interest rate in short run, but Granger causes inflation rate only in the long run. It has predictive content for monetary aggregates, nominal interest and inflation rate that could be used in monetary policy formulation.

I Introduction

Probably no economic issue in recent years has been so singularly important in public discourse in India as the issue of black money. Though the recent demonetization by the Government of India has lent more importance and interest to the issue, yet presently there are no credible research efforts to assess its macroeconomic impact on the Indian economy. While there are reasons¹ for this, it is nonetheless pertinent that efforts to understand the macroeconomic impact of black money should persist more so now when increasingly legislative measures and economic policies are being implemented by the Indian government to curb its growth.

There are many compelling reasons to study the macroeconomics of black income. It distorts key macroeconomic statistics such as GDP, inflation rate, interest and exchange rates, etc., which in turn could lead to inappropriate policy responses. It also reduces tax revenue causing a vicious cycle of increased budget deficit, tax rate hikes and reduced public expenditure which adversely affect the growth rate of the economy.

To offer a relatively deeper understanding of the macroeconomic impact of black income, the present study explores how the black income in India has impacted its monetary sector² comprising of the Reserve Bank of India (RBI) and

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