THE ECONOMIC IMPLICATIONS OF THE UNION BUDGET, 1974-75

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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*

The economic implications of the Union Budget for 1974-75 can be analysed in the environment of economic conditions which prevailed in India during the previous year. The Indian economy passed through a period of unprecedented strain and stress during 1972-73 on account of the failure of the monsoon in many parts of the country during the *kharif* season in 1972. This failure caused unprecedented strain in the agricultural sector and subsequently in the industrial sector. During 1973, the country had a good monsoon in most parts of the country which led to a slow but steady economic revival after October 1973. Thus the first part of the year 1973-74 continued to suffer from backlash of the previous year's failure of monsoon and the subsequent drought conditions. It is only in the latter half of the year that the economy began to slowly chart its course to normalcy because of an excellent monsoon during June to September 1973.

NATIONAL INCOME

The growth of national income resumed its upward course during 1973-74 after the severe setback in 1972-73. Thus national income at constant prices rose by 5.5% in 1969-70, by 4.3% in 1970-71, by 1.7% in 1971-72 after which it fell in 1972-73 by 1.7% and is estimated to have risen by 6% in 1973-74. In this connection, the "Economic Survey of

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* The author, an eminent economist, is an authority on taxation. This text is based on a public lecture delivered in Bombay, on 4th March 1974, under the joint auspices of the Forum of Free Enterprise and other organisations.

1973-74" of the Government of India appropriately points out that "since agriculture accounts for nearly one half of India's national income, the forecasting of the rate of growth of national income necessarily involves a judgement on the state of the weather." Unfortunately, the monsoon remains the prime determinant of the prosperity of the Indian agriculture and, therefore, directly affects the growth of national income.

The Fourth Plan had as its target an average annual rate of growth of national income at 5.7%. Unfortunately the annual rate of growth of national income during the Fourth Plan is not likely to even exceed 3.5%, indicating that during this period the country has achieved a very low rate of growth.

AGRICULTURAL PRODUCTION

The rate of growth of agricultural output was 6.7% in 1969-70 and 7.3% in 1970-71. Unfortunately, it actually fell by 0.8% in 1971-72 and further by 9.1% in 1972-73. As a result of the good monsoon in 1973, agricultural production is estimated to rise by 10% to 15% during the year 1973-74. Nevertheless, in most crops, the output in 1973-74 will not be significantly higher than in 1970-71. In the meanwhile population in India is estimated to have risen by more than 40 million people since 1970-71 which indicates the prime cause for greater pressure from the demand side on our output of the agricultural sector especially in respect of foodgrains. The statistics of output of foodgrains indicates clearly this position:—in 1969-70, India produced 99.5 million tons of foodgrains, in 1970-71, 108.42 million tons of foodgrains, in 1971-72, 105.17 million tons of foodgrains, in 1972-73, 95.20 million tons of foodgrains and the estimated output for 1973-74 is around 108 to 110 million tons.

In the Fourth Plan, an important target was to achieve an annual rate of growth for foodgrains at the rate of 5.6% per annum. Unfortunately, during the Plan period the annual overall growth rate in respect of output of foodgrains was only 3% or less. Thus it is clear that the country has an agricultural output and output of foodgrains roughly equivalent to what it had four years ago but this output has to sustain the population which has swelled by 40 million people. It is small wonder hence a continuous demand pull on the available supply of food and agricultural production tends to keep their prices at record high levels despite excellent monsoons.

INDUSTRIAL PRODUCTION

Industrial production had grown steadily during the period 1960-65 at an average annual rate of between 8% and 10%. But by 1969-70, the rate of growth of industrial production was 7.4%, in 1970-71 it was 3%, in 1971-72 it was 3.3%, in 1972-73 it was 5.3% and during the year 1973-74 it is estimated to have fallen by 2.5% for the period April to June 1973 in comparison with the same period of the previous year.

