# Inflation Endangers Economic Progress

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> "People must come to accept private enterprise not as a necessary evil. but as an affirmative good."
>
> — Eugene Black
>
> President. World Bank

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**A. D. SHROFF**

The Union Budget is an extremely fascinating subject. But the Budget, as it has been commonly understood, is not revealed by the Finance Minister's speech alone. His speech has to be studied in conjunction with a number of papers which are presented to Parliament at the time the Finance Minister presents his Annual Statement of Accounts. These documents are of a varied character. Two most important documents which throw considerable light on the analysis of the previous year's position that the Finance Minister presents to the Lok Sabha and his estimates of revenue and expenditure for the coming year as well as his proposals, are the Economic Survey and the Explanatory Memorandum. Last year, while speaking on the Budget, I paid a tribute to the writer of the Economic Survey for 1959-60 for its being very objective and dispassionate. The Economic Survey for 1960-61 is also an extremely able survey, but is not as objective and dispassionate. Whilst attempting to present a factual account of what has happened in the economy of the country during 1960-61, the Survey is heavily loaded with a certain bias and ideology which should be omitted from a real economic survey. Even in spite of that, the conclusion reached by the writer is:

> "The broad assessment for 1960-61 that emerges from this review is that while the economy registered a continuing advance in several directions, the rise in prices and the strain on the balance of payments were indicative of a deficiency of the resources available relatively to the demands on them".

We should bear in mind two things, namely, the sustained rise in prices which is taking place during the last several years and the serious drop in the balance of payments which we have been experiencing, as these dominate the entire economic situation of the country today.

Before an analysis of the Budget for 1961-62 is made, ii is very necessary to consider a few broad facts and figures as these must be kept in view in considering the Budget.

The Budget of any year is a photographic presentation of the economic situation in the country.

There was an increase in industrial production during the 10 months of 1960-61 of 11.7 per cent over the previous year. The wholesale prices recorded a further rise of 6.5 per cent and there was a fall of Rs. 69 crores in our foreign balances during the year. There has been a growth in national output since we embarked on planned development, but it is significant that the growth has been uneven. In 1956-57, we had a growth of 5 per cent in national output or in the total production of the country, both agricultural and industrial. In 1957-58, there was an actual fall of 1 per cent; in 1958-59, there was a rise of 7.4 per cent and for the last year for which statistics are available, viz., 1959-60, there was a very small rise of 0.5 per cent.

Since the commencement of the Second Plan, wholesale prices have risen by no less than 25 per cent. The impact of this important factor, which is of a sustained character, on our economic life, should be noted. **A** rise of 25 per cent in a country where the average **per capita** monthly income is Rs. 25/- is serious. The all-India working class consumer price index, which is compiled by the Government of India with base 1949, has risen by a little less than 25 per cent. During the last 43 years of the Second Plan, we imported into this country Rs. 4825 crores worth of materials. During the same period, we were able to export only Rs. 2728 crores leaving a net



receipt on our balance of payments of Rs. 2097 crores. Over the Second Plan period, additional taxation raised by the Central Government was Rs. 797 crores and that raised by the States, Rs. 244 crores. Therefore, the country had to bear additional taxation of Rs. 1,041 crores.

There has been a large expansion in public expenditure. In 1951-52, the total Budgets of the Union and the State Governments showed a total expenditure of Rs. 998 crores. In 1960-61, the figure stands at Rs. 2,587 crores. During the Second Five-Year Plan, the Government estimated that it would collect through small savings Rs. 500 crores, against which they are now expected to succeed in collecting Rs. 390 crores. The Government raised through public loans during the last 5 years Rs. 762 crores. The gap which was created between revenue and expenditure was made good by deficit financing, which came to about Rs. 1,200 crores.

On the basis of last year's taxation, the Finance Minister estimates that in 1961-62, we should get a revenue of Rs. 962.92 crores, showing a deficit of Rs. 60.60 crores. The Finance Minister, without caring as to what the public may think of, is so bold as to emphasise that he is not going to carry on the Budgets on the basis that deficits should remain uncovered and has, therefore, suggested that he should impose additional taxes of Rs. 60.87 crores, which will leave a small surplus of Rs. 27 lakhs at the end of 1961-62.

