

THE ECONOMIC IMPLICATIONS OF  
THE UNION BUDGET, 1972-73

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# THE ECONOMIC IMPLICATIONS OF THE UNION BUDGET, 1972-73

*By*

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The Union Budget for 1972-73 must be analysed in the setting of economic developments which occurred in India during the previous year.

## ABNORMAL CONDITIONS

The Indian economy was hit by a series of abnormal occurrences during 1971-72. These were: First there occurred an influx of over ten million refugees fleeing from political persecution into the Eastern part of India from what was formerly known as East Pakistan and now constitutes Bangla Desh. This influx of refugees which was truly unprecedented in the annals of human history imposed a tremendous economic burden of supporting, feeding and housing these refugees which had not been fully anticipated by India. Secondly, natural calamities occurred and took a severe toll. There were droughts in Maharashtra and Andhra Pradesh, a cyclone in Orissa and floods in Uttar Pradesh, Bihar and West Bengal. Third, the Indo-Pakistan war forced the economy to be put on a war footing upsetting its normal economic development. Fourth, various international monetary and political developments like the sudden

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\* The author, an eminent economist, is a well-known commentator on taxation. This text is based on a public lecture delivered under the auspices of the Forum of Free Enterprise in Bombay on 24th March 1972.

suspension of U.S. aid after the breakout of Indo-Pakistan war created further problems in economy and brought home severely the need for self-reliance. The very fact that despite these dramatic developments and the unprecedented strains which occurred, the Indian economy continued to make moderate progress is an indication of its strength and the soundness of its structure and performance. A brief survey of the main developments which occurred in the Indian economy can be given as they provide the background in which the Union Budget for 1972-73 was framed and presented.

### NATIONAL INCOME

The goal for growth of national income was set at 5.5% per annum in the Fourth Plan. In 1969-70, the growth of national income amounted to 5.3% and in 1970-71, it amounted to 4.7%. For the year 1971-72, the growth of national income is estimated at around 4% which is a commendable performance when taking into account the various abovementioned strains which occurred in the path of normal economic development of the country. An analysis of the growth of national income indicates that it is largely accounted for by progress in the agricultural sector. The industrial sector unfortunately was relatively stagnant. Thus, the pattern of growth of national income envisaged in the Fourth Plan has not been achieved.

### AGRICULTURE

The agricultural front was the most promising sector of the Indian economy for the year 1971-72. The annual rate for growth of agricultural production which was negative in 1968-69, rose to 7.1% in 1969-70, 6.7% in 1970-71 and is estimated around 3.8% in 1971-72. The output of food

grains in 1970-71 reached a record level of 107 million tons as a result of which buffer stocks reached peak levels. The output of food grain for 1971-72 is expected to even surpass previous years' records. The production of commercial crops was somewhat erratic and leaves much to be desired in certain sectors.

The Government has continued its policy of encouraging the use of chemical fertilisers but it is somewhat perturbing to note that the annual growth rate of consumption of fertilisers was only 6.5% in 1970-71, against a targeted growth rate of 29%. The Government continued its basic policy of encouraging small farmers and marginal farmers, promoting schemes for dry farming and attempting to solve the rural unemployment problems. These schemes which are in the right direction should further accelerate the progress on the agricultural front in the years to come.

### INDUSTRIAL STAGNATION

The most disturbing aspect of the Indian economy in the past year was the stagnancy in the industrial sector. Industrial production grew approximately at an annual rate of 9% during the years 1961 to 1965. However, in 1966 the rate of growth was actually minus 0.7%, in 1967 it was 0.9%, in 1968 it rose to 6.4% and in 1969 it increased to 7.1%. In 1970, the growth rate of industrial production declined to 4.8% and it is estimated that in the first eight months of 1971, industrial production was higher by only 2% as compared with the corresponding period in the previous year.

It is estimated that the growth rate of industrial production is running around 3 to 3½% which is truly a disappointment.

ing figure. A variety of factors is responsible for the stagnancy in the rate of growth of industrial production. But as the "Economic Survey" for 1971-72 of the Government of India correctly points out, "what is seriously impeding industrial growth is neither procedural difficulties nor policy restraints *but the general dearth of savings*". Indeed it is disturbing to find that the corporate savings in the Indian economy have now reached an all-time low level—a factor which must be viewed with considerable apprehension and which may have severe long-term repercussions in progress of the industrial sector in the coming years.