The failure of the monsoon in 1972 led to a severe power crisis since many power stations are based on hydro-electric facilities. Power cuts became widespread after the monsoon failed in 1972 and continued through more than half of 1973. With the sharp deterioration in power supply, it is not surprising that many industrial groups suffered severe declines in output. The industrial picture thus was stagnant and indeed depressing. "The Economic Survey for 1973-74" points out that "the rate of growth of industrial production in the Fourth Plan period is likely to be no more than half the postulated target rate of 8-10%". Many industries worked much below their full capacity indicating that in the coming year substantial growth in industrial production could be achieved if the idle capacity of various industries is utilised or worked fully by supplying adequate power and other essential inputs to industries.

EMPLOYMENT

One of the most depressing features of the Indian economy is the continued failure to provide employment opportunities for both uneducated and educated people. Employment statistics indicate that total employment in the public sector in March of each year was as follows: — in 1969 — 100.95 lakhs, in 1970 — 103.74 lakhs, in 1971 — 107.31 lakhs, in 1972 — 113.05 lakhs and in 1973 — 118.81 lakhs. However, it may be noted that the figure for 1972 was swelled merely because of a transfer of the number of people employed in coal mines from the private sector to the public sector upon the nationalisation of the coal industry. Similar figures of employment in the private sector were: in 1969 — 65.3 lakhs, in 1970 — 67 lakhs, in 1971 — 67.6 lakhs, in 1972 — 67.7 lakhs, in 1973 — 69.4 lakhs.

Moreover, the number of job seekers registered with the employment exchanges rose from 56.88 lakhs at the end of June 1972 to 75.96 lakhs by the end of June 1973 — an increase of over 33%. The number of educated job seekers rose from 26.11 lakhs in June 1972 to 35.29 lakhs in June 1973. It is indeed ironical to read in the "Economic Survey for 1973-74" that our Government feels thus: — "In a country where there is a considerable amount of unemployment, those who have a secure job are in the category of very privileged class and they have to bear this fact in mind in asking for a larger size of national cake". The vast amount of unemployment prevailing in India constitutes perhaps the largest waste of human resources ever witnessed in the world.

INDUSTRIAL INVESTMENT

Statistical data on industrial investment is inadequate and relatively unsatisfactory. In the past year we have had a booming stock market. The variable dividend industrial securities index rose from 94.3 in September 1972 to 107.1 in September 1973 and share prices continued to rise thereafter. New issues were heavily oversubscribed.

The statistics of capital issues and of capital goods import licences issued shows a rise during the past year. However, public sector investment under the Fourth Plan which was targeted at Rs. 3,050 crores is estimated to be only Rs. 2,700 crores. This has resulted in sizeable shortfalls in investment in crucial sectors like iron and steel, fertilizer and coal and to some extent for the myriad of shortages prevailing in the Indian economy.

PRICE BEHAVIOUR

The Indian economy in 1973 was plagued by a savage dose of unprecedented inflation. The index of wholesale prices rose by 6.2% in 1970, by 3.9% in 1971, by 7.8% in 1972, and by 19.2% in 1973. However, more important is the fact that it rose between December 1971 and December 1972 by 13.7% and between December 1972 and December 1973 by 24%. Food prices rose in 1972-73 in the aftermath of the drought condition but did not fall subsequently despite the good monsoon and crops in 1973-74. The prices of industrial products also rose in 1973. It is acknowledged in the "Economic Survey of 1973-74" that the nationalisation of the wheat trade disrupted the supply, led to poor procurement and shortages in essential foodgrains. The result of the inflation was that certain sectors of the economy which were price controlled suffered severely where the cost of their inputs were not controlled in price and many of them suffered a profit squeeze on account of this factor. In case of those sectors where there was no control on prices, producers attempted to pass on to the consumers the inflationary impact of their costs with varying degrees of success varying with consumer resistance or the lack of it. Later on in the year, the oil crisis resulted in a sudden flare-up in the prices of oil causing a ripple of inflation in the various sectors of the economy.

