THE ECONOMIC IMPLICATIONS OF THE UNION BUDGET, 1969-70

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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

PROFESSOR RUSSI JAL TARAPOREVALA*

I

BUDGET OFFERS A CHALLENGE TO THE PRIVATE SECTOR

This article presents an economic analysis of the Union Budget for 1969-70. The Union Budget must be viewed in the context of economic conditions as they have prevailed in the country during the past year and as they are likely to shape in the coming months.

A few basic economic indicators are analysed first to give a picture of conditions as they have prevailed in the recent past.

The years 1967-68 and 1968-69 were years in which a slow but steady revival took place after the economy had passed through crisis conditions in 1965-66 and 1966-67 when there were major droughts, a collapse of agricultural production, a major industrial recession and a substantial set-back in

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economic development. Thus, National Income at constant prices, which had risen during the Third Plan period, actually fell in 1965-66 by 5.7 per cent., rose by only 1.1 per cent. in 1966-67, but jumped up sharply by 8.9 per cent. in 1967-68 and is expected to rise further by another 3 per cent. in 1968-69, indicating clearly that the economy has resumed its forward march.

Similarly, agricultural production which had slumped in the drought years has recorded dramatic improvement in the past two years. Production of food grains fluctuated thus: in 1964-65 it was 89 million tons, in 1965-66, 72 million tons, in 1966-67, 74 million tons, in 1967-68, 96 million tons and in 1968-69 it is estimated to be not less than 96 million tons.

The increase in agricultural production was partly the result of new agricultural strategy adopted by the Government which included measures like the use of higher-yielding varieties of seeds, promotion of multiple cropping, expansion in supplies of fertilisers, encouragement of inputs of water and mechanisation in farming etc.

Industrial output

Industrial production which had increased at a rate of over 8 per cent. per year during the calendar years 1961 to 1964, increased only by 7.2 per cent. in 1965 and by only one per cent. in 1966 after which it actually declined by half per cent. in 1967. Thereafter it increased by 5.6 per cent. in the first nine months of 1968 and it is expected to expand at a rapid rate in the coming year. The capital markets have also shown signs of revival and equity prices have risen by more than 25 per cent. in the last year.

A most remarkable feature of the Indian economy during the past year has been the fact that the galloping inflation that had set in previously was completely halted in the past year. Thus, the general price index which had risen by 13.8 per cent. in 1966 and by 15.4 per cent. in 1967 actually fell by 1 per cent. in 1968. Indeed, this was the first year since 1955 when the price level has shown a decline in relation to the preceding year. The fall in the price level is all the more remarkable in so far as it occurred in a year in which the budget of the Central Government showed a deficit of Rs. 260 crores. This clearly indicates that large-scale deficit financing does not invariably lead to inflation. In 1968, money supply rose by only 6.5 per cent. but national output in real terms increased by 8.9 per cent. The halt in inflation can be largely ascribed to a rapid increase in national output which was not accompanied by a disproportionate increase in the money supply.

The Bank Rate was cut in 1968 and the general availability of finance from the banking sector has been easier during the past twelve months than it had been hitherto.

Moderate revival

On the external front, there was a decline in imports in 1967-68 because of the reduction in food imports, on account of the bumper harvest. Exports showed an increase during the year. Thus, the situation of the country in relation to its balance of payment and external trade showed promise of some improvement. The background outlined above indicates that the Budget has come at a time when the economy has shown clear signs of a moderate revival after two disastrous years of drought and recession. The budget strategy has been to steer a steady course which will not upset the momentum of the economic recovery but may help it to progress.