## INVESTMENT

Moreover, investment trends in the economy present a curious picture. The number of new companies registered has risen quite sharply from 1,510 companies with an authorised capital of Rs. 273 crores in 1968-69 to 1,927 companies with authorised capital of Rs. 333 crores in 1970-71. Similarly, the number of letters of intent and the number of industrial licences issued show a rapidly rising trend. Thus, in 1969, the number of industrial licences issued was 221, in 1970 it was 363 and during January to September 1971, it rose to 495. The value of import licences issued for capital goods was Rs. 73 crores in 1969-70, Rs. 127 crores in 1970-71 and Rs. 120 crores during April to September 1971 (compared with Rs. 63 crores during the corresponding period in 1970).

Sanctions for capital issues also showed an upward trend. The total capital issued to the public by companies was Rs. 133 crores in 1968-69, Rs. 137 crores in 1969-70

and Rs. 148 crores in 1970-71. But the "Economic Survey" of the Government of India points out that "while the bulk of proposed outlays were to be financed by loans from the term-lending institutions, Indian as well as foreign, to an extent past accumulations held in reserve were also to be drawn upon. But private corporate savings from within have contributed only marginally to this expansion". This indicate the grave situation prevailing in respect of corporate savings.

Government has attempted to spur industrial production by making some changes in the industrial licencing policy such as allowing automatic expansion to double the licenced capacity in the case of industries not controlled by the large houses or by foreign corporations. However, such measures do not appear to have borne fruit to-date.

### PLAN OUTLAYS

It is now recognised that there is likely to be a substantial shortfall in the plan outlay budgeted for the past year. The level of public investment has also remained sluggish and unsatisfactory.

Inadequate plan activity in recent years is indicated by the fact that total plan outlay in the public sector declined around 11.3% of national income in 1965-66 to hardly 7% in 1969-70 and is estimated at 8% in 1970-71. For the current year 1971-72, the plan outlay for the public sector is estimated at  $8\frac{1}{2}\%$  of national income which is a far cry from 11% attained in Third Plan period.

The sluggishness of Indian economy can be partly attributed to lower plan outlays as also to the fact that levels

of investment in the entire economy have declined. The "Economic Survey" for 1971-72 correctly points out that whereas the level of private savings is in the vicinity of 9.0% of national income, the level of public savings has dropped from 2.4% in 1965-66 to around 1.5% today, which is much lower than 3% reached at the end of the Third Plan period. Similarly, the inflow of foreign savings amounted to 3% of national income in 1965-66, 3.8% of national income in 1966-67 and has slumped to 1.6% in 1971-72. It is the avowed aim of government policy to raise the rate of public savings to 3.9% of national income by 1973-74.

### MONEY SUPPLY

Money supply with the public for the period 31st March to January end had risen in 1970-71 by Rs. 475 crores and for the same period in 1971-72, it is estimated to have increased by Rs. 625 crores. But during the current year the entire increase in the money supply has been appropriated for governmental purposes. Thus, in the period 31st March to January end in 1970-71, net bank credit to the Government increased by Rs. 307 crores; for the same period, in 1971-72, it rose by Rs. 764 crores. On the other hand, the net bank credit to the commercial sector, which has risen in this period in 1970-71 by Rs. 238 crores *actually fell or contracted* in the same period in 1971-72, by Rs. 215 crores. It is conceivable that to some extent the relative stagnancy of private sector may have been due to the squeeze in monetary resources made available to it from the banking sector.

## BALANCE OF PAYMENTS

The balance of payments position was under pressure but the country's foreign exchange reserves had reached a comfortable level which could absorb the strains caused by the war and the suspension of U.S. aid.

## PRICE LEVEL

The most encouraging feature of Indian economy during the past year was that despite the unprecedented strains to which the economy was subject the price level was kept well under control. Indeed, taking the calendar year 1971 as a whole, the average rise in the general price level was only 3.9% whereas in the previous year it was 6.2%. This very small increase in prices shows that as a result of restrictive credit policy and other fiscal measures taken by the Government, inflationary measures were kept well under control.