BUDGETARY TRENDS

The only target of the Fourth Plan which was comfortably exceeded was the target of additional taxation. Thus during the Fourth Plan, the Government secured through additional taxation no less than the massive amount of Rs. 3,900 crores. On the other hand, despite this tremendous increase in taxation, the Central Government's budget ran continued deficits as follows: 1971-72 the deficit was Rs. 738 crores, 1972-73 the deficit was Rs. 680 crores and in 1973-74 the deficit was Rs. 650 crores against an original estimate deficit of Rs. 85 crores. The budgets of the various State Governments also showed continued deficits. These vast doses of deficits financing were responsible in a large measure for the galloping inflation which plagued the Indian economy in the past.

The Public Sector enterprises also failed to show surplus which was necessary for financing further expansion and growth. On 31st March 1973, 101 public sector undertakings had made a net profit of Rs. 18.1 crores for the year 1972-73, as compared with the loss of Rs. 18.9 crores in the previous year of 93 concerns. "The Economic Survey for 1973-74" states that it is hoped that the profit of the Public Sector undertakings may rise to Rs. 34 crores. This is a negligible profit, when thousand of crores of public funds have been invested in these concerns. The need of the hour is to ensure that the Public Sector runs efficiently and produces adequate surplus for financing expansion, growth and development.

The working of the railways also leaves much to be desired. The railway budget indicated that the railways were running at a tremendous deficit and that the efficiency of their working had seriously deteriorated.

The Fifth Plan places substantial emphasis on the growth of public saving for financing the country's development. The private savings are expected to rise from 9.4% of gross national product in 1973-74 to 9.7% in 1978-79. Public savings are targeted to rise from 2.8% of gross national product to 6% during the same period. It is acknowledged in the "Economic Survey for 1973-74" that the financing of the Fifth Plan will have to depend upon largely on indirect taxation, taxation of agricultural income and higher electricity tariffs. It is noted that direct taxation has reached a saturation point and cannot be expected to contribute substantially to budgetary revenues in the coming years.

MONEY, CREDIT AND BANKING

The stock of money with the public rose in 1969-70 by 10.8%, in 1970-71 by 11.2%, 1971-72 by 13.1%, 1972-73 private sector. Thus from 31st March 1972 to 26th January 25th. 1974 by 9.6%. Similarly the total money supply including public and time deposits rose in 1969-70 by 12.4% and 17.7% by 1972-73.

The main cause of the continuous monetary expansion is to be found in the expansion of net bank credit to the Government sector — and *not* in expansion of credit to the private sector. Thus from 31st March 1972 to 26th January 1973 net bank credit to the Government sector rose by Rs. 1,074 crores whilst to the private sector it fell or contracted by Rs. 329 crores. Between 31st March 1973 to

25th January 1974, the net bank credit to the Government sector rose by Rs. 1,032 crores whilst to private sector it shrank or declined by Rs. 171 crores. In the context of the above mentioned figures, the credit squeeze of the Reserve Bank of India and the tight money policy attempted to be followed by it appear to be misconceived and irrelevant as curbs to check rising prices.

BALANCE OF PAYMENTS

India's total foreign exchange reserves stood at Rs. 776.5 crores by January 1974 and indicated a drop of Rs. 70.1 crores in the past year. Although the country's exports have risen to over Rs. 2,000 crores and the indications are that they will continue to rise because of the unprecedented boom in the world trade and the rise in the prices of goods internationally, there was a corresponding trend of increasing costs of imports. Thus in 1973-74 imports of food alone are estimated to cost Rs. 350 crores. The sudden increase in the price of oil has thrown the position of balance of payments in the coming year into great uncertainty. Oil imports will cost Rs. 500 crores more in the coming year. Thus it is essential that export earnings should grow at a rate substantially in excess of Fifth Five-Year Plan target of 7.6%, if the country is to pay for its imports mainly through export earnings. Export promotion thus becomes of paramount importance in the coming year.

