THE ECONOMIC ENVIRONMENT IN INDIA—1967

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"People must come to accept private enterprise not as a necessary evil. but as an affirmative good."

—Eugene Black

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By

N. *A. Palkhivala*

The subject of economic environment comes home to every citizen every hour of the day. It is reflected in prices and wages, in the outlook for industry and the future of the entire nation.

The Committee on Economic Development, which made a study of economic growth in the Latin American countries during the last fifteen years, reached the central conclusion that the most important factor in the economic development of Latin America has been the economic policy followed by each nation of that continent. Abundance or scarcity of natural resources, rates of population growth, the level of education and geographical conditions, have a strong impact on the economic environment; but more important than them all is the economic policy pursued by the Government. This is as true of India as of any other country. If countries like Burma and Indonesia, which have the potentiality to be among the richest countries in the world, are still in the throes of economic distress, it is wholly due to the suicidal policies pursued by their Governments. If our own Government had followed a different economic policy during the last ten years, the history of this country would have been very different.

*Based on a talk delivered at Ahmedabad on January 12, 1967. The author is an eminent advocate and authority on taxation.

The six facets of governmental policy which have the strongest influence on the economic environment are—

(i) monetary stability,

(ii) fiscal policy,

(iii) export policy,

(iv) climate for free enterprise,

(v) balance between agricultural and industrial development and

(vi) the attitude, receptive or otherwise, towards foreign capital.

In terms of the above six criteria India serves as a warning, and not an example, to the rest of mankind.

MONETARY INSTABILITY

To talk of monetary stability in India is like talking about snakes in Iceland—the thing does not exist. Inflation is inevitable since our Government has been living beyond its means and beyond our means for ten years. Prices have risen 80 per cent in the last ten years. 28 per cent has been the rise during the last two years alone, as against the 25 per cent rise in prices during the last ten years in the stable countries. The wholesale price index of all commodities is 198, and of food 210 (as against 100 in the base year 1952-53), representing a rise of 17.4 per cent and 23.1 per cent respectively in the course of one year. The real national income of India fell sharply by 4.7 per cent in 1965-66, and the per capita real income by 7.1 per cent. Thus we took a long step backwards in the last year of the third Plan.

India holds the pre-eminent position among the great race of international borrowers. In 1951 our foreign indebtedness was practically nil; in 1956, at the end of the first Five-Year Plan, it was Rs. 114 crores: in 1961, at the end of the second Plan, it was Rs. 761 crores; in 1966, at the end of the third Plan, it stood at the staggering figure of Rs. 2,629 crores. During the third Plan, one-fourth of the foreign indebtedness, incurred at Government to Government level, was used merely to pay interest on and repay the principal of existing foreign loans. India is the largest single debtor of the World Bank, our total loans from it being in excess of $ 740 million.

During the first Plan, deficit financing was of the order of Rs. 330 crores; during the second Plan it rose to Rs. 954 crores; and during the third Plan it touched the figure of Rs. 1,150 crores, while on another calculation it was of the order of Rs. 1,400 crores. From April to December 1966 the amount of deficit financing was Rs. 250 crores.

Since our Government had taken adequate and sustained measures to ensure the decline and fall of the rupee, our currency had to be devalued on the 6th June last year. Devaluation was desirable and advisable, equitable and unavoidable. But thereafter we took the wrong turn at the crossoads and did not take the follow-up measures which would have resulted in devaluation lifting India out of the quagmire and which would have created prosperity out of prostration. "The diagnosis which pointed to the need for appendectomy in the form of devaluation was not wrong. The expectation that the surgeon would stay awake through the operation and not fall asleep with the scalpel in his hand, was". A Report published exactly a year ago by the Economic & Scientific Research Foundation showed that barring Indonesia, India's rate of growth has been the lowest in Asia and the Report further said that at the present rate of growth India would reach the economic level of Japan in 2100 A.D. The Government of India's reaction was, not to sit up and start thinking, but to say that such a conclusion should be deleted from the Report. Such a reaction is worthy of Mr. Podsnap in Dickens' **Our Mutual Friend,** who thought that he could put reality behind him by a flourish of his hand.

Small wonder that there is frustration all round. Intelligent men are prone lo get violent in their words; and the unintelligent tend to become violent in their deeds.

FISCAL POLICY

The fiscal policy of the Government of India constitutes the worst aspect of its handling of the national economy. As far as direct taxes are concerned, India is the highest taxed nation. When the Government tries to refute !his case we are tempted to say that just as no taxation without representation is one principle of democracy. the other is — no taxation with nlisrepresentation. The rate of income-tax rises to 82.2 per cent on earned income and 89.4 per cent on unearned income, over and above the liability to make Annuity Deposit. The maximum marginal rate of personal income-tax is only 53 per cent in Germany, 60 per cent in Japan, 60 per cent in Norway and 65 per cent in Sweden. There are many socialist countries in the world, but lndia is the only country where income-lax and wealth-tax can together amount to more than 100 per cent of the total income. The most expensive hobby of Indians is work. Comparative data establish that we impose heavier taxes on honest enterprise and endeavour than any other country.