The budgetary position of the Government of India can be reviewed to highlight certain basic and important factors revealed in the latest Budget. The budget for 1968-69 had indicated a revenue surplus of Rs. 131 crores. The revised estimates put the surplus at slightly less than Rs. 4 crores. At current levels of taxation the Budget for 1968-69 would have shown a revenue deficit of Rs. 60 crores which the Finance Minister has sought to convert into a revenue surplus of Rs. 40 crores by imposing additional taxation which will yield to the Centre Rs. 100 crores in 1969-70. Taking the revenue and capital Budgets together, the overall deficit in the Budget for 1968-69 was estimated at Rs. 290 crores, but the revised estimates have placed it at Rs. 260 crores. At the current level of taxation, the overall deficit for 1969-70 would have been Rs. 350 crores which is sought to be reduced to Rs. 250 crores through the new taxation proposals which are expected to yield to the Centre Rs. 100 crores. These figures clearly reveal that for the second year in succession, the Finance Minister has presented a Budget with a substantial overall deficit. The past year has already shown that the deficit of Rs. 260 crores has not resulted in any inflationary pressure in the economy and it is likely that if national output rises during the coming twelve months the Budget for 1969-70 may contribute to growth in the economy through its strategy of deficit financing without causing any rise in the price level.

Important trends

The Budget data and papers reveal certain important trends which can have profound implications in the coming years. The Budget clearly shows that the Centre was put under unprecedented strain by the Financial demands of the States. Thus in the revenue Budget the total transfers to the State of tax receipts shown in the Budget for 1968-69 at Rs. 438 crores actually rose as per the revised estimates to Rs. 491 crores and are expected to rise by another Rs. 27 crores in the Budget for 1969-70. The assistance to States and Union Territories which was shown in the revenue Budget for 1968-69 at Rs. 478 crores has now risen in the revised estimates to Rs. 537 crores and the Budget for 1969-70 provides for Rs. 596 crores for this item—a rise of Rs. 118 crores over the last year's Budget!

The capital Budget indicates that the Central Government's total assistance to States and Union Territory Governments which was shown in the Budget for 1968-69 at Rs. 881 crores rose to Rs. 937 crores as per the revised estimates but is expected to fall to Rs. 799 crores in the coming year's Budget: However this may prove to be an underestimate. It is therefore clear that the finances of the States are not in a healthy condition and that the Centre has been under unprecedented pressure to meet the financial demands of the various States. The Central Government was unable to impose fiscal discipline and efficiency on the various States which is not a healthy factor in the country's economy.

Defence expenditure

The expenditure on defence has also gone up sizably. Thus, in the revenue Budget defence expenditure which was estimated in the budget for 1968-69 at Rs. 894 crores is shown to have risen in the revised estimates for the year to Rs. 943 crores—an increase of Rs. 49 crores. Further for 1969-70 defence expenditure in the revenue Budget is estimated to rise to Rs. 986 crores indicating that defence expenditure has risen by almost Rs. 90 crores over the previous year's Budget estimates. In the capital Budget defence expenditure is shown at Rs. 108 crores under the revised estimates for 1968-69 and Rs. 124 crores in the Budget for 1969-70. Of the total disbursements in the Central Budget on capital and revenue account in the coming year of Rs. 4,980 crores defence expenditure will now account for Rs. 1,110 crores—over one-fifth of the Central Budget. Defence should enjoy the highest priority in order to ensure the nation's strength and revival. But the time has come when the Government should make a careful assessment and order a continuous review to see that this vast sum of Rs. 1,110 crores which will be spent on defence is efficiently and properly spent so that the nation gets the maximum benefit out of this huge outlay.

Outlay on agriculture

The Budget also reveals that as a result of the agricultural revival the outlay for food and fertiliser subsidy which was expected to be Rs. 79 crores in the Budget for 1968-69 actually turned into a surplus of Rs. 119 crores in that year and during the coming year these transactions are expected to result in a surplus of Rs. 36 crores. Thus, resources which had to be utilised in the past for food and fertiliser subsidies are now no longer shown as large burdens in the Central Government Budget.

The Budget papers show that the provisions for the Plan total Rs. 1,903 crores against a total Plan outlay of Rs. 1,859 crores in the previous year's Budget. This indicates actually a small increase in the Plan outlay. The Budget has been criticised as having failed to make a large provision for the Plan and critics have argued that as a result of this the Budget is at best a *status quo* Budget and will not spur the economy forward. The adequacy or inadequacy of Plan expenditure in the context of the country's needs can always be debated without coming to any scientific conclusion. But the data shows that the Budget has provided for a sizable development effort. Before comparing the figure on the outlay of the Plan it may be pointed out that the total developmental expenditure shown in the revenue Budget in revised estimates for 1968-69 at Rs. 335 crores is estimated to rise to Rs. 380 crores in the Budget for 1969-70. Further the developmental expenditure shown in the capital Budget in the revised estimates for 1968-69 at Rs. 523 crores is expected to rise to Rs. 669 crores under the Budget provisions for 1969-60.