BUDGETARY DEFICIT SOARS

For the year 1973-74, the total budgetary deficit which was estimated at Rs. 87 crores is now shown in the revised estimates to have soared to Rs. 650 crores. The Finance Minister has pointed that this colossal increase is due to certain unavoidable expenditures such as:- First Rs. 220 crores more had to be spent on drought relief, second, special assistance to the States to meet the natural calamities required Rs. 91 crores more than the budget estimate, third, the food subsidy took Rs. 121 crores more than the budget estimate and fourth, the implementation of Third Pay Commission reports including the payment of dearness allowance on the cost of living basis took Rs. 230 crores more. Thus despite an attempt to economise on governmental expenditure, the deficit soared to Rs. 650 crores. Successive annual deficits amounting to many times the budget estimates thus continue unchecked leading to strong inflationary pressures in the Indian economy. It is essential that this unhealthy fiscal habit of the Central Government be controlled if inflationary pressures are to be dampened in the coming years.

PLAN OUTLAYS

In 1972-73 the Plan outlay was Rs. 3,973 crores. In 1973-74 against budget figure of Rs. 4,364 crores actual plan outlay amounted to Rs. 4,171 crores. The budget provides for a total Plan outlay in 1974-75 at Rs. 4,769 crores. This superficially looks like an increase of Rs. 600 crores over the previous year. In fact, the rise is around Rs. 278 crores only because of differences or changes in the accounting approach to plan outlays which have been made this year. If one takes into account the rise in prices which have occurred in the past year, it is clear that the Plan outlay in the real terms proposed in the budget is likely to be somewhat lower than the previous year's outlay indicating that at best in real terms plan outlays are stagnant or actually declining and that the budget presented by the Finance Minister provides for a one year pause in the planning or a plan holiday. In the context of the gigantic Fifth Five-Year Plan, it is difficult to conceive how the plan is hoped to be implemented in the remaining four years if in the first year the Plan outlay is as small as is proposed in the budget. Nevertheless, in the context of the strong inflationary pressure which is causing havoc in the Indian economy, a one-year pause in planning is to be welcomed as affording an opportunity for consolidation. It is hoped that the Government will use the opportunity in the coming year to lay a proper, sound foundation from which the economic growth could be resumed.

The Finance Minister has pointed out that he has provided in the budget for important outlays in core sectors in the coming year. Thus the budget has outlays of Rs. 97 crores for coal development, Rs. 162 crores for steel development, Rs. 75 crores for non-ferrous metals development, Rs. 342 crores for the railways, Rs. 163 crores for fertiliser development, Rs. 246 crores for agricultural programme, etc. The emphasis on development of the core sector thus contained in the budget is welcome. But it is doubtful whether these provisions will be able to make up for substantial shortfall which have occurred in the past in outlays on these sectors.

BUDGET PROPOSALS

At current levels of taxation, the budget deficit for 1974-75 is estimated at Rs. 311 crores. Additional taxation estimated to yield Rs. 186 crores in 1974-75 is proposed in the budget by the Finance Minister leaving a net deficit estimated at Rs. 125 crores. However, it is abundantly clear that at the end of the year the deficit will be much larger than this figure and it is likely to be at least between Rs. 300 to Rs. 1500 crores if not more because of the following factors: the budget assumes that there will be a good monsoon and better agricultural production in 1974-75; it also assumes that the prices will not rise due to the budgetary levies and that the States will not require additional aid.

These assumptions appear somewhat optimistic and unrealistic. The budget provides for food subsidy only of Rs. 100 crores whereas the outlay on this subsidy is likely to be around Rs. 300 crores. The budget assumes that the Centre will not have to give any additional help to the States to meet the natural calamities because Rs. 750 crores will be given to the States under the recommendation of the Sixth Finance Commission. Further the budget provides for only Rs. 120 crores for payment of dearness allowance to Government employees. This figure would be fully utilised if the prices did not rise at all in the coming year! Since prices are expected to rise in the coming year, the expenditure on dearness allowance for Government employees will be substantially in excess to the budget provision. In short, the budget has continued the past year's habit of substantially underestimating the potential deficit which will lead to further inflation.