Corporate taxation in India is beyond question heavier than in any other country. In no other country does the rate of aggregate tax on resident companies soar beyond 54 per cent of the total income. In no other country does the total incidence of tax as between the company and the shareholder pierce the 95 per cent barrier as it does in lndia. Only in Chile (where the tax on resident companies is 30 per cent) there is the exceptional rate of 66 per cent imposed on two U.S.A. corporations alone, because those corporations mine copper in Chile and deplete the national mineral wealth. Thus 66 per cent is intended to be a special confiscalory rate of tax on two foreign exploiters, whereas we impose that rate, and even worse, on our own national companies.

It is well recoguised that a high level of taxation is not disinflationary but positively inflationary, because if the solution to the problem of inflation is more production, then a very high level of taxalion which reduces the margin of saving and the amount available for investment is a potential inflationary force. Further, it destroys all cost consciousness: a company has as little incentive to economise when 70 per cent of its expenses are met by the Government, as a citizen has to work when it is more profitable to evade tax on Rs. 20 than to earn Rs. 100.

Other under-developed countries like Ireland and Nigeria have already hitched their fiscal wagon to the star of incentive and experienced a rate of economic growth higher than that of India. Apart from U.S.A., Germany and Japan, other developed countries like Belgium and Holland (1964 witnessed the largest income-tax reduction in Holland's history) have employed the fiscal stimulus and with lower tax rates reaped richer harvests.

The remark that tax rates in India cannot be reduced because of widespread evasion. is on a par with the observation that you should not go into water till you have learnt to swim.

The crushing burden of taxation is reflected on the Stock Exchange. During the third Plan the leal value of investments in ordinary shares declined by as much as 42 per cent. A few years ago when new companies were floated 94 per cent of the share capital was subscribed by the public; now the public participation is only 17 per cent.

Bringing into existence state sponsored financing institutions and making Stale loans to private enterprises bereft of support by the investing public, cannot possibly help to redress the balance The Government's fiscal policies make it impossible for the nation to breathe freely and it is little consolation that an apparatus for artificial respiration is available for use.

A very eminent economist, Dr. P. S. Lokanathan, has observed in the latest Report published by the National Council of Applied Economic Research :

> "There is not the slightest doubt that the major factor responsible for the poor shape of the capital market is the Government's fiscal policy.... The continued sluggishness of the market in India has no parallel in other countries; it is something special to India and reflects Indian policies and Indian performance."

During the third Plan the actual realisation by way of additional txation was Rs. 2,880 crores as against the target of Rs. 1,710 crores originally framed. The fourth Plan assumes that the huge additional taxation raised in the third Plan provides a "base" for raising further additional taxation of Rs. 2,730 crores. Even this figure of Rs. 2,730 crores would in reality be insufficient during the fourth Plan period, because it has been arrived at on the basis of a fantastically optimistic estimate of financial resources from other sources :

(a) The "balance" from current revenues at pre-Plan rates of taxation was a negative one of Rs. 470 crores during the third Plan, but the fourth Plan expects a munificent contribution of Rs. 3,010 crores from this source.

(b) The fourth Plan takes a credit of Rs. 335 crores "as economies in non-Plan expenditure", whereas with the increased dearness allowance to Government employees there will be a huge increase in non-Plan expenditure.

(c) Public sector enterprises are most unlikely to treble their surpluses, as the fourth Plan expects them to do.

If any Government is foolish enough ever to implement the fourth Plan, we shall have to write on the gates of our economy the famous words of the greatest Italian poet: "Abandon hope, all ye who enter here."

EXPORT POLICY

The total exports of India in 1965-66 were only Rs. 838 crores as against the imports in the same year of Rs. 1,262 crores. In that year Ceylon exported 491 millions lbs. of tea as against 440 million lbs. by India. This is a most depressing picture, when you remember that in 1949 Indian tea .accounted for 51 per cent of the total world exports. There has been a decline of 20 per cent in our export of jute last year. In the first half of 1966 Pakistan was able to export 110,000 tonnes of sacking against India's 79,000 tonnes. Likewise, India has been losing her share of the world market in manganese ore.

If anyone wants to have an idea of how foreign exchange is spent by India, not in promoting exports but in promoting a devalued image of Indian goods abroad, he might turn lo Beirut where the Government pays an annual rent of 45,000 Lebanese pounds for showroom space, in half of which are displayed rusty tea tins, biscuits which had been fresh two years ago, dust-laden packets of peppermint, and a host of other articles in a condition which demonstrates the incredible level of official inepitude.

After devaluation nothing has been done to boost exports. In fact, the paradoxical situation is that with the taking away of import entitlements an exporter is worse off after devaluation than he was before. Those commodities whose export used to secure more than 40 per cent import entitlements would still be in need of subsidy or other assistance after devaluation, if exports are even to be maintained at the present level.