## EMPLOYMENT PICTURE GRIM

Finally, the picture on the employment front continued to remain disappointing. Employment in the public sector during the recent past has been thus: at the end of March 1968, it was 98.2 million, in March end of 1969, it was 100.95 million, in March end 1970 it was 103.74 million and in March end 1971 it was 107.11 million. However, the above-mentioned figures take into account the fact that in the year ended March 1969, bank employees were transferred from the employment statistics of the private sector to those of the public sector. Employment in the private sector was thus: at the end of March 1968 it was 65.2 million, in March end 1969 it was 65.3 million, in March end 1970 it was 67.0 million and in March end 1971 it was 67.4 million. Thus the picture of employment in both the



public and private sectors continued to show relative stagnancy in the growth of employment opportunities and jobs. It is also indicative of the fact that in recent years the gigantic unemployment has been barely tackled and tremendous work is required to solve it.

### BUDGETARY POSITION

Coming to the budgetary position of the Government of India, it must be stressed that in 1971, besides the main budget, there were two further supplementary budgets. These three budgets introduced within the space of one year new direct and indirect taxes which are estimated to yield Rs. 500 crores in a full year. The present budget was, therefore, presented in the context of a gigantic dose of taxation which had already been administered to the Indian economy in the year 1971. Obviously, then the scope or need for a further large quantum of taxation in the current year was limited by this factor.

### BUOYANT REVENUE YIELDS

The new taxes levied in 1971, together with buoyant tax collections, yielded total tax revenues to the Centre of Rs. 3,846 crores for the year 1971-72 against the earlier budget estimate of Rs. 3,608 crores. At current levels of taxation, the tax revenues are estimated to yield Rs. 4,228 crores during 1972-73. This indicates that on the revenue side there has been a very substantial step-up in yield from taxation to the Central Government.

### INCREASES IN EXPENDITURE

On the expenditure side, a few special items may be analysed. In the first budget of 1971, the expenditure on re-

fugees was estimated at Rs. 60 crores. It is now estimated to have been Rs. 325 crores of which Rs. 120 crores were got from foreign sources leaving a net burden on refugee relief to Rs. 205 crores. Defence expenditure, which was budgeted at Rs. 1,241 crores, rose for the year 1971-72 to Rs. 1,411 crores and is expected to continue at that level in the coming year. There was a substantial shortfall in the plan outlay. As a result of these changes, the surplus in the revenue account for 1971-72 estimated at Rs. 140 crores was converted into a small deficit of Rs. 26 crores. At the current level of taxation, the revenue surplus of 1972-73 is estimated at Rs. 219 crores.

### MODERATE DEFICIT

In the capital budget, as a result of shortfall in the plan outlays, the deficit for 1971-72 which was budgeted at Rs. 373 crores shrank to an estimated deficit of Rs. 359 crores. The overall deficit for 1971-72 budgeted at Rs. 233 crores rose to a figure of Rs. 385 crores. The variation is not excessive taking into account the various obviously abnormal occurrences which took place last year. For the year 1972-73, the capital budget is estimated to show a deficit of Rs. 594 crores and deducting therefrom the revenue surplus of Rs. 219 crores will leave a net deficit of Rs. 375 crores. The Finance Minister has proposed the additional taxation of Rs. 183 crores in the budget of which Rs. 50 crores would go to the States giving a net addition of Rs. 133 crores to the Central Government. This, therefore, is estimated to reduce the budgetary deficit to Rs. 242 crores for the current year.