INDIRECT TAXATION

The Finance Minister has proposed additional excise duties which are estimated to yield Rs. 191.97 crores of which the States' share will be Rs. 25.92 crores leaving the Centre with Rs. 166.05 crores in 1974-75. The new excise burdens are spread over 49 items of which 43 items were already subject to excise duties and six new items are to be subject to excise duty for the first time. The changes in excise duties are expected to yield additional revenues from various important items which are as follows:- cigarettes, Rs. 17.20 crores, unmanufactured tobacco, Rs. 8.49 crores; motor spirit, Rs. 12.43 crores; paints and varnish, Rs. 3.73 crores; cosmetics, Rs. 4.10 crores; plastics, Rs. 8.56 crores; paper, Rs. 10 crores; rayon & synthetic fibre and yarn, Rs. 10.74 crores; cotton yarn, Rs. 14.19 crores, cotton fabrics, Rs. 7.86 crores, cement, Rs. 6.40 crores, iron

& steel products, Rs. 7.18 crores, refrigerators and airconditioners, Rs. 5 crores, motor vehicles, Rs. 16.25 crores, metal containers, Rs. 6.25 crores.

It will be thus seen that the burden of change in excise duties has spread over a large number of goods presumably in the hope that the inflationary impact will be minimised. Nevertheless, there can be no doubt that most of the excise duties which have been levied in the budget will be passed on to the consumers by the manufacturers and will have an inflationary impact.

CUSTOMS DUTIES

The Finance Minister has proposed slight changes in the customs duties which are estimated to yield Rs. 20.05 crores. The auxiliary duty on items paying hitherto at the rate of 10% has been raised to 15%. This will yield Rs. 16 crores. The duty on imported items like whiskey, gin, brandy, etc. has been raised and is estimated to yield Rs. 35 lakhs. These levies will also be undoubtedly passed on to the consumers and result in further price hikes in the coming year.

REVENUES RAISED THROUGH INDIRECT LEVIES

Post and telegraph charges have been raised to yield Rs. 42 crores in 1974-75.

The picture of the budget is that the Finance Minister has exclusively relied on indirect taxation and other measures to raise resources. Indirect taxation changes are expected to yield Rs. 212 crores. The increase in railway freight and fares announced in the Railway budget is expected to yield Rs. 136 crores. The increase in the postal and telegraph rates is expected to yield Rs. 42.80 crores in 1974-75 giving a total figure of resource mobilisation by these measures by not less than Rs. 390 crores. The changes proposed in the budget in indirect taxation together with higher railway charges and postal and telegraph charges and the various outlays proposed in the budget will result in an increase in prices in the coming year of *at least* 15% if not more!

DIRECT TAXATION

The Finance Minister has proposed certain changes in direct taxation which are estimated to yield Rs. 14.5 crores in the Financial year 1975-76, that is, Assessment Year 1976-77. Thus during the coming year the entire mobilisation of resources is done through indirect measures as outlined above. The changes proposed in the budget are prospective, that is, applicable for the assessment year 1975-76 or the Financial Year 1974-75.

PERSONAL TAXATION

In the field of personal taxation, the Finance Minister has accepted the recommendations of the Wanchoo Committee Report. He has proposed that the maximum marginal rate of income tax be reduced from 97.75% to 77%. The exemption limit for income tax is to be raised from Rs. 5,000 to 6,000. This will eliminate an estimated 400,000 persons from paying income tax. This reduction in the number of low income assesses together with certain other changes announced by the Finance Minister will greatly simplify the work of the Income Tax Department. These changes should enable the income-tax administration to concentrate on the larger and more important cases. The Finance Minister has estimated that as a result of the tax cuts in personal income tax the loss of revenues in a full year would amount to Rs. 60 crores. In 1974-75 it is estimated it would amount to Rs. 36 crores but the Finance Minister has not taken these figures into account in the hope that such losses in revenue would be made up through better compliance by assessees and better administration of tax collection.