Thus taking into account the provision made in the capital and revenue budgets the total developmental expenditure is expected to rise by more than Rs. 190 crores in the coming year. These figures may be compared with the following figures showing the increase or decrease in the total developmental expenditure on the capital and revenue accounts in past years: in 1963-64 it increased by Rs. 93 crores over the previous year's figure but in 1964-65 it increased by only Rs. 37 crores, in 1965-66 it actually declined by Rs. 39 crores, in 1966-67 it declined by Rs. 23 crores, in 1967-68 it declined by Rs. 18 crores but in 1968-69 the revised estimates show an increase of Rs. 119 crores and the Budget for 1969-70 provides for a further increase of Rs. 191 crores.

Development outlay

The record clearly indicates that the Budget for 1969-70 provides for a sizable increase in the developmental expenditure, substantially in excess of the increases in such expenditures during the past many years. Indeed, the total provision in the Budget for development expenditure is higher than such provisions made in the past many years. Thus, the Budget does involve a substantial effort to step up developmental outlays which should spur the economy in the coming months.

The Budget papers also clearly indicate the urgent need to revitalise the managerial and operational efficiency of the public sector enterprises. Indeed, it may be argued that the unsatisfactory performance of the public sector enterprises has been a major factor which puts the Government of India's Budget under great strain and also retards the growth of national income. The present investment of the Central Government in industrial and commercial enterprises—over 80 in number—is more than Rs. 3,500 crores. Out of this, the investment in 55 running concerns was around Rs. 3,200 crores. But these concerns showed a net total loss of Rs. 35 crores during the past year. Here then is a vast sector of public investment which is making no contribution to national income and is actually a burden on the public exchequer. Whilst the Memorandum on the public sector interprises circulated with the budget papers indicates the various steps that are being taken to make them more efficient and profitable it is doubtful whether such steps will be adequate or effective in ensuring that these enterprises generate substantial surpluses or profits which can then be used for national development.

In the context of the unfortunate working of the public sector enterprises it is a matter of some regret that the Government is not only taking inadequate steps to ensure the dynamic and profitable operation of these undertakings but continues to pour large sums of money into further loans and capital contributions of such enterprises. Thus, the investments in such enterprises shown at Rs. 186 crores in the budget for 1968-69 are shown in the revised estimates at Rs. 205 crores and are further expected to rise in the budget for 1969-70 to Rs. 296 crores.

The Budget also provides for large loans to be extended to such enterprises. Thus, the loans extended to them are shown to have risen from Rs. 217 crores provided for in the budget for 1968-69 to Rs. 383 crores in the revised estimates for the year. The Budget provides for a continued expansion of the public sector in industrial and commercial enterprises. But such outlays will act as a drag on the economy in the long run unless these investments are made to pay off in terms of profits and efficiency. In the short run, the large investments planned in the public sector enterprises, especially in Bokaro Steel at Rs. 170 crores in the coming year, may result in the revival of capital goods industries in the private sector and to that extent may act as a boost to the economy.

Taxation

The Budget contains proposals for increases in taxation amounting to Rs. 127 crores of which Rs. 100 crores will accrue to the Centre and Rs. 27 crores will be shared by all the States. The excise duties on a wide variety of goods imposed are expected to yield Rs. 104 crores of which the Centre will get Rs. 80 crores. The net increase in the yield from customs duties after giving substantial reliefs in export duties will be Rs. 9 crores. Increases in direct taxation are estimated to yield Rs. 11 crores to the Centre and to Rs. 2.5 crores to the States. Increases in rates of posts and telegraphs are expected to yield Rs. 6 crores which will be just sufficient to cover the anticipated revenue deficit of this sector. Thus, the Budget makes a relatively modest tax effort during the coming year. It has already been argued that the Budget contains provisions to resume developmental outlays on a substantial scale to spur the economy forward. Those who argue that developmental expenditure should have been raised much more have not shown a sound method by which this can be done.