## GROWTH THROUGH LARGER PLAN OUTLAYS

The budget contains proposals for a moderate increase in taxation together with a reasonable deficit to be left uncovered. The strategy of budget seems to be to spur growth by a sizeable step-up in plan outlays. The total outlays on central plan schemes for 1972-73 is to be stepped up to Rs. 2,307 crores from a figure of Rs. 1,823 crores of the previous year which represents a jump of Rs. 484 crores or approximately 27%. This includes provision of Rs. 240 crores in 1972-73, as compared with Rs. 130 crores for schemes involving a thrust towards achieving social welfare with future growth, that is, schemes like providing rural water supply, slum clearance, primary education, schemes for the educated unemployed, etc. The Finance Minister pointed out that "the budgetary provision for the Central Plan proper is being increased by Rs. 332 crores". If internal surplus and other extra-budgetary resources are taken into account the increase in the Central Plan will work out to Rs. 484 crores or 27 per cent.

Moreover, if one takes into account the Centre, States and Union territories together, the provision for the Plan for the coming year is envisaged at Rs. 3,973 crores as against Rs. 3,263 crores in the previous year, that is an increase of Rs. 710 crores or 22%. The Government hopes that such a substantial increase in the plan outlay will spur economic growth over the coming months and the increased outlays in the public sector will act as a catalyst for reviving the growth of the entire industrial sector of the economy. The budget therefore depends primarily on large plan outlays to be used as an instrument of growth rather than alternative measures

such as tax incentives. If the substantially increased outlays on the plan contained in the budget are achieved and if there are no shortfalls on the plan outlays, the Indian economy could get a certain forward thrust or momentum in the coming months.

## TAXATION PROPOSALS

The various taxation proposals of the Finance Minister can now be analysed.

As mentioned earlier, the budget contains proposals for new taxation estimated to yield in 1972-73 Rs. 183 crores of which Rs. 50 crores will be accrued for the States, leaving a net yield of increased tax of Rs. 133 crores available to the Centre. Out of the total tax effort of Rs. 183 crores, the proposals for new direct taxation are estimated to yield in 1972-73, Rs. 16 crores of which the Centre's share would come to Rs. 14 crores. The remaining tax effort is through indirect taxation.

## INDIRECT TAXATION

The indirect taxation proposed in the budget can be analysed thus:

The main characteristic of the indirect taxation proposals is that customs duties and import duties are sought to be increased over a vast range of items or commodities. Hence the tax burden, except in the case of a few items, is spread very thinly, minimising its direct inflationary effect. Indeed, because of the very small increases in indirect taxes levied on each of the vast range of items it is possible that in a number of cases a proportion of the indirect tax burden may be absorbed by the manufacturers of these various items.

Hence, while the budget proposals for indirect taxation are bound to have a certain degree of inflationary effect in so far as indirect taxes proposed in the budget will be passed on to the consumers by the manufacturers of various items, because of the structure and range of items attempted in the taxation proposal, the total inflationary impact may be minimised. A portion of the burden of the new indirect taxes may be absorbed by the manufacturers of various items in their profit margins.

### CUSTOMS DUTIES

The budget has proposed changes in the customs duties which are estimated to yield additional revenue of Rs. 8.60 crores. This has been achieved by slightly raising the import duties on most products.

### EXCISE DUTIES

Changes are proposed in the excise duties levied on a very large number of items. The items on which substantial increases in excise duties are sought to be levied are as follows:

The duties on tobacco and cigarettes are increased to yield an estimated Rs. 14 crores. The Finance Minister has proposed an increase in the excise duties on art silk fabrics of the more expensive quality to yield Rs. 8.59 crores. He has also proposed an increase in the excise duty payable on synthetic fibre yarns, which is estimated to yield Rs. 6.50 crores. From the administrative and practical angle it is difficult to understand why both yarn and final fabric are sought to be taxed separately. The more efficient way of taxing the synthetic fibre industry is to levy a stiff excise duty on the yarn and perhaps not to allow the manufacturers of

such yarns, who are already making profits, to pass on the full extent of the excise duty to the weavers. The indirect taxation in this fashion would be more efficient and easy to collect.

The budget has under the euphemistic guise of "rationalisation" adjusted the whole range of excise duties as to yield Rs. 10.70 crores. This is done by regrouping the slabs of excise duties.

A substantial increase in excise duty has been levied on steel so as to discourage its usage. This is estimated to yield Rs. 36.20 crores. This will push up the price of steel and hence the costs of engineering industry. There is also an increase in the excise duty on aluminium and its products which is estimated to yield Rs. 4.18 crores.