It is hoped that these expectations are realised. The acceptance of the recommendations of the Wanchoo Committee for a tax cut in direct personal taxation is an act of great political courage which should lead to lesser tax evasion and provide incentive to individuals to work harder and to earn more.

There are a few other minor changes in the taxation of personal incomes proposed in the budget. In respect of the taxation of gratuity and other retirement benefits, it provides total exemption from income tax of gratuity amounts paid under the Payment of Gratuity Act. Transfers of provident fund amounts from one provident fund to another are to be facilitated by redrafting the law. Income-tax on partnership firms has been lowered. Overall there has been an attempt to reduce rates of income-tax payable by individuals and liberalise some of the exemptions contained under the Income-Tax Act, which are steps in the right direction.

WEALTH TAX

It is a matter of considerable regret that the Finance Minister has somewhat nullified the reduction in income-tax by increasing the wealth tax payable by individuals. The rates of wealth tax are sought to be raised so that the slab of wealth attracting tax at present at the rate of 2% will be taxable at 3% and the slab of wealth attracting tax at the rate of 3% will now be taxed at 4%. This change in the rates of wealth tax can impose a minimum additional burden of Rs. 10,000/- on individuals. The exemption of one farm house has been removed and has been linked with the overall exemption for properties of rupees one lakh. The separate exemption for agricultural land upto Rs. 1.50

lakhs has been removed and linked with the exemption for certain specified items such as shares, etc. Lump sum annuities purchased by a taxpayer or under contract with him will not be excluded from the taxable wealth.

CORPORATE TAXATION

The Finance Minister has extended the development rebate for a further period up to 1st June 1975 in respect of plant and machinery which was ordered before 1st December 1973. The extension of the development rebate to all plant and machinery installed up to 1st June 1975 should give substantial relief in tax to many new expanding industries. To encourage the change from oil fire boilers to coal fire boilers, it is proposed to give rebate in respect of boilers upto 1st June 1975.

SURTAX

The budget proposals have raised the slab of surtax on profits above 15% of the total capital from the existing rate of 30% to 40%. The increase in surtax is estimated to yield Rs. 5 crores.

Thus the budget only contains a few changes in Corporate taxation.

The changes in direct taxation proposed by the Finance Minister should provide strong incentive for individuals and companies to save and to invest in the coming year. The psychological impact of the cut in the personal income tax should be substantial. The cut in the personal income tax automatically reduces the rate at which capital gains are taxed in the hands of individuals. This should therefore stimulate individuals to invest in shares and other productive assets and lead to a great willingness on their part to bear the risks of industrial investment through the stock market.

CONCLUSION

In conclusion one may try and assess the outlook of the Indian economy in the context of the budget proposals and the various other factors outlined earlier. The growth of national income will depend largely on the coming monsoon. Agricultural production will continue to play a dominant role in the national economy and its progress in the coming year will be largely determined by weather conditions. Industrial production could grow by the utilisation of idle capacity existing in the industry provided industry gets its full supply of power.

The budget should stimulate activity in the stock markets and provide incentives for individuals to invest in shares in the coming year provided that other political and economic factors do not adversely affect the industrial prosperity. It is likely that the money supply will continue to expand.

The budgetary deficit for 1974-75 is likely to exceed from Rs. 300 crores to Rs. 500 crores and provide a stimulant for further inflation in the Indian economy. The Indian economy is likely to witness a further inflationary dose and prices in the coming year will rise by at least 15% and are likely to rise by probably a much greater figure.

The balance of payment position will remain tight on account of the oil crisis. It may be concluded that the budget has taken a courageous step in reducing direct taxation. It is to be hoped that the Government will follow up the budget with other practical policies which will stimulate the industrial growth and spur the growth of national income.

"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.

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