The Finance Minister has attempted to achieve maximum results within the limitations imposed upon him by various conflicting pressures on the Central Budget and the effort has been accompanied by a second dose of deficit financing estimated at Rs. 250 crores in the coming year together with a taxation of Rs. 100 crores. A larger developmental effort could only have been attempted by increasing substantially the deficit financing which would then probably have led to strong inflationary pressures in the economy or by raising taxation substantially which would have retarded economic growth and progress.

Striking feature

A most striking feature of the new Budget proposals has been the dramatic effort by the Finance Minister to tax the agricultural sector. The Finance Minister has correctly recognised that the agricultural sector should bear at least a small burden of taxation since it benefits substantially from the development outlays made under the new agricultural strategy of the Government. Accordingly, he has imposed an *ad valorem* duty of 10 per cent. on fertilisers which will yield Rs. 22 crores and *ad valorem* duty of 20 per cent. on power-driven pumps which will yield Rs. 2 crores. These duties are relatively modest and even if passed on to the agriculturists will impose a burden of taxation on them which will be nominal in relation to the rise in their incomes which had occurred in the past two years. The strategy of taxing the agriculture in the coming years should be through the levy of excise duties on a wide variety of articles entering into the consumption of the rural population.

Underestimate

The Finance Minister has also announced that agricultural lands will be subject to wealth tax for the assessment year 1970-71. He has claimed that the additional revenue will be Rs. 5 crores. This appears to be a gross underestimate. The wealth tax on agricultural land if properly administered should yield more than double the figure estimated by the Finance Minister. Further, the attempt to tax the agricultural sector through wealth tax appears to be premature because it will cause enormous administrative complications and great strain on the tax gathering machinery of the Central Government.

The Finance Minister has said that the entire proceeds of the wealth tax on agricultural property would be passed on to the States as grants in aid. In view of this it may be asked why the Centre should have undertaken to impose the wealth tax on agricultural land at this juncture. The Central

Government has thus undertaken to impose direct taxation on agriculture which is unpopular and which the State Governments have been refusing to undertake many years. The correct approach for the Central Government for raising direct taxation on agriculture to finance the coming Fourth Plan should have been to force the States to substantially increase their agricultural income-tax rates in order to make the agricultural sector bear a portion of the burden of direct taxes. In principle, any effort to make the agricultural sector contribute to the total tax revenues and thereby to the developmental effort of the country is to be welcomed and supported. It is only argued here that the direct taxation of agriculture should be the responsibility of the State Governments and the Centre was ill advised to have attempted to fulfil this responsibility as it has done in the Budget.

The Budget has provided for the maximum development expenditure possible within the financial resources available to the Central Government. Thus, it leaves scope for the private sector to expand substantially so that a sizable part of the country's development, especially on the industrial front can be carried out successfully. It may be argued that the Budget has not contained sufficient changes which would reduce the burden of taxation on the private sector and thus enable it to have resources for expansion and growth. But a cut in taxation is only one of the methods which could be used by the Government to stimulate investment in the private sector.

The Finance Minister should now boldly take other steps to enable the private sector to raise the resources which it will need to expand in the coming years. A follow-up step after the Budget which should be taken immediately is a cut in the Bank Rate by one per cent. Such a cut in the Bank Rate will not have any inflationary impact in the economy. Indeed the experience of 1968 shows clearly that a cut in the Bank Rate does not necessarily result in inflation. In the present economic conditions a cut in the Bank Rate will revive the capital markets, stimulate investment in the private sector and create the conditions for fast economic growth and take-off. The Budget offers a challenge to the private sector to participate vigorously in the task of developing this great country and it is hoped that the Government will help the private sector to grasp this opportunity to expand by creating in the coming years conditions for its growth by taking measures such as a cut in the Bank Rate.