CLIMATE FOR FREE ENTERPRISE

The climate lor free enterprise must be considerably improved if we intend to brighten the economic environment. The country has all the enterprise and human labour

which it needs, but these tremendous forces cannot be brought to fruition when free enterprise is anathema to the Government. We harness power in coal and oil, in fall and stream, but the greatest of powers — the immeasurable reservoir of the people's faith and response, energy and endeavour — is left to channel off where it will. This imponderable human force is beyond the vision of our restrictive regulations and Plans.

Our companies need to grow bigger if the working classes are to be paid better wages and the cost of production is to be kept down. Sales of the ten top companies in India account for only 19 per cent of the country's total industrial output. as against 43 per cent in Britain and 30 per cent in the United States and Japan.

It is significant to note that in U.K. the most powerful Trade Unions stated before the Monopolies Commission that they favoured bigger companies and larger industrial groups, because the bigger companies could ensure stability of employment and higher wage level.

IMBALANCE BETWEEN AGRICULTURAL AND INDUSTRIAL DEVELOPMENT

Even our planners have admitted that there is a vast imbalance in the Indian economy between agricultural and industrial development. This is the result of our Government's preoccupation with steel and heavy industries which is so incessant that such plants are almost treated as the temples of a new materialistic faith. When Prof. Colin Clark was asked whether he favoured the building of more steel plants in India, he gave the memorable reply : "This is a problem in compararivc religion."

The enterprises in the public sector keep on producing steel, while a substantial part of it is unsaleable. Unfortunately, it is not a particularly edible commodity; hence the average citizen has to spend long hours standing in food queues.

FOREIGN CAPITAL

Our excessive taxation and unstable economic policy have scared off foreign capital. A total inflow of foreign private investment of the order of Rs. 300 crores was predicated for the third Plan; not even half the target was in fact reached.

SUGGESTIONS

The economy cannot possibly improve unless there is a new order of priorities. There is no mathematical calculus for economic engineering; but we would do well to bring to the surface of the mind a few oft-repeated suggestions:

First, the realisation must dawn on the men in power that our Plans and our laws are not for angels or beasts but for human beings. In the last analysis, enonomics is a matter of human nature and not a collection of nicely wrapped formulas ready to be applied to the ticklish and tangled problems which beset the country.

Secondly, the highest priority should be given to tbe task of maintaining price stability. No wiser principle can be commended to our Government than the maxim that the economist or politician who is willing to trade away price stability for an expected higher rate of economic growth, may end up finding that he has lost both.

Thirdly, it will be impossible to hold the price line unless production increases with the money supply. Production must be increased by freeing the economy from the heavy hand of the bureaucrat with his pen-and-pencil armies and permit-licence armouries. The estimate that more acreage of floor-space is brought into use for official paper work than the new acreage brought under cultivation, may be rejected as slightly exaggerated.

Our system of licensing for commencement, diversification and expansion of production has put out of commission the two greatest economic power-houses — price and competition. Inefficiency, incompetence and profiteering are provided sheltered markets. Control is wielded from Delhi in a country where it takes hours to put through a telephone call over a few hundred miles and days before you can be assured of a seat on a plane. An exhortation to manufacturers and traders to hold the price line is less fruitful than vigorous and realistic steps to increase production: it is easier to increase the national product than to change the national character.

Fourthly, the sufferings of our people will have been borne in vain if the Central and State Governments continue to put growthmanship before consolidation and to regard deficit financing as a handy all-purpose tool.

Fifthly, drastic measures should be taken to ensure that the public sector with its Rs. 2,000 crore investment shows good results. In 1963-64 public sector enterprises in working condition controlled 22 per cent of the gross fixed assets (of all companies in the public and private sectors) and produced only 7.6 per cent of the total output. They earned a gross rate of return (profits before tax) of

1.7 per cent on capital employed, against 19 per cent in the private sector; their retained profits amounted to 1.4 per cent of the paid-up capital, as compared to 6.5 per cent in the private sector.

Sixthly, taxation will have to be considerably brought down if a spurt is to be given to savings and industry is to be enabled to meet higher costs. The radiating potencies of direct taxes go far beyond mere raising of revenue. They propel tendencies which can obstruct effort, deflect enterprise and constrict growth, and can prevnt the bringing forth of "the maximum gifts of each for the fullest enjoyment of all". Bad economics may temporarily be good politics; but politics should be behind a fiscal law. and not in front of **it.**

Seventhly, a lot of energetic and imaginative action is needed to enable India to hold her own in the world markets. Without increased exports our moribund economy cannot revive.

Bacon's dictum, "Knowledge is power" has passed into a byword. **A** nation attains the height of prosperity when knowledge and power are combined in the same individuals. The State faces its greatest crisis when knowledge is possessed by some and power by others.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise.

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

—A. D. Shroff
(1899-1965)
Founder–President
Forum of Free Enterprise

Have you joined the Forum ?

The Forum of Free Enterprise is a non-political 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.

Membership is open to all who agree with the Manifesto of the Forum. Membership fee is Rs. 10/- (Entrance fee Rs. 10/-). Associate Membership fee, Rs. 5/- (Entrance fee Rs. 5/-). Bona fide students can get our booklets and leaflets by becoming Student Associates. Student associateship fee, Rs. 2/- (Entrance fee Rs. 2/-).

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