One will be naturally curious to know how this revenue of Rs. 1,023 crores is going to be raised next year. When the average person in India becomes increasingly aware of how taxes are raised, collected and how the money is spent, we will have reached the day when public opinion must influence Government policies. Therefore, greater education in understanding the Budget of this country is an essential prerequisite to the cultivation of right public opinion. It should, therefore, be a matter of interest to know how the Finance Minister will raise the

Rs. 1,023.52 crores. This amount comes under several main heads of revenue, some of which are as follows:

| | | |
|---|---|---|
| Customs | Rs. 193 crores | (164 crores in 1960-61) |
| Excise | Rs. 435 „ | (in 1960-61 estimated Rs. 394 crores, revised Rs. 406 crores) |
| Corporation tax (company taxation) | Rs. 141 „ | (Rs. 140 crores in 1960-61) |
| Income-tax | Rs. 133 „ | (Rs. 131 crores in 1960-61) |
| Estate duty | Rs. 9 lakhs | |
| Wealth Tax | Rs. 7 crores | |

Taxes on railway fares are proposed now to be amalgamated in the railway revenues and contribution from the railways to the Union Budget

| | | |
|---|---|---|
| Expenditure tax* | Rs. 80 lakhs | (in a budget of Rs. 1,023 crores, or 0.08%) |
| Gift tax | Rs. 80 lakhs | |
| Opium | Rs. 6.25 crores | |
| Administrative services | Rs. 97 lakhs | |
| Interest | Rs. 13.84 crores | |
| Social and developmental services | Rs. 47 crores | |
| Currency and Mint | Rs. 60 crores | |

The main bulk of the item "Currency and Mint" is the profit made by the Reserve Bank of India, which is owned by the Government. There is one very efficient department of the Union Government, located at Nasik. With all the scarcities and limitations experienced by the different industries, the Nasik Printing Press is never allowed to suffer from any deficiencies in its working. It works at maximum efficiency and the Reserve Bank is never short of currency notes to be supplied to the

*Looks like employing an elephant's trunk to pick up a needle.



Government to feed what is called "deficit financing". The more the Government indulges in deficit financing, the more notes are to be issued by the Reserve Bank, and the more the interest charged to the Government for allowing the Government to use its own notes. That is how the RBI will make a profit of Rs. 42 crores next year.

There is an omnibus item of "Other Sources of Revenue" at Rs. 39 crores for which there is no explanation.

Railways usually contribute about Rs. 53 crores from their profits. The passenger fare tax is amalgamated into the railway contribution which will be Rs. 21 crores next year.

The Government will also be spending about Rs. 1,023 crores. Let us see how it will spend it. The Government must have offices to collect taxes and duties. In 1961-62, they will require Rs. 30.5 crores to do that.

| | | |
|---|---|---|
| Debt services (to pay for interest charges) | ... | Rs. 81.9 crores |
| Administrative services | ... | 58.4 „ |
| Social and developmental Services | ... | 173.5 „ |

A good part of the social and developmental expenditure is wasted on exhibitionist projects like the community development projects.

| | | |
|---|---|---|
| Currency and Mint | ... | Rs. 12 crores |
| Civil works (to house the growing staff of the Government) | | Rs. 21.7 „ |
| Defence services | ... | Rs. 282.9† „ (against Rs. 266.7 crores last year) |
| Extraordinary items | ... | Rs. 10.9 „ |
| Grants to States and Adjustment | ... | Rs. 287.3 „ (against Rs. 158.9 crores last year) |

†To provide a good welcome to our so-called friendly neighbours from the Chinese border!

These are the main items of expenditure. The Finance Minister has made a number of proposals to meet the deficit of about Rs. 60 crores mainly by additional customs duties and excise duties. Of this, Rs. 57 crores will be raised by additional excise duties and customs duties. Direct taxes will increase by Rs. 3 crores.

We have had a number of inquiries on our taxation structure. Recently, a very objective study on one aspect of our taxation structure was made by the National Council of Applied Economic Research under the leadership of Dr. P. S. Lokanathan. That study attempts to assess the burden and impact of direct taxes on the economy and particularly, the effect it has on capital formation, i.e., inducing and encouraging people to save more. The study is very objective, so much so that it proceeds on the basis and assumption that all the ideology that is being preached by the Government must be accepted, viz. that disparities of income and wealth should be reduced, that gradually ownership and control of the means of production, distribution and exchange should be controlled by the Government and a 'socialist pattern of society' will come to be established in India. The study has arrived at certain very definite conclusions. It has, for instance, come to the conclusion that taking the whole direct taxation structure, the country has reached a point where direct taxation cannot be substantially increased without causing very severe repercussions on the development of the country. Direct taxation, as levied in the form and the magnitude that it has reached, is resulting in providing no incentive to save. The study points out that although it is true that a State must try to reduce the disparities of income and wealth, so long as the State accepts the presence of the private sector and wants to develop the country on the basis of a mixed economy, the presence of people with money and large incomes is unavoidable. But what is happening today as a result of direct taxation is that people with large income are left with practically nothing to invest further in the development of the country. Psychologically, they get the impression that the country does not need them and, therefore, there is no need for them to save any further.



In our country of 400 millions, there are only about a million people who pay income-tax. According to the Finance Minister, a million people are today contributing Rs. 274 crores, as per estimates for 1961-62, Rs. 133 crores of income-tax and Rs. 141 crores of Corporation tax, to which must be added Rs. 7 crores of wealth tax, Rs. 80 lakhs of expenditure tax and another Rs. 80 lakhs of gift tax. The National Council study has made a very significant remark that in the matter of direct taxation, a stage has been reached where people with large income feel that any addition to their wealth does not leave them with any further disposable income. In such a situation, the only result that would ensue would be that people would see that there is no sense in saving any more money. This has a tremendous effect on capital formation. The study also brings out that over a period of years not only are the Governments saving less — in fact they are borrowing — but corporate savings or the money that is saved by joint-stock companies, are also on the decline. The net situation is that the rate of corporate savings is not rising in proportion to the rate of new investment they are making. This is what in ordinary parlance is called over-trading. The economy is facing this situation today. It is true that direct taxation must bear its own share of the needs of the country, but unfortunately, direct taxation during the last 4 or 5 years has been pushed up to limits where even Government spokesmen admit that the limit has been reached. Therefore, the only other course left open is to fall back on indirect taxation.

The Union Government has mainly relied on two forms of indirect taxation, the customs revenue and the excise duties. The following figures will be revealing as tc what is happening in the sphere of indirect taxes during the last few years.

In 1950-51, we had a total tax revenue at the Central Government of Rs. 404 crores, of which direct taxation was Rs. 179.8 crores, representing 44% of the total tax revenue, and indirect taxation consisting of customs and excise was Rs. 224.7 crores, representing 55.5% of the total tax revenue. In 1955-56, our total tax revenue had gone up to Rs. 485 crores, whereas direct taxation had declined to Rs. 173 crores. The proportion had significantly changed; direct taxes represented 35.7% of the total tax revenue while the percentage of indirect taxes had gone up from 55.5 to 64. In 1960-61, the total tax revenue had gone up to Rs. 848 crores, of which Rs. 277 crores representing 32.6% were from direct taxes and Rs. 571.6 crores representing 67.3% were from indirect taxes. For the year 1961-62, the Finance Minister proposes to raise a tax revenue of Rs. 913 crores of which Rs. 285.6 crores will come from direct taxes still reducing the percentage to 31.2, and indirect taxes to Rs. 628 crores representing 68.7% of the total revenue.

There is a philosophy behind this continuous resort to indirect taxation. It is said by Government spokesmen that since India is a poor country and since the exemption limit is kept at Rs. 3,000 for income-tax, only a million citizens pay income-tax. If the Government wants more money, then the only way to raise it. is through indirect taxes so that a very large number of people who are consumers of a vast range of necessaries, semi-necessaries, and luxuries would contribute to the revenues through excise duties. But it is forgotten by the officials of the Finance Ministry, the Planning Commission and their economic experts that excise duties on commodities can be regulated only on certain principles. There are certain commodities which are necessary and which have inelastic demand. People will buy them whatever their price, and excise duties imposed on them will yield more and more revenue. But there are other commodities which are subject to elastic demand; that is to say, the consumer adjusts his attitudes for purchasing these commodities according to the prices. As a result of the excise duties, the prices of such commodities go up and there is what is called "sales resistance" and the consumer will reduce his purchases.



The Finance Minister, in his budget speech, says that one of the objectives of framing these proposals is to induce people not to consume so much. But most of our 400 million people are poor and are living on the margin of subsistence. Often, the Prime Minister and other Government spokesmen have appealed to the masses to practise austerity and tighten their belt, promising to build up a dreamland for their children or their grandchildren. Can anyone tighten his belt on a shrinking stomach? The Finance Minister when he is asking people to reduce consumption forgets the actual level of consumption that the country has reached. When planning was started, people were given to understand that one of the fundamental objectives of a rapid, large-scale economic development of the country on a planned basis was to raise the standard of living of the people. After 10 years of planning, after spending thousands of crores of rupees with the avowed objective of giving a higher standard of living to the people, it is rather a cruel joke to call upon the 400 million people to reduce consumption. But, that unfortunately is the philosophy behind these new excise duties.

If we examine some of the specific proposals made by the Finance Minister, it will be observed that there are several self-contradictions. We are almost tired of hearing that if the country is to develop fast on a large scale, we must industrialise and that a country largely dependent on agriculture as India can never be a rich country if we do not industrialise. Since we have not yet reached a stage of self-sufficiency in the development of our industries, we are substantially dependent on foreign countries for the supply of capital equipment, essential raw materials, components and spares of machinery, etc. One of the proposals made by the Finance Minister is to raise additional revenue by way of customs duty of Rs. 30 crores, out of which Rs. 7.78 crores will be raised by an additional duty on the import of capital plant and machinery and components. It is incomprehensible how this proposal, which will increase the capital cost of the new industrial projects, can be reconciled with the widely advertised and broadcast anxiety of the Government to bring about rapid and large-scale industrial development. But, unfortunately, the trouble with our Government is that the country has allowed it to get away with anything, whether there was any meaningful purpose behind it or not.

Creating an industry in India is starting with an initial handicap, as compared to foreign competitors. We have to import capital equipment, pay freight, insurance, special erection charges, and bring foreign technicians for long periods. In many respects, that initial handicap works out to 35 to 40 per cent of the total capital cost. Particularly at a time when the cost of plant and machinery has been going higher, to impose a higher customs duty on import of plant and machinery is defeating the objective of the Government to bring about rapid industrialisation. There are a number of other items which, though not of major significance, still add up to the initial cost of starting industries or of running various industries.

As regards excise duties, the major items are as follows:

| | | | | | |
|---|---|---|---|---|---|
| Motor spirit | ... | Rs. | 39 | crores | |
| Kerosene | ... | „ | 8.5 | „ | |
| Sugar | ... | „ | 46 | „ | |
| Matches | ... | „ | 18 | „ | |
| Steel ingots | ... | „ | 12.5 | „ | |
| Tyres & Tubes | ... | „ | 13.5 | „ | |
| Tobacco | ... | „ | 49 | „ | |
| Vegetable products | ... | „ | 5.25 | „ | (kitchen tax!) |
| Coffee | ... | „ | 1.35 | „ | |
| Tea | ... | „ | 7.65 | „ | |
| Cotton cloth | ... | „ | 38 | „ | |
| Additional excise on textile | ... | „ | 19.96 | „ | |
| Cement | ... | „ | 17.50 | „ | |
| Refined diesel oils | ... | „ | 40.00 | „ | |
| Industrial fuel oil | ... | „ | 10.50 | „ | |
| Motor vehicles | ... | „ | 10.00 | „ | |
| Coal cess | ... | „ | 5.4 | „ | |



The total effect of all these excise duties can only be to raise the cost of living in the country. There is a controversy between economic thinkers on this subject, as to whether part of the additional resources should be raised by Government through indirect taxation or through deficit financing. Deficit financing reached a total of Rs. 1,200 crores in the Second Plan. It is estimated by the planners that it will be restricted to only Rs. 550 crores in Third Plan. Some believe that indirect taxation is better than deficit financing for the reason that it can be controlled, and it can go up to only a certain level beyond which it is bound to cause public reaction which will exercise a healthy restraint. The other school of thought believes that deficit financing should be resorted to. But both schools of thinkers agree on one conclusion, viz., that the result of either method of raising additional resources will be inflation, and a rise in the general level of prices and, consequently, a rise in the cost of living. As the spiral of inflation starts operating, the vicious circle of demand for further wages, increase in the cost of production and further rise in prices will follow.

In the new excise duties proposed, there are 14 commodities where duties have been raised from their present level and 18 other commodities which have been picked up for new duties. I must admire the skill of the Finance Ministry in preparing the list because although they did not want to offend all, they have not spared anyone from being hit. The net has been spread so wide that although it ropes in large number of consumers of a vast range of commodities, the strand has been attempted to be made thin so that no one particular section of the community can say that it has been particularly hit. But the cumulative effect of these new duties will be that the consumers will have to part with Rs. 28 crores of their purchasing power if they are to maintain their existing standard of living.

It is not unusual that the estimates of the Finance Ministry are under-estimated. There is, for instance, a new duty levied on yarn manufactured by cotton and woollen industries. That duty is not paid only on yarn sold by the mills, but yarn manufactured by the mills and taken in process for the manufacture of cloth. It is estimated to give a net revenue of Rs. 53 crores. Since the Budget was announced, people in the textile industry have been calculating on the basis of their day-to-day experience as to what it would cost. A number of people with whom I have discussed the matter give me to understand that the amount will not be Rs. 53 crores, but may well be Rs. 8 crores. Similarly, the additional duty on what is called medium "A" grey has not been well estimated. That might also yield substantially higher revenue than estimated. By and large, by the end of the year, instead of excise duties showing an additional revenue of Rs. 28 crores, it might well be in the region of Rs. 35 to 37 crores.

Some excise duties which have been proposed are particularly objectionable. One can understand levying excise duty on a product manufactured by an established industry. But to impose excise duty on the product of an industry which is just settling down and which is capable of large expansion, provided it is left free to obtain competitive costs in course of time, is bound to affect the growth of that industry. Let us take, for instance, the radio industry. In a country of 400 million people, the total number of sets sold last year was barely 226,000 while in a small country like Japan, they sold 10 million sets last year. This industry is just settling down. It has still to depend to a large extent on imported components, and it is striving to attain self-sufficiency. Levying an excise duty of 20 per cent in the case of radio receivers selling at Rs. 300 and more is bound to cause substantial "sales resistance" and will hamper the growth and development of the new industry. Excise duty on tobacco is going too far. I have spoken to cigarette manufacturers in the country, who very rightly point out that the new impost on tobacco is not the only additional burden on the industry. Excise duties have been raised on paper and a new duty is put on paper used in the manufacture of cigars and cigarettes. If the cumulative effect of all these is taken, these new imposts are bound to affect and hamper the growth and development of these various industries. The



more important reason why I am critical of the levy of these excise duties is that it brings us back to one of the two dominant features of our country, namely, the sustained rise in prices and the increase in the cost of living.

The public must appreciate what inflation means. It means that the rupee which used to buy a certain minimum quantity of goods and services at a given time does not in course of time buy the same quantity of goods and services; or in technical terms, there is a depreciation in the value of the rupee. I have not known of any country in the recent history of the world which can with complacency allow an indefinite internal depreciation in the value of the currency without ultimately causing a severe repercussion on the external value of the currency of that country. It is a matter of common knowledge that particularly during the last 12 months in important international financial centres of the world the rupee is commanding a lower value than its par value. For instance, 100 Hongkong dollars which we used to buy last year for Rs. 83 now have to be bought for about Rs. 116. Although it is illegal that anybody should deal in foreign currency unless he is an authorised dealer approved by the Reserve Bank, it is no use disguising the fact that every day one hears of the pound sterling being paid in the unofficial market at Rs. 18 against our par value of Rs. 13.34. Obviously, the horsesense of the people has started operating. The continuous depreciation in the internal value of the rupee is causing misgivings in the minds of the people outside India about the ultimate capacity of this country to maintain the par value of the rupee abroad. This is particularly a grave situation for this country when we are borrowing very substantial amounts from abroad which will have to be repaid not in our rupees but in foreign currencies.

There are one or two items of relief given by the Finance Minister. One is the reduction of tax on what are called bonus shares. The tax on bonus shares was 30 per cent till the budget was introduced and it is now proposed to be reduced to 123%. The bonus shares are issued out of the capitalised reserves built out of taxed profits and to levy a tax on the capitalisation of taxed reserves is really double taxation. The admission by the Finance Minister is that the Government is now satisfied that this tax on bonus shares is hindering capital formation in the country. The National Council's study has, after analysing the whole position, come to the conclusion that there is not a shred of jusfification for maintaining the tax on bonus shares. Although the Finance Minister has seen the rationale of not having this tax, whilst acknowledging that it is wrong, he has still maintained the tax but at a reduced rate, because apparently the Government must live on prestige.

It may be of interest to know what is the public debt of the country. On March 31, 1939, it was standing at Rs. 484 crores. On March 31, 1961, the Finance Minister estimates that it will be at the staggering figure of Rs. 6,570 crores. All this money has been spent so that we may improve our standard of living! At the same time, the Finance Minister has stated that the time has come when we must reduce our consumption! Some of this money has been invested in public services like the railways which are seldom punctual, where third-class passengers are packed like sardines, where there are no sufficient wagons to carry coal from pitheads to industry! This Government is trying to create an industrial empire. It must have its fertiliser plants, steel plants and whatnot. By 31-3-1961, Rs. 703 crores would have been invested in these new industries. The return they got last year was 0.5% on their investment.

One very significant omission in the whole Budget is a close analysis of the foreign exchange situation. Beyond expressing concern that our foreign exchange situation is difficult, there is no light thrown at all as to what is proposed to be done to improve the situation. The Third Plan will have a capital outlay of Rs. 12,000 crores, the foreign exchange component being Rs. 2,600 crores. We have been borrowing moneys from abroad for many years past. From 1961 to 1966, there is a budget for repaying



Rs. 600 crores, partly by way of interest charges on the loans borrowed abroad and partly repayment of those loans which are due by 1961-66. So, in the next 5 years, we shall need Rs. 3,200 crores of additional foreign exchange if the projects in the Third Plan are to be implemented. At the time we started the Second Plan, we had Rs. 746 crores of balances lying in London and the U.S.A. The planners of the Second Plan had estimated that at the end of that Plan, these balances will be reduced by Rs. 200 crores and that they will be able to obtain foreign loans of Rs. 800 crores. We are almost at the end of the Second Plan. Instead of Rs. 800 crores, friendly Governments have given us Rs. 1,400 crores. Instead of our foreign balances going down by Rs. 200 crores, they have gone down by about Rs. 590 crores with the result that the balances of Rs. 746 crores have come down to Rs. 157 crores. At a time like this, to embark on this ambitious plan of collecting Rs. 3,200 crores to implement the Third Plan is inviting serious and difficult situation for the country. The actual difficulty is that, whilst we are adding to our industrial capacity even at this stage by borrowing money from abroad, we are short of money to buy essential raw materials to keep going our existing capacity. Months after people like me had drawn the attention of Government, at a recent meeting of the Import Advisory Committee, the Commerce Minister has made an important statement that the Government would give higher priority to import machinery components rather than capital goods for new industries. If only a little more of this realism dawns on New Delhi, if we can get together and mobilise public opinion adequately and effectively, that is the only saving feature I see for the stabilisation of the economy of the country.

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Based on a lecture delivered in Bombay on March 8, 1961.

**Free Enterprise was born with man and shall survive as long as man survives.**

**—A. D. Shroff**

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