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TAXATION PROPOSALS ANALYSED

Some of the important tax proposals in the Union Budget for 1969-70 may be briefly reviewed: the Finance Minister has proposed a substantial cut in the export duties on jute manufactures involving a sacrifice in revenue of Rs. 12 crores. This should stimulate jute exports in the coming months. The excise duty on jute goods has however been raised to yield Rs. 5 crores. The jute industry has been classified as a priority industry entitled to development rebate at the higher rate of 35 per cent. in respect of new plant and machinery installed from April 1, 1969. These measures should help to revive the jute industry and improve its export performance.

The excise duties on coarser yarn and grey fabrics have been cut sacrificing Rs. 15 crores in revenue. However, an increase in the excise duty on superfine, fine and printed fabrics has been announced and it is estimated to yield Rs. 9.5 crores. It should be possible for the textile industry to easily pass on to the consumer the small levies on these luxury fabrics. The textile industry has also been declared as a priority industry entitling it to a development rebate at the rate of 35 per cent. in respect of new plant and machinery installed from April 1, 1969. These measures will assist the revival and growth of the textile industry.

An *ad valorem* duty on sugar at the rate of 23 per cent. has been imposed. This duty is likely to fall on the manufacturers in respect of the sugar sold in the free market and therefore it is likely to mop up Rs. 27.45 crores from the profits made by sugar manufacturing units on account of the partial decontrol of sugar. The duty is therefore not likely to increase the price of sugar.

The Finance Minister has increased the excise duty on cigarettes to yield an additional Rs. 16 crores in the coming year. In his budget speech he has announced in the past that "I did not do a neat enough job" in regard to the duties on cigarettes. The increase in the excise duty on cigarettes is relatively modest and will undoubtedly be passed on to the consumer without adversely affecting the industry. There appears to be still very large scope for increasing the taxes on cigarette and tobacco. Indeed more than half the additional taxation required to finance the Fourth Plan can be easily raised in the coming years by enhancing the taxes on cigarettes and tobacco.

The budget contains proposals for increasing the excise duty on motor spirit and superior kerosene which are estimated to yield Rs. 28 crores. Here again, these taxes will be passed on to the consumer with marginal inflationary impact. Increases in the excise duties on rayon and synthetic fibres and yarn have been announced whereas the duty on nylon yarn has been reduced. The net effect of these proposals will be an increase in the revenue of Rs. 5 crores and these duties are likely to be passed on to the consumer.

The Finance Minister has announced an *ad valorem* excise duty of 10 per cent. on processed foods, electrical appliances, pilfer proofs and caps to yield Rs. 4 crores in revenue. The imposition of this excise duty on processed foods at this juncture may be criticised as being premature insofar as it is essential to encourage the growth of processed foods in the coming years in the context of agriculture revolution which makes it imperative that food preservation and processing should be rapidly expanded. *Ad valorem* duties have been announced in substitution to specific duties on a number of products and justified by the Finance Minister by saying that *ad valorem* duties "act as a spur to reduction in cost and prices". It is very doubtful whether this goal will be achieved and the imposition of excise duty on the *ad valorem* basis will indeed cause enormous administrative complications. The taxation of agriculture and excise duties has already been commented upon earlier.

It will be seen that the Finance Minister has spread his net wide in the field of indirect taxation and his attempt to spread the new tax levies in such a fashion as to have the minimum inflationary impact and be relatively easily palatable.

In the field of direct taxation, the Finance Minister has announced increases in the rates of income tax levied on individuals on slabs of income between Rs. 10,000 and Rs. 20,000. These changes will mean the taxpayer with an income of Rs. 15,000 will have to pay an additional Rs. 110 and taxpayers with an income of Rs. 20,000 and more will have to pay Rs. 275 more. These changes are expected to yield an additional revenue of around Rs. 14 crores. The imposition of this enhanced burden of income tax on the middle class people is unjustified in the present context considering that it is this class and especially those in it with fixed incomes who have been most severely mauled by the inflation in the recent past.