The excise duty on kerosene is to be increased to yield Rs. 29.80 crores, which is bound to be passed on to the consumers.

In order to tax the agricultural sector in an indirect way, the excise duty on fertilisers is raised from 10% to 15% to yield a revenue of Rs. 12.50 crores.

Power-driven pumps will now have to bear excise duty which will yield Rs. 2 crores.

## DIRECT TAXATION

The Finance Minister has proposed a number of minor changes in the field of direct taxation. Most of the changes proposed are prospective, that is applicable in the assessment year 1973-74.

The budget has proposed that casual or non-recurring income in excess of Rs. 1,000 will be subject to income tax.

Winnings from lotteries are to be taxed on a concessional basis by allowing a deduction in computing taxable income from such lotteries of Rs. 5,000 plus 50% of the winnings.

Winning from crosswords puzzles and lotteries will be subject to deduction of tax at source of 34.5%. Payments to contractors and sub-contractors are to be subject to deduction of tax at source of 2% and 1% of the sales value respectively.

Capital gains from the transfer or sale of jewelry held for personal use are now to be subject to capital gains tax.

Dividends received from cooperative society which were exempt from taxation are now to be subject to income tax.

With effect from 1st April 1972, the rate of interest paid to and payable by assesseees in respect of refunds and taxes due will be at the rate of 12% per annum.

The provisions for exemption of charity trusts from taxation both in respect of income tax and wealth tax are sought to be substantially tightened to ensure that charity funds are not directly or indirectly used for the benefits of the donors or their relatives or trustees.

Investment in the Unit Trust Scheme linked with insurance is to be made deductible like life insurance premium in computing taxable income.

In relation to the wealth tax, it is proposed to include assets in industrial proprietary concern or partnership firm within the exemption of Rs. 1½ lakhs for various types of assets, which are excluded from the wealth tax.

### CORPORATE TAXATION

In the field of corporate taxation, the Finance Minister has proposed that those engaged in priority industries who

were eligible for a 5% deduction in computing their taxable income will lose this tax concession. This would increase the burden of income tax on the corporate sector by Rs. 4.5 crores in 1972-73 and Rs. 6 crores in a full year. There is merit in doing away with the existing list of priority industries in so far as it is old and many of the industries in it have ceased to have a case for any favourable tax treatment. But the complete abolition of the priority list of industries for purposes of corporate taxation is wrong. The Finance Minister should have framed a new priority list of industries eligible for this tax concession taking into account the needs for industrial expansion in the Fourth and Fifth Plan. As an example, small-scale industries should have been given priority status because these industries have been given enormous debt financing by the bank which they may find difficult to pay without income tax concessions. Similarly, other industries which are in their infancy should have been put on a new priority list for this tax concession.

The surcharge on the corporate income tax of  $2\frac{1}{2}\%$  is to be continued for the assessment year 1972-73. Advanced tax payable in the year would have the surcharge at the rate of 5%. The burden of corporate taxation will rise by Rs. 9 crores in 1972-73 as a result of this change and by Rs. 12 crores in a full year.

It will thus be seen that relative minor changes in direct taxes have been proposed in the budget. But taking into account the fact that the scope for direct taxation was very limited, the additional tax burdens are bound to further erode private savings by transferring them into public exchequer.



## CONCLUSION

To sum up, the budget contains a modest tax effort which was the maximum that could have been attempted in the context of the gigantic tax burdens imposed by three successive budgets in 1971. The strategy of growth through large plan outlays may start the nation on a new cycle of development but it is necessary that around the end of the year, the Finance Minister should consider tax cuts to further spur growth. In this respect the outlook is ominous.

In the budget speech, the Finance Minister has announced that the clubbing of the income and wealth of husband, wife and minor children for tax purposes and harsher taxes on Hindu Undivided Family may be attempted at the end of 1972. It appears that measures for reducing the rates of taxation recommended by the Wanchoo Committee are not likely to be accepted. If the Finance Minister imposes new tax burdens at the end of the year, as he has threatened in his budget speech, he will deal a death blow to accelerated economic development which he has attempted through gigantic plan outlays in the budget.

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