THE UNION BUDGET 1994-95

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By

Nani A. Palkhivala

Those who watched the presentation of the Budget on television must have been distressed to see some MPs behave like unruly, irresponsible school children. You are reminded of Rudyard Kipling's dictum "Politics is a dog's life, without a dog's decencies".

The biggest curse of the party system in any democracy is that it breeds a tendency to look at every measure on purely party lines. An almost universal tendency of all politicians is to view the budget not as a national budget but as a party budget. This causes either wholesale approval or total condemnation by those politicians whose critical perception is no higher than forty watts.

The detailed proposals in this year's Budget are, as usual, less important than the overall thrust of the package. The Budget is historically important because it marks a turning point in the way Indians think about their economy—less like a tortoise and more like a

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Mr. Palkhivala is the President of the Forum of Free Enterprise. The text is based upon the public talk in Bombay on 3rd March, 1994, and subsequently in Calcutta, Madras, Hyderabad. Bangalore, Pune, Ahmedabad, Jaipur, Delhi, Muscat and Dubai.

tiger. The arthritic economy is increasingly performing like an athletic economy.

Contrary to some expectations, the Budget has not proved to be the biggest bonfire of controls. The expectations of the public were unlimited, while the options available to the Finance Minister were limited. On the whole it is a stimulating Budget, subject to some important reservations.

The state of the economy is more favourable than ever before. The omens were propitious when, on 28th February 1994, the Budget was introduced in the Lok Sabha. The foreign exchange reserves aggregated to $13 billion. Over 23 million tonnes of food-stocks were in the public system. Inflation was down to 8.5 per cent. The current account deficit in balance of payments was negligible. The Finance Minister had good reasons to expect six per cent increase in the gross domestic product (GDP) next year.

Great stress on three E's.—The Budget has understandably laid great stress on the three E's—Exports, Energy and External finance. The government proposes to pay off the IMF loan of $1.4 billion before the due date. It would also like companies to repay their foreign loans prematurely, if such a course is permissible under the contractual terms. Exporters and other foreign exchange earners may retain their income in foreign exchange up to

25 per cent, and up to 50 per cent in the case of 100 per cent export-oriented units. The rupee will be freely convertible on current account, with the result that the education of children abroad, foreign medical treatment and foreign travel will be greatly facilitated.

In the banking sector there would be a reduction in interest of one percentage point on term loans—from 15 per cent to 14 per cent. But the minimum rate of interest would remain unchanged at 15 per cent on overdraft accounts.

The period for which debentures, units of the Unit Trust of India and approved mutual funds are required to be held in order to qualify as long term capital assets, has been reduced from three years to one year.

In the field of personal taxation the most welcome feature of the Budget is the abolition of surcharge of 12 per cent. One wishes it had been paired with similar abolition of corporate surcharge which remains at 15 per cent.

The threshold of personal taxation is proposed to be increased from Rs. 30,000 to Rs. 35,000. But this is wholly inadequate, having regard to the erosion in the value of the rupee. The exemption limit was fixed in 1981 at Rs. 15,000 which is equivalent to more than Rs. 45,000 today. Equity and justice are on the side of the opposition who propose to move an amendment that the exemption limit should be raised to Rs. 50,000 to eliminate the necessity of annual revision.

In our era of mafia raj, no impartial observer can fail to admire Dr. Manmohan Singh who is an outstanding technocrat of exemplary integrity. But that should not blind us to the unfavourable aspects of our national finance.

Disturbing deficit. — The most disturbing feature of the Budget is that according to the revised estimates for 1993-94 the fiscal deficit will be Rs. 58,551 crore, while GDP at current market prices is Rs. 802,000 crore. This means that the ratio of the fiscal deficit to GDP is 7.3 per cent as against the original plan that the deficit would be 4.7 per cent of GDP. For 1993-94, the revenue deficit originally estimated was Rs. 17,630 crore, while according to the revised estimate it is Rs. 34,058 crore — a variance of 93.2 per cent. The budgetary deficit originally estimated was Rs. 4,314 crore, while the revised estimate is Rs. 9,060 crore — a variance of 110 per cent. The original estimate of the fiscal deficit was Rs. 36,959 crore, while the revised estimate is Rs. 58,551 crore as stated above — a variance of 58.4 per cent. This year's revised estimates have crossed the prudent norms of variance. Such violent variations make a mockery of the very purpose of making estimates. The same government which, with the vast resources at its command, is unable to form estimates within a reasonable margin of error, demands that individuals and companies must pay their tax long before the year is over on a reasonably accurate estimate of their income, on pain of having to pay swingeing penal interest!

The revised estimate of the government's present indebtedness is Rs. 470,000 crore. This is almost 60 per cent of our GDP. Unborn generations are a group wholly unrepresented in Parliament and to protect their vital interests, it is essential that we bear the burden of our national debts. In the words of Thomas Jefferson, one of the outstanding Presidents of the USA, "The question whether one generation has the right to bind another by the deficit it imposes is a question of such consequence as to place it among the fundamental principles of government. We should consider ourselves unauthorized to saddle them with debts and morally bound to pay them ourselves". If this is a principle of political morality, India is stridently immoral. According to this year's Budget the government's interest payments next year will aggregate to Rs. 46,000 crore which means that no less than 53 per cent of the revenue receipts of the Government of India will go to pay interest. We are clearly in a debt trap — borrowing more funds merely to pay interest on existing debts.

Lack of fiscal discipline. — Discipline in incurring non-Plan expenditure is the collective responsibility of the entire government. The Finance Minister by himself can do precious little by way of imposing such discipline. The non-Plan expenditure has been burgeoning at the rate of 15 per cent year after year. The cavalier manner in which the government has sanctioned the expenditure of Rs. 1 crore by every member of the Lok Sabha and of the Rajya Sabha at a time when the deficit has reached alarming proportions — is an index to the recklessness so characteristic of the Union government.

Excise. — One of the most objectionable features of the Budget is the imposition of excise duty on various products which formerly were not liable to excise or were liable to lower excise. The main cause of the widespread and intense public dissatisfaction with the Budget has been the ill-thought-out revision of excise.

Service tax. — The Budget has introduced "service tax" for the first time. No doubt service tax is constitutionally valid, but it is unwise. The proposal today is to levy service tax on three services — brokerage, general insurance and telephones. But nothing is more dangerous in India than the introduction of a new tax. Tax revenues are to Indian politicians what drugs are to junkies — they can never have enough.

For instance, excise was formerly levied only on the goods expressly specified by law. Then the 1975 Budget introduced Item No. 68 as the residuary item (unspecified goods) imposing a "nominal duty at the rate of one per cent ad valorem". The rate of excise under this residuary item was increased from one per cent in 1975 to 12 per cent by 1985!

The proposed items chargeable to service tax will multiply as quickly as rabbits. Services are rendered

by countless professionals — including physicians, surgeons, architects, accountants, business consultants and lawyers. Where will the categories of service tax end?

The least defensible item of service tax is that on telephones. The Indian telephone system is a national disgrace compared to the efficiency of the service in other lands. This obese public sector enterprise represents the low water mark of efficiency. Our telephones render no service but a blatant disservice. To levy tax on such a disastrous disservice is to betray a degree of audacity which calls for nationwide opposition.

Entry of Foreign Institutional Investors (FIIs). — Globalization in all its forms is the order of the day. Production, investments, communications and information are today globalized as never before.

Throwing open the Indian economy to FIIs is a move in the right direction. We should welcome FIIs who are willing to bring in foreign exchange and to boost the Indian stock exchanges. Their advent into India is in the long-term interest of our country. On the day of the Budget, about 145 FIIs were registered with the Securities and Exchange Board of India (SEBI) in consultation with the Reserve Bank of India. Fifty of them are actively trading in India.

Two basic points may be noted about the FIIs. First, they have **not** come here out of motives of philanthropy or charity, or out of a desire to assist and to be loyal to the. Third World. It is true that investment by FIIs can ebb out as fast as it has flooded in. "The slightest whiff of danger and they will be gone. There is no doubting the depths of their pockets; but you cannot count on their loyalty." I do not think this veiled criticism is justified. After all, the FIIs are in fact and in law accountable to their own participants and they must sell off their investments at the time which is most beneficial to those who own the fund or the company. If they perform their legitimate and rational duty towards those who own them, they cannot be branded as fickle investors.

The second point, even more important, is regarding the desirability of a cap on investments by FIIs. In an ideal world, the nationality of capital would be irrelevant. But we are not living in such a world.

Instead of wasting our time and energy on non-issues, like the renaming of a university, a well-informed public debate should take place on the question — how long will Indian industries remain Indian?

Today's Guidelines permit each FII to invest up to five per cent of the capital of an Indian company. The overall ceiling on the aggregate investments by FIIs

taken together is 24 per cent of the capital of a company. But the vital point is that in calculating the 24 per cent overall ceiling, investments represented by (a) Offshore Funds, (b) Global Depository Receipts, and (c) Euro-convertibles are to be excluded. If the excluded investments are also taken into account, it is clear that the 24 per cent ceiling would be substantially exceeded. Further, the 24 per cent cap can be legally circumvented by an FII making investments through those associate companies which are technically Indian entities and, therefore fall outside the purview of SEBI's regulations. A public discussion in depth is required on this point. In Taiwan and in South Korea the aggregate holding of FIIs is pegged at 10 per cent.

Britain was the world-renowned home of the motor car industry. However, one enterprise after another in the field of automobile manufacture has changed hands in Britain. The last but one motor car enterprise to remain in British hands was Rover, but even that has now been acquired by the German firm, BMW. Thus today there is no British-owned company in the field of motor car manufacture except Rolls Royce.

During the first forty years of our republic, our national industries were suffocated and strangulated, and our entrepreneurial culture was asphyxiated, — all in the name of socialism. Would not the national psyche be hurt if today a sizable chunk of Indian industry were to be taken over by FIIs (or the foreign

parties to whom they sell) only because they are able to pay an attractive price? I hope there are still Indians left who do not count their wealth in money alone.

India has now become a shareholding democracy. Among the citizens who buy or subscribe for shares, there are many who have no idea whether Wall Street is a thoroughfare or a new mouthwash. There are 22 stock exchanges in India and 28 mutual funds (public and private). About 7000 companies are quoted on the stock exchanges. In addition, 500 new public companies have been floated during the last twelve months. The total number of shareholders and participants in mutual funds is estimated to be 22 million. Naturally, it is the well-managed companies with a bright future which will attract the attention of foreign investors, whose resources are far greater than those of their Indian counterparts. The biggest FII — Fidelity Investments — has under its control, aggregate funds of $268 billion, whereas the total market capitalization of all the shares on the Bombay Stock Exchange is equivalent to about $115 billion.

Level playing field. — Indians can hold their own against their counterparts abroad. But they expect, in fairness, a level playing field. The level playing field should not be merely in relation to the product manufactured by an Indian enterprise but also, equally importantly, in the field of investment. It is here that the Indian investor faces a great handicap. First, because of

higher taxation, the Indian resident is left with substantially lower capital (accumulated income) than the foreigner. Secondly, when it comes to capital borrowed for the purpose of investment, the Indian is at even a greater disadvantage. On his borrowed funds, he is obliged to pay, under legal compulsion, a rate of interest which is 200 to 300 per cent higher than the rate which the foreigner has to pay on the loans he raises abroad. In its desire to acquire large reserves of foreign exchange, the Indian government is putting its own nationals at a tremendous disadvantage.

The Budget affords an excellent example of the fact that in India we are accustomed to a comfortable time-lag of thirty years intervening between the consciousness that a particular reform is required in the public interest and a serious attempt to undertake it.

Promissory estoppel. — The most perturbing part of the reaction of NRIs and of foreigners to the Finance Bill is their mistrust of the Indian government, born of their bitter experience of the maddening changes in Indian laws and their painful consciousness that the law permits what honour forbids. Total absence of honour and good faith on the part of the Indian government is ever fresh in their minds. The Finance Act, 1986, shamelessly discontinued investment allowance without the three years' notice which was mandatory under the law. Similarly, the Finance Act, 1990, abolished, without any notice, various reliefs and tax concessions which had been in operation for a long time — ranging from 13 to 25 years. The government bluntly refused to consider the palpable injustice entailed as regards schemes which had been in the process of implementation and which had been undertaken by trusting taxpayers on the basis of existing law.