Certain minor changes in the taxation of corporate and business incomes have also been announced. The income tax levied on registered firms is proposed to be levied in respect of incomes of such firms between the slab of Rs. 10,000 and Rs. 25,000 at the rate of 4 per cent. This will result in slight increases in the taxation of registered firms. The Finance Minister has very wisely simplified the definition of widely held companies, by specifying that any company whose shares are listed on the recognised stock exchanges will be treated as a widely held public company. This will simplify the administration of the provision applicable to closely held companies and also ensure that the companies whose shares are held by members of the public are taxed at the lower rate of income tax applicable to public companies. The provision of tax holiday applicable to new industrial undertakings has been extended for five years beyond 1971. In order to make investments in shares of companies attractive to investors, the Finance Minister has provided that the first thousand rupees of dividend income from Indian companies will be exempt from income tax in the hands of the shareholders. This should help to popularise the habit of investing in shares among middle class people and attract the flow of personal savings for financing the corporate sector.

The Finance Minister has proposed certain changes in tax administration which can only be described as unfortunate and unjustified. The scheme for advance payment of income tax is sought to be revised. Under the present scheme, if an assessee paid advance tax as demanded by the authorities he was treated as having fulfilled the requirements of law. Thereafter if his income turned out to be higher the law imposed on him an obligation to pay the additional tax due under the self-assessment provision which was introduced some time ago. The budget now seeks to provide that assessees subjected to advance tax will have to make estimates of their income and pay the advance tax computed on such estimates even before their financial year ends. It is provided that if the income as assessed finally is found to be 33-1/3 per cent. more than the estimated income as per the assessee's reckoning heavy penalties will be levied on the assessees in respect of the shortfall in advance tax payment. This provision will cause tremendous hardship to many small and medium-sized business and industrial firms. It must be remembered that small sized business and industrial firms in India just do *not* possess sophisticated financial accounting which will enable them to make precise estimates of their profits even before their financial year closes. Such firms usually know their profits only after their financial year has closed, their stock-taking is completed and the books of accounts are written up fully. Therefore the new provisions may result in a tremendous hardship to small and medium-sized business and industrial firms as they will not be able to accurately estimate their incomes before their financial year ends and will subject them to severe penalties under the new provisions. It is questioned why the Government has introduced such penal provisions when it has already provisions for ensuring that assessees pay their taxes under the self-assessment provisions. The only plausible reason for this approach would be that the Government is so desperate for funds that it wants to terrorise the assessees into paying the taxes some four or five months earlier than they would normally have to pay under the self-assessment provisions which require that the tax must be paid within a month after the return of income tax is filed. The penal provisions attached to payments of advance tax based on the assessees' estimates of income need to be abolished.

The Finance Minister has also drastically enhanced the penalties to be levied under the Wealth Tax Act to levels at which penalties will far exceed the tax payable and result in total confiscation of the wealth of the assessees. At the present time the penalty for late filing is two per cent. of the tax payable for every month during which the default continues subject to a limit of an aggregate of 50 per cent. of the wealth tax. It is now proposed to make penalty for late filing equal to half per cent. of the entire wealth for every month during which the default continues. This provision is excessively harsh. It is well known that there are often substantial variations in the valuation of properties under the wealth tax law. Certain assessees may not be able to file their returns because they may genuinely feel that their wealth is below the taxable limits. If thereafter their wealth is assessed by the authorities arbitrarily in a fashion which makes them subject to the tax they would be subject to penalty for late filing mentioned above which can rise to an aggregate equal to the entire net wealth. This will involve inequitable and total confiscation of the wealth of many innocent people, especially many small people who may not even realise that they are within the ambit of wealth tax.

The penalty for failure to produce accounts and documents under the wealth tax is now sought to be increased to one per cent. of the net wealth and a maximum of 100 per cent. of the net wealth. Here again, it must be realised that often assessees may be unable to produce their accounts and documents for reasons such as illness, etc., at the time when they are called upon to produce their accounts and the new provision would subject many innocent assessees to incredibly high penalties. There is something drastically wrong with the approach in tax legislation which provides for penalties which are so incredibly harsh that it would appear that the authorities are keen to terrorise the assessees. It must be realised that such unrealistic penalties may cause great injustice and inequities which may drive even the honest tax assessees to take a hostile attitude towards the tax administration. They will disrupt the normal human relations which should be encouraged to exist between the assessees and the tax authorities. The Finance Minister should carefully review the new provisions and make changes so that tax laws do not become tyrannical which they should not be under a democratic set up.

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,
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