I should like to repeat here the suggestion I had made last year. While every Finance Minister is entitled to make such amendments in the law as he thinks proper, the government should act in a manner calculated to protect the **assessee** by enabling him to avail himself of what is called in jurisprudence the equity of "promissory estoppel". The government should apologize for the breaches of faith committed in the past and publicly avow that its policy hereafter would be to ensure that those who act on the faith of the existing law would be protected. The doctrine of promissory estoppel which prevents the government from going back on its promise can be enforced in the High Courts and the Supreme Court by any aggrieved citizen or foreigner. Unfortunately, there are no words in the Budget Speech which can possibly give rise to the equity of promissory estoppel.

Excessive secrecy. — Excessive secrecy continues to stifle pre-budget economic debate. Patrick Lenkin, Sir Richard Clarke, and Peter Jay among others have repeatedly pointed out that there is no reason whatever

for secrecy about direct taxes. But the fossilized minds in the North Block are totally unresponsive to any new idea unless, per chance, it originates in their own heads.

The legitimate complaint of the NRIs that they have been discriminated against, as compared to FIIs, might not have arisen if there had been an open public discussion regarding the two categories before the Budget.

Instability in laws. — I believe that no civil servant should be allowed to work in the Finance Ministry unless he has taken a Foundational Course which emphasizes one truth. The truth is that stability in tax laws is to a nation what stability in family life is to an individual; and, therefore, where it is not necessary to change, it is necessary not to change. On the contrary, our Finance Ministry is filled with bureaucrats who eternally mistake amendment for improvement and change for progress. In the first decade of our republic, several budgets hardly made any change in the direct tax laws — they merely prescribed the rates of tax. On the top of the 150-odd changes made in the direct tax laws last year, this year's Budget has amended more than sixty sections of the direct tax Acts. Between April 1993 and February 1994, the Import Trade Control was altered by 195 Notifications, and the Export Trade Control by 34 Notifications.

Two-year budget. — There would be tremendous saving in time and energy, cost and public inconvenience, if we adopt the system of a Union Budget for a period of two years at a time. It would make for greater stability in place of the insensate annual changes to which we are accustomed. As many as **21** States of the USA have adopted the practice of two-year budgets. President Clinton has publicly said that he intends to introduce the practice of two-year budgets from October **1996.** Though we may not be enamoured of the attitude of Americans towards India in some areas, we should learn from them the way of saving the nation's time, effort and energy.

The 5 p.m. ritual.—The time of day when the general budget is introduced in Parliament needs to be reconsidered. I am firmly of the view that the general budget should be presented in the morning, just as the railway budget is presented in the morning year after year. During the British days, the general budget used to be introduced at 5 p.m. for a reason which suited British rulers. Since the British time was $5^1/_2$ hours behind the Indian Standard Time, the Chancellor of the Exchequer could inform the House of Commons on the same day about the fiscal changes proposed in the Indian budget. No Indian Finance Minister has had the wisdom to change this practice, even though the justification for it has long ago vanished. Dr. Manmohan Singh has been an innovator in many areas and I wish he would have the courage to make a change in the timing of presenting the general budget. Once the change is effected, no Finance Minister would ever go back to the 5 p.m. ritual. (Before Mr. Morarji

Desai became the Finance Minister, the new rates of taxation applied to income earned during the very year in which the budget was introduced. Mr. Desai saw the injustice of it and made the new rates applicable to the accounting year following the budget. This equitable change has invariably been adhered to. This is how a rational practice, once innovated by a strong man, continues to be followed in subsequent years.)

One other change for which credit should also go to Dr. Manmohan Singh is his endeavour to introduce fruitful egalitarianism in place of sterile socialism.

Such a change has openly come over Britain. The Labour Party of Britain which had been the great champion of ideological socialism, has announced that it has made a U-turn in its policy. john Smith, the leader of the Party, said last year that he was relaunching the Labour Party as the party of the individual citizens and that he intended to chart a future in which the traditional associations of the Party with state ownership, high taxation and trade union power would be buried forever. In a reference to the Labour Party's old attachment to public ownership of the commanding heights of the economy, john Smith said that the new commanding heights were education and training. He categorically said that there would be no commitment to renationalization in the next manifesto of the Labour Party and that. the most important priority would be to invest in people, to

provide opportunities and skills that were the building blocks for individuals and national prosperity.

India can wait no longer for the dawn of a new era when ethical socialism will become the national policy in place of ideological socialism.

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The Forum of Free Enterprise is a non-political and non-partisan organisation, started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions, and other means as befit a democratic